EU Direct Tax Newsalert

Non-confidential version of the EC's State aid opening decision in GDF Suez

On 5 January 2017, the European Commission ("EC") published its opening decision in the formal investigation into Luxembourg tax rulings obtained by entities of GDF Suez. The opening decision dated 19 September 2016 explains the reasons for the initiation of the formal investigation and the additional information requested from Luxembourg in order to reach a final conclusion. This decision represents therefore the opening, not the outcome, of the EC's formal investigation into this matter.

Background

The formal investigation pertains to the granting by Luxembourg of several tax rulings between 2008 and 2013 to several GDF Suez Luxembourg entities relating to the tax treatment of certain interest-free convertible instruments ("ZORAs").

According to the description of the facts in the opening decision: GDF Suez Treasury Management Sarl and LNG Supply SA issued ZORA instruments to other Luxembourg group entities. The ZORAs were interest-free and automatically convertible into shares of the issuers at a conversion ratio determined based on the principal amount of the ZORAs. The principal amount was defined as being equal to a certain issuance value plus an annual accretion amount determined in function of the net operational income of the issuer less a margin. The ZORA holders entered into prepaid forward sale agreements with other Luxembourg group entities in relation to the shares in which the ZORAs were convertible.

According to the opening decision, the tax treatment applied to the ZORAs was: the ZORA issuers deducted the annual accretion amount (recorded in their financial statements) from their taxable base on an annual basis, reducing their annual income to a margin determined as a percentage of the financial assets. The ZORA holders maintained the instruments at their acquisition value and, upon conversion, could defer the gain under the roll over provisions of Art. 22bis of the Luxembourg Income Tax Law (LITL) (which provides that conversion of convertible loans into shares can benefit from a roll over relief, except for the capitalized interest related to the current year).

As part of the preliminary proceedings Luxembourg supported the treatment as being fully in line with the Luxembourg tax provisions, detailing the technical arguments applicable at each level.

Key reasons

The EC believes at this stage that the treatment applied to the entities involved in the financing arrangement can lead to State aid based on the following preliminary grounds:

- The EC considers that the deductibility of the accretion amount on the ZORAs at the level of the ZORA issuers is not a correct application of two specific articles of the LITL which the EC retains as being the framework of reference in this case (although the direct application to the case is not clear), as well as of the Luxembourg accounting rules; it questions in this respect the possibility for recognition of the annual accretion amount as a deductible expense and whether independent parties would have agreed to the terms of the ZORAs;
- As subsidiary arguments, the EC considers that in a situation where the accretion amount could represent a deductible charge (i) it should have led to a taxation in the hands of the ZORA holders; (ii) the calculation of the margin is not considered in line with the arm's length principle; (iii) the application of the participation exemption at the level of the beneficiaries of the prepaid forwards is questioned on grounds of double non-taxation, as well as the application of the Luxembourg anti-abuse provisions, without detailed development of these arguments.

Next steps

If the EC's approach is confirmed in its final decision, further litigation before the European Courts is likely.

According to the statement of the Luxembourg government issued on the same day with the publication of the decision, Luxembourg is confident that the allegations of State aid in this case are unsubstantiated and that it will be able to convince the EC that no particular tax treatment or selective advantage was granted.

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