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Tax updates: hot topics Q1/2 2025

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1. **France:** New tax and social regime for management equity plans

The Finance Act 2025 introduces a new regime for the taxation of management equity plans (MEPs). This new system will apply to the net gain realized on securities held by employees in consideration for their duties as employees in the company issuing these securities (or an associated group company).

This gain will be taxed as employment income (maximum rate of 45%) with the exception, if certain conditions are met, of a fraction which will be taxed as a capital gain (subject to a 30% flat tax).

The gain will be eligible for capital gains tax treatment only if the manager bears a risk of capital loss, and, in the case of unregulated instruments, if the securities have been held for at least two years. The fraction of the gain eligible for this regime will be capped at a return on investment corresponding to three times the company's financial performance assessed over the holding period.

The excess portion of this gain, or the entire amount if the conditions mentioned above are not met, will be taxed as salary.

The entire gain (without application of the x3 multiple) will be excluded from the scope of application of social security contributions, but the manager will be subject to a new employee contribution, collected directly from the employee, at a rate of 10% for the portion taxed as wages.

These new rules apply to transfers from 15 February 2025 and will therefore affect plans already in place.

Although the Finance Act provisions clarify how MEPs are taxed, key practical issues remain unsolved. The French tax authority is expected to issue guidelines in due course, notably on two concessions relating to tax deferral on rollover and the calculation of the 30% threshold.

2. **Spain:** Spanish withholding tax on dividends

The Court of Justice of the European Union (CJEU) has ruled that Spain's imposition of withholding tax (WHT) on dividends paid to nonresidents in a loss-making position, while refunding domestic WHT to resident entities in equivalent circumstances, is contrary to the free movement of capital.

On 19 December 2024, the CJEU issued a ruling in a case involving a WHT refund request filed by a UK-resident entity before the Provincial Council of Biscay.

The taxpayer, a UK-resident entity, requested the refund of 10% WHT borne on dividends distributed by a Biscayne resident entity, arguing that, based on the double taxation agreement between Spain and the UK and given its tax loss position in the UK, such WHT was not recoverable in its country of residence.

The taxpayer argued that this difference in treatment constituted a restriction on the free movement of capital.

When comparing the rules applicable to resident and nonresident investors, the CJEU found that the Biscayne regional rules allow resident companies to recover WHT where they incur losses, because the domestic WHT is an advance payment of corporate tax. This is refundable when the dividend recipient incurs tax losses. Nonresident companies in the same loss-making situation do not have this mechanism available to them. The lack of a refund mechanism for such WHT implies that it becomes an immediate and final tax for the nonresident investor. This difference in treatment can constitute an advantage for a resident company.

The CJEU rejected the justifications presented by the Provincial Council of Biscay, which argued the need to ensure effective tax collection, the balanced allocation of taxing rights among Member States, and the prevention of the risk of double taxation of income.

Although the judgment refers to dividend income, its conclusions may also be extended to WHT applied to other types of income (such as interest and royalties). The decision relates to the Biscay regional rules on withholding tax, but the same conclusions should also apply under Spanish national law.

Non-Spanish investors should seek specialized advice to explore opportunities for reclaiming WHT.

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3. **Ireland:** VAT recovery for holding companies

VAT recovery on professional costs incurred either directly through advisors or indirectly through inter-group recharge of such costs is a complex area for holding companies.

The Irish tax authorities typically apply a narrow approach as a starting point with respect to such costs, and the entitlement to reclaim VAT will be fact-specific, depending on the nature of the transaction (e.g., share sale, purchase, reorganization).

It is a core principle of VAT that the right to VAT deduction should not be limited where there is a direct and immediate link to a fully VATable activity or where a cost is a general overhead of a fully VATable business. There have been various CJEU cases that have addressed this area, providing guiding principles for holding companies. The Irish courts have not been immune to this, and a recent Court of Appeal judgment (Covidien) is likely to result in further challenges in this area.

The High Court ruled in favor of the taxpayer in 2024, determining that VAT incurred on services related to the management and oversight of subsidiaries could be entitled to VAT deduction. The Court of Appeal recently overturned this High Court decision, and Covidien now faces a potential VAT liability of €45.9 million. The case has been sent back to the Tax Appeals Commission (TAC) for further consideration of the VAT technical arguments.

Regardless of the outcome at TAC, the Court of Appeal decision is likely to embolden challenges to the VAT recovery position. The Court of Appeal emphasized the need to precisely identify how input costs are connected to the taxable output of managing shareholdings.

Corporate groups incurring transaction costs will wish to assess how this ruling (along with other guiding EU principles) may affect their ability to recover VAT on similar expenses.

Advance consideration should be given to the level of advisor costs and the likely VAT recovery. Early consideration of the VAT position should provide cash flow certainty, mitigating the risk of VAT recovery being later denied or partially disallowed.

4. **Netherlands:** Tax classification of partnerships

As of 2025, updated tax classification rules for (foreign) entity partnerships and funds for joint account (FGR) apply. The revised regulations aim to reduce the number of hybrid mismatches. Dutch partnerships (e.g., CVs) are, by default, viewed as transparent for tax purposes going forward.

Under the updated rules, a foreign partnership should typically be viewed as transparent, unless it qualifies as a FGR. This would be the case if the following requirements are met:

- The fund qualifies as an investment fund or institution for collective investment in securities (ICBE) within the meaning of Article 1:1 of the Financial Supervision Act.
- Participations in the fund are transferable, participations are not considered transferable if they can only be transferred back to the fund itself through redemption (this is also referred to as a redemption fund).
- The activities of the fund are not considered a business enterprise for Dutch tax purposes.

The changes to the FGR definition raise various practical and fiscal complications; therefore, following a public consultation, the State Secretary of Finance has confirmed that they will be exploring whether to amend the rules with any changes anticipated to apply from 1 January 2027 at the earliest.

In a private equity (PE) context, it is essential to evaluate the (ongoing) classification of partnerships. This is typically relevant for Dutch WHT rules, whereby the impact of the FGR definition, in combination with the fund structure (such as feeder funds in low-tax jurisdictions), should be considered.

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5. **Netherlands indirect tax update:** VAT recovery for holding companies and demerger rules for RETT

VAT recovery

On 1 July 2025, specific resolutions will be repealed or updated that will affect VAT recovery for holding companies in the Netherlands. The changes may restrict the (ongoing) recovery of VAT on costs associated with shareholding activities. PE funds and portfolio (holding) companies should evaluate cost allocations and consider taking steps to mitigate the potential adverse impact. Additionally, the disposal of shares by businesses that regularly engage in share trading, such as PE funds and their affiliates, may be viewed as VAT-exempt sales in the future. This could mean that input VAT recovery on these related transaction costs would only be possible for share disposals to non-EU purchasers. PE houses will want to monitor the changes as the revisions evolve.

Real estate transfer tax exemption for reorganizations

Stricter conditions for applying the real estate transfer tax (RETT) exemption in the case of a demerger will come into force on 1 July 2025. In short, the new rules for the tax-neutral facility require that real estate must be transferred as part of a business (business requirement), maintained for three years (business continuation requirement), and that similar interests must be acquired and held for three years (holding requirement). Due to the business requirement, acquiring isolated real estate assets through a demerger may no longer be tax-neutral.

Furthermore, as of 1 January 2025, the internal reorganization exemption rules have been updated to reflect the revised entity classification rules. As a result, the exemption may be limited to intra-group transactions between Dutch limited liability companies or their foreign equivalents. Consequently, foreign partnerships may no longer meet the requirements for the exemption. The impact should be considered if a reorganization (e.g., as part of the exit strategy) is expected.

6. **Germany:** New developments on the deduction of interest expenses

On 24 March 2025, the German Federal Ministry of Finance (MoF) published its revised application letter on the German interest barrier rule. The new decree applies to financial years beginning after 14 December 2023, which do not end before 1 January 2024. For matters referring to previous financial years, the former decree of 2008 remains applicable.

With the legislative adjustments implemented into German tax law by the end of 2023, the German interest barrier rule was aligned with the Anti-Tax-Avoidance Directive (ATAD). Since the definition of interest was broadened, the changes have tightened interest deductions in Germany.

The main part of the decree covers the new definition of interest and outlines which categories shall be considered interest expenses and interest income. It concludes that it should not only comprise regular interest but also costs associated with borrowing, such as financing fees. This expansion means more expenses fall under the interest barrier rule, increasing the tax burden for many companies. The MoF asserts that expenses and income should be treated equally, meaning that all expenses classified as interest by the payer will be considered interest income for the recipient. However, this interpretation lacks absolute legal certainty since the decree is not binding for fiscal courts.

The final letter also confirms that expenses related to the depreciation of capitalized interest (e.g., capitalized financing costs being part of the production costs) will be classified as interest under the interest barrier rule, but only for interest expenses capitalized in fiscal years starting after 14 December 2023 and not ending before 1 January 2024. This provision is particularly beneficial for the real estate sector, as it avoids the need for complex reconstructions of historical production costs to identify interest components under a specific relief possibility.

With the increased relevance of the German interest barrier rule due to the expanded definition of interest and the overall rise in financing costs, the new decree outlines the current interpretation of the MoF, which is binding for the German tax authorities.

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7. **Germany:** German Federal Ministry of Finance publishes final decree regarding the application of anti-hybrid rules

On 5 December 2024, the German Ministry of Finance (MoF) released the final decree on the application of German anti-hybrid rules, providing clarity on several issues raised in the earlier draft from July 2023. While the final decree addresses some open questions, uncertainties remain, particularly regarding documentation obligations and the practical implications of the rules.

The German anti-hybrid rules, enacted in 2021 through the EU Anti-Tax Avoidance Directive (ATAD) Implementation Law, apply to expenses incurred after 31 December 2019. These rules aim to deny the deductibility of expenses in Germany if the corresponding income is not taxed or, in the case of financing transactions, is subject to low taxation due to hybrid mismatches or double deductions. The rules primarily target intra-group transactions that create tax benefits through hybrid mismatches.

In terms of controlled foreign corporation (CFC) regimes, the decree states that income included in a CFC regime qualifies as taxed income. However, the MoF takes the position that income inclusion under CFC regimes that determine their tax base by consolidating profits and losses of all, or certain, foreign-controlled entities, cross-entity or cross-border (so-called blending systems) is not sufficient for the subject-to-tax exemption to apply. Although not explicitly referenced, the US-global intangible low-taxed income (GILTI) and other minimum taxation regimes based on blending principles are not expected to qualify as CFC regimes that can prevent nontaxation.

In contrast, the decree states that the inclusion of expenses within a foreign CFC regime does not constitute a double deduction, irrespective of whether the expenses are included in a CFC or a minimum-taxation regime, even if based on a blending system.

Under the dual-inclusion exemption, expenses remain deductible if they offset income taxed in both Germany and another jurisdiction. A link between the expenses from the hybrid transaction and the double-included income is not required.

Overall, while the final decree offers some guidance, the complexity of the rules necessitates a careful analysis of each situation, particularly for structures involving U.S. entities. Further, no additional clarification was included on documentation obligations.

8. **Germany:** Federal Central Tax Office publishes updated fact sheet on WHT exemptions for dividends

On 17 March 2025, the German Federal Central Tax Office (FCTO) updated its fact sheet on the eligibility for an exemption or refund of WHT for dividends under the German anti-treaty shopping rule. The factsheet provides nonbinding guidance on how the "personal eligibility" condition and stock exchange clause apply.

The FCTO has revised its interpretation to adopt a look-through approach, allowing for the modification of the dividend WHT position based on how the indirect shareholder would be taxed had it received the dividend directly. The indirect shareholder does not need to qualify for relief from WHT under the same double tax treaty or EU Directive; however, any claim will be limited to the amount of relief to which the indirect shareholder is entitled.

This view appears more closely aligned with the wording of the German anti-treaty shopping rule and the relevant jurisprudence of the CJEU.

The fact sheet is especially relevant for taxpayers with higher-tier shareholders residing outside the European Union who cannot directly benefit from the EU Parent-Subsidiary Directive.

The updated fact sheet does not introduce new insights regarding the requirements for objective eligibility for a relief (which assesses the economic activities carried-out by the applicant and its substantial connection to the source of income) or for the alternative "main benefit" test (that allows the taxpayer to prove the absence of a tax motivation for an interposed entity).

The fact sheet for royalties has not been updated; however, the dividend fact sheet might also be helpful in discussions with the FCTO regarding royalties.

The FCTO and the Federal Ministry of Finance have been collaborating to reduce processing times for applications for WHT relief. As part of these efforts, starting from 1 January 2025, WHT certificates (for dividends and royalties) can be issued for up to five years (rather than the previous three-year limit).

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9. **Luxembourg:** Technical clarifications on partial liquidations implemented into Luxembourg tax law

On 11 December 2024, the Luxembourg Parliament enacted significant legislative changes affecting corporate taxpayers, including technical clarifications to Article 101 of the Luxembourg Income Tax Law (LITL).

Generally, Article 101 LITL treats a liquidation of a Luxembourg company as a sale of shares and subject to capital gains tax for the shareholder (rather than as a dividend and subject to dividend WHT) where certain conditions are met. The newly implemented changes to Article 101 LITL specifically include partial liquidations within its scope (subject to the relevant conditions listed below) as of 1 January 2025.

The amended Article 101 LITL aims to clarify the tax treatment of a redemption of a share class by codifying case law.

Article 101 LITL now classifies a redemption of a share class as a partial liquidation, where it satisfies the following conditions:

- The redemption applies to the entire class of shares and is followed by a corresponding reduction in the capital of that share class within six months of the redemption.
- Share classes are established during incorporation or through a subsequent increase in share capital.
- Each share class has unique economic rights, as defined in the articles of association, distinguishing them from other share classes.
- The redemption price may be determined based on criteria specified in the articles of association or other referenced documents to establish the fair market value of the share class at the time of redemption.

Where these conditions are met, no WHT will apply on the redemption of that class of shares. Instead, the redemption will be treated as a partial liquidation and taxed as a capital gain or loss for the shareholder.

The Luxembourg parliament has also implemented a compliance measure linked to the update of Article 101 LITL. Where an individual possesses a substantial stake (specifically, 10% of the total share capital at any point within the five years leading up to the transfer), the individual's identity must be disclosed in the company's annual tax return.

The inclusion of the partial liquidation mechanism in the LITL aligns the LITL with long-standing practice and affirms the WHT treatment of a redemption of a share class in Luxembourg where the conditions are met.

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10. UK: HMRC clarifies its guidance on LLP salaried member rules

Where three conditions are satisfied, the salaried member rules treat individual members of a limited liability partnership (LLP) as employees for the purposes of income tax and national insurance contributions, rather than self-employed members.

One of these conditions (condition C) is that the member's capital contribution is 25% or less than their annual "disguised salary" from the LLP. The rules include a targeted anti-avoidance rule (TAAR) that disregards arrangements that have a main purpose of ensuring that the salaried member rules do not apply.

HM Revenue and Customs (HMRC) changed its guidance on the TAAR in February 2024. This indicated that HMRC considered that the TAAR would apply where a capital contribution is increased pursuant to an arrangement that allows members to alter their contributions in each period in order not to meet condition C. Members of LLPs will often enter into top-up arrangements that ensure they do not satisfy condition C (and therefore remain self-employed).

Following representations from the Chartered Institute of Taxation and others, HMRC amended its guidance in March 2025 to confirm that a contribution to an LLP under a top-up arrangement will not trigger the TAAR if the arrangement results in a genuine contribution made by the individual to the LLP, intended to be enduring and giving rise to real risk (PM259200). Real risk refers to whether the individual is personally at actual risk of losing the contribution if the LLP makes a loss or becomes insolvent. The amended guidance, in effect, reverses the changes that were made in February 2024. This is a welcome development, as the previous update had caused uncertainty about how HMRC would apply the rules in practice.

PE houses that have LLPs within their structures will wish to review their arrangements to ensure that their individual members fall within HMRC's revised guidance.

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