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CJEU case law on the field of tax law

Katerina Savvaidou
Assistant Professor Auth
Jean Monnet Chair
“European Tax Policy and Administration”

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Harmonization of taxation in EU

- Whilst the harmonization of indirect taxes (VAT, excises duties) was considered necessary from the outset to avoid obstacles to trade and to free competition (falls within the exclusive competence of the European Union), the harmonization of direct taxes was not considered indispensable at the common market stage (falls within the competence of Member States).
- However, later on became clear that the free movement of establishment of business, services and capital (fundamental principles) in the Community required a **minimum degree of coordination of direct taxes**.
- Coordinating direct taxes does not imply surrendering national tax powers, but exercising them consistently with all other EU Member States in a way to comply with fundamental freedoms without harming the respective tax revenues.

Coordination of direct taxes

- The EU Treaty makes no explicit provision for legislative competences in the area of direct taxation.
- Legislation on the taxation of companies has usually been based on article 115 of the Treaty on the Functioning of the European Union (TFEU), which authorises the Union to **adopt directives** on the approximation of laws, regulations or administrative provisions of the Member States which directly affect the internal market.
- These require unanimity and the consultation procedure.

EU STRATEGY

Juncker plan: 10 priorities

EU TAX POLICY

Making the internal market function better, incl. fight against tax fraud, fairer taxation…

EU INTERVENTION

PRIMARY LEVEL OF INTERVENTION

1. HARMONISATION OF TAX LAW

Article 113 TFEU (unanimity):
- VAT directives, incl. administrative cooperation
- Excise duties (Reg. 389/2012), incl. administrative cooperation
- FTT
- Energy taxation

2. APPROXIMATION OF LAWS & ADMINISTRATIVE ACTIONS

Article 114 TFEU (qualified majority):
- Fiscalis (Reg. 1286/2013), with as an example: CCN-CSI & CCN-Mail

Article 115 TFEU (unanimity):
- Administrative cooperation in direct taxation (Dir. 2011/16)
- Tax agreements with neighbouring countries (e.g. Dec. 2016/1830)
- ATAD (Dir. 2016/1164)
- Parents-subsidiaries, mergers…

3. ADMINISTRATIVE COOPERATION & CAPACITY BUILDING

Article 197 TFEU (qualified majority):
- Fiscalis (Reg. 1286/2013), with as examples:
- Risk mgt platform
- E-Audit platform
- Technical assistance
- Workshop for judges (unit D.3)

SECONDARY LEVEL OF INTERVEN-TION

4. IMPLEMENTATION OF EU MEASURES (FROM PRIMARY LEVEL)

Examples for VAT:
- IT systems, incl. VIES for taxpayers
- communication workshop
- Project group for specifications

Examples for excise duties:
- IT systems for tax administrations
- IT systems for economic operators

Examples for admin. coop° in DT:
- eForms
- XML schemas for AEOI
- Project group on quality and feedback on AEoI
- eLearning module on legislation

Coordination of direct taxes Adoption of Council Directives

Principle of subsidiarity

- Is the principle whereby the EU does not take action (except in the areas that fall within its exclusive competence), unless it is more effective than action taken at national, regional or local level.

Principle of proportionality

- Principle of proportionality requires that any action by the EU should not go beyond what is necessary to achieve the objectives of the Treaties.

Integration of direct taxation

Positive Integration: through EU Council Directives

- Directive 90/434/EEC of 23 July 1990 on a common system of taxation applicable to mergers, divisions, transfers of assets and exchanges of shares concerning companies of different Member States (the Merger Directive)
- The Directive 90/435/EEC on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States (the PSD Directive)
- The Directive 2003/49/EC of 3 June 2003 on a common system of taxation applicable to interest and royalty payments made between associated companies of different Member States (the "I+R" Directive)

Negative Integration: through the CJEU case law

➢ Judgement of the CJEU on the compatibility of national legislation with primary law (fundamental principles, e.g. article 49 TFEU) or secondary law (EU Council Directives in the field of tax law) after a request for a preliminary ruling

❖ Negative integration of direct taxes supplement positive integration of direct taxes in EU

EU Council Directives

- **Objectif**: remove tax obstacles

➢ Merger Directive: remove fiscal obstacles to cross-border reorganizations involving companies situated in two or more Member States.

➢ Parent-Subsidiary Directive (PSD): eliminate tax obstacles in the area of profit distributions between groups of companies in the EU and to eliminate double taxation of income derived from profit distributions at the level of the parent company.

➢ Interest – Royalty Directive (IRD): eliminate withholding tax obstacles in the area of cross-border interest and royalty payments within a group of companies.

- **By means of**: tax advantages provided for companies entered in their scope

➢ Merger Directive: provides for deferral of taxes for capital gains.

➢ Parent-Subsidiary Directive: provides for an exemption from withholding taxes of the dividends and other profit distributions paid by subsidiary companies to their parent companies.

➢ Interest – Royalty Directive (IRD): provides for an exemption from withholding taxes on royalty payments or on interest payments arising in a Member State.

The Merger Directive
Principle of subsidiarity

- “whereas national tax provisions disadvantage operations, such as mergers, divisions, transfers of assets and exchanges of shares concerning companies of different Member State, in comparison with those concerning companies of the same Member State;
- “whereas it is necessary to remove such disadvantages”
- “whereas it is not possible to attain this objective by an extension at the Community level of the systems presently in force in the Member States, since differences between these systems tend to produce distortions”
- “whereas only a common tax system is able to provide a satisfactory solution in this respect”
- “Whereas the common tax system ought to avoid the imposition of tax in connection with mergers, divisions, transfers of assets or exchanges of shares, while at the same time safeguarding the financial interests of the State of the transferring or acquired company”
- “Where as the system of deferral of the taxation of the capital gains relating to the assets transferred until their actual disposal, applied to such of those assets as are transferred to that permanent establishment, permits exemption from taxation of the corresponding capital gains, while at the same time ensuring their ultimate taxation by the State of the transferring company at the date of their disposal”

The Merger Directive

- The objective of Directive 90/434/EEC (Merger Directive) on a common system of taxation applicable to mergers, divisions, transfers of assets and exchanges of shares concerning companies of different Member States is to remove fiscal obstacles to cross-border reorganizations involving companies situated in two or more Member States.
- The Merger Directive provides for **deferral of the taxes** that could be charged on the difference between the real value of such assets and liabilities and their value for tax purposes (tax advantage).
- The deferral is granted provided that the receiving company continues with their tax values and effectively connects them to its own permanent establishment in the Member State of the transferring company.
- The Merger Directive includes a list of the legal forms to which it applies. The companies must be subject to corporate tax, without being exempted, and resident for tax purposes in a Member State.

ejtn refj

EU Parent-Subsidiary Directive (PSD)

- The Council Directive 90/435/EEC of 23 July 1990 on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States was introduced to **eliminate tax obstacles** in the area of profit distributions between groups of companies in the EU.
- The objective of Directive 90/435/EEC was to exempt dividends and other profit distributions paid by subsidiary companies to their parent companies from withholding taxes and to **eliminate double taxation** of such income at the level of the parent company.
- *"Before the entry into force of Directive 90/435/EEC, the tax provisions governing the relations between parent companies and subsidiaries of different Member States varied appreciably from one Member State to another and were generally less advantageous than those applicable to parent companies and subsidiaries of the same Member State. Cooperation between companies of different Member States was thereby disadvantaged in comparison with cooperation between companies of the same Member State. It was necessary to eliminate that disadvantage by the introduction of a common system in order to facilitate the grouping together of companies at Union level".*

EU Parent-Subsidiary Directive (PSD)

- Directive 90/435/EEC has been substantially amended several times.
- See: Directive 2011/96/EU of 30 November 2011.
- Later on the Council adopted Directive 2003/123/EC to broaden the scope and improve the operation of the Directive 90/435/EEC (updating the list of companies covered, reducing of the participation threshold, eliminating double taxation for subsidiaries of subsidiary companies).
- Council Directive 2015/121/EC of 27 January 2015 amended Directive 2011/96/EU.

ejtn refj

EU Interest-Royalty Directive (I+R Directive)

- The I+R Directive is designed to eliminate withholding tax obstacles in the area of cross-border interest and royalty payments within a group of companies by abolishing withholding taxes on royalty payments or on interest payments arising in a Member State.
- These interest and royalty payments shall be exempt from any taxes in that State provided that the beneficial owner of the payment is a company or permanent establishment in another Member State.
- *"Since the objective of the proposed action, namely setting up a common system of taxation applicable to interest and royalty payments of associated companies of different Member States cannot be sufficiently achieved by the Member States and can therefore be better achieved at Community level, the Community may adopt measures, in accordance with the principle of subsidiarity as set out in Article 5 of the Treaty. In accordance with the principle of proportionality, as set out in that Article, this Directive does not go beyond what is necessary in order to achieve that objective".*
- A company of a Member State shall be treated as the beneficial owner of interest or royalties only if it receives those payments for its own benefit and not as an intermediary, such as an agent, trustee or authorized signatory, for some other person.
- The Directive 2003/49/EC was amended by Directive 2004/66/EC, Directive 2004/76/EC and Directive 2006/98/EC

Integration of direct taxation and fight against tax evasion or avoidance

Positive Integration: through EU Council Directives

- All the above Directives (the Merger Directive, (the PSD Directive and the "I+R" Directive) contains special <u>anti-avoidance/abuse rules</u>

❖ Article 11 (1) (a) of Merger Directive

❖ Article 1 (2) of PSD Directive 2011/96/EU

❖ Article 1 (2) of PSD Directive 2015/121 of 27 January 2015 amending Directive 2011/96/EU

❖ Article 5 of I+R Directive 2003/49/EC of 3 June 2003

Negative Integration: through the CJEU case law

➢ The CJEU may conclude that a national legislation that <u>restricts the exercise of a fundamental principle of</u> TFEU, could be justified for <u>an overriding reason of public interest</u>, such as fight <u>tax avoidance</u>, as long as the national measure also respect the principle of proportionality.

The Merger Directive

- "*Whereas it is necessary to allow Member States the possibility of refusing to apply this Directive where the merger, division, transfer of assets or exchange of shares operation has as its objective tax evasion or avoidance*".

The Merger Directive

- Article 11(1)(a) of Directive 90/434/EEC provides:

- "*A Member State may refuse to apply or withdraw the benefit of all or any part of the provisions of Titles II, III and IV where it appears that the merger, division, transfer of assets or exchange of shares*:
- (a) *has as its principal objective or as one of its principal objectives tax evasion or tax avoidance; the fact that one of the operations referred to in Article 1 is not carried out for valid commercial reasons such as the restructuring or rationalisation of the activities of the companies participating in the operation may constitute a presumption that the operation has tax evasion or tax avoidance as its principal objective or as one of its principal objectives*".

ejtn
refj

CJEU case tax law
Merger Directive: anti-avoidance rule

- See: CJEU Leur-Bloem, C-28/95, 17 July 1997:

➢ Article 11 of Directive 90/434 is to be interpreted as meaning that in determining whether the planned operation has as its principal objective or as one of its principal objectives tax evasion or tax avoidance, the competent national authorities must carry out a general examination of the operation in each particular case.

➢ Such an examination must be open to judicial review (Case C-19/92 Kraus).

➢ It is for the Member States, observing the principle of proportionality, to determine the internal procedures necessary to stipulate that the fact that the planned operation is not carried out for valid commercial reasons.

➢ However, the laying down of a general rule automatically excluding certain categories of operations from the tax advantage, on the basis of predetermined general criteria, whether or not there is actually tax evasion or tax avoidance, would go further than is necessary for preventing such tax evasion or such tax avoidance and would undermine the aim pursued by Directive 90/434.

PSD and prevention of fraud or abuse

- Directive 2011/96/EU of 30 November 2011

➢ "2. *This Directive shall not preclude the application of domestic or agreement-based provisions required for the prevention of fraud or abuse*".

PSD anti-abuse rule

Article 1 of Directive 2015/121 of 27 January 2015 amending Directive 2011/96

In Directive 2011/96/EU, Article 1(2) is replaced by the following paragraphs:

"2. Member States shall not grant the benefits of this Directive to an arrangement or a series of arrangements which, having been put into place for the main purpose or one of the main purposes of obtaining a tax advantage that defeats the object or purpose of this Directive, are not genuine having regard to all relevant facts and circumstances.

An arrangement may comprise more than one step or part.

3. For the purposes of paragraph 2, an arrangement or a series of arrangements shall be regarded as not genuine to the extent that they are not put into place for valid commercial reasons which reflect economic reality.

4. This Directive shall not preclude the application of domestic or agreement-based provisions required for the prevention of tax evasion, tax fraud or abuse."

ejtn refj

PSD anti-abuse rule

- It is necessary to ensure that Directive 2011/96/EU is not abused by taxpayers who fall within the scope of its application.
- Some Member States apply domestic or agreement-based provisions aimed at tackling tax evasion, tax fraud or abusive practices in a general or in a specific way.
- However, those provisions may have different levels of severity and, in any case, they are designed to reflect the specificities of each Member State's tax system. Moreover, some Member States do not have any domestic or agreement-based provisions for the prevention of abuse.
- Therefore, <u>the inclusion of a common minimum anti-abuse rule in Directive 2011/96/EU would be very helpful to prevent misuse of that Directive</u> and to ensure greater consistency in its application in different Member States.

ejtn refj

PSD anti-abuse rule

- The application of anti-abuse rules should be proportionate and should serve the specific purpose of tackling an arrangement or a series of arrangements which are not genuine, that is, which do not reflect economic reality.
- To that end, when assessing whether an arrangement or a series of arrangements are abusive, Member States' tax administrations should undertake an objective analysis of all relevant facts and circumstances.
- While Member States should use the anti-abuse clause to tackle arrangements which are, in their entirety, not genuine, there may also be cases where single steps or parts of an arrangement are, on a stand-alone basis, not genuine. Member States should be able to use the anti-abuse clause also to tackle those specific steps or parts, without prejudice to the remaining genuine steps or parts of the arrangement.

ejtn refj

PSD anti-abuse rule

- That would maximise the effectiveness of the anti-abuse clause while guaranteeing its proportionality.
- The ‘to the extent approach’ can be effective in cases where the entities concerned, as such, are genuine but where, for example, shares from which the profit distribution arises are not genuinely attributed to a taxpayer that is established in a Member State, that is, if the arrangement based on its legal form transfers the ownership of the shares but its features do not reflect economic reality.
- This Directive should not affect in any way Member States' ability to apply their domestic or agreement-based provisions aimed at preventing tax evasion, tax fraud or abuse.

EU Interest-Royalty Directive (I+R Directive)

- <u>Article 5 of Directive 2003/49/EC of 3 June 2003</u>

Fraud and abuse

“1. This Directive <u>shall not preclude</u> the application of domestic or agreement-based provisions required for the prevention of fraud or abuse.

2. Member States may, in the case of transactions for which <u>the principal motive or one of the principal motives is tax evasion, tax avoidance or abuse</u>, withdraw the benefits of this Directive or refuse to apply this Directive”.

ejtn refj

Justification of a restriction on the exercise of freedoms guaranteed by the TFEU

Overriding reasons in the public interest:

1. Preventing the risk of tax evasion or tax avoidance

2. Protecting the balanced allocation of the power to impose taxes between the Member States

3. Protecting the cohesion of the tax system

4. Increasing the effectiveness of fiscal supervision

❖ Principle of proportionnality

CJEU’s case law in tax avoidance cases

- Regarding the VAT:

✓ CJEU case Cantor Fitzgerald (C-108/99), case Halifax (C-255/02), case Part Service (C-425/06), case Weald Leasing (C- 103/09), Tanoarch (C-504/10), case EMS-Bulgaria Transport OOD (C-284/11)

- Regarding direct taxation:

✓ CJEU ICI (C-264/96), Eurowings Luftverkehrs AG (C-294/97), Marks & Spencer (C-446/03), Kofoed (C-321/05) [Merger Directive], A.T. Finanzamt Stuttgart-Körperschaften (C-285/07), Foggia (C-126/10) [Merger Directive], 3M (C-417/10), Thin Cap GLO (C-524/04), Lankhorst (C-324/00), X&Y (C-436/00), De Lasteyrie du Saillant (C-9/02), Cadburry Schweppes (C-196/04), Oy (C-231/05), Test Claimants (C-524/04) [thin cap rules], NV Lammers & Van Cleeff (C-105/07) [thin cap rules], Lasertec Gessellschaft (C-492/04) [thin cap rules], SGI (C-311/08), SIAT (C-318/10), ELISA (C-451/05), Argenta Spaarbank NV (C-39/16), X gmbH (C-135/17)

Recent CJEU case tax law:
tax evasion or avoidance - abuse or rights

Compatibility of French legislation (prior approval of the tax authorities) with the article 11(1) a of the Merger Directive (90/434/EEC) and the article 49 of TFEU (freedom of establishment)

Case Euro Park Service (C-14/16)

Danish cases on beneficial ownership Joined cases T Danmark (C-116/16) and Y Denmark Aps (C-117/16)

Compatibility of Danish legislation (exemption of withholding tax for the payment of dividends) with the article 1 of the PSD Directive (90/435/EEC) and the article 49, 54 and 63 of TFEU

CJEU judgement in case Euro Park Service (C-14/16)

Merger Directive: article 11 (1) (a) tax evasion and avoidance

Freedom of establishment

CJEU decision in case Euro Park Service (C-14/16)

- The CJEU rendered on 8 March 2017 a judgment regarding the interpretation of the article 11 (1) (a) of the Merger Directive [90/434/EEC of 23 July 1990], providing aux Member States the possibility of adoption of national legislation that gives the possibility of refusing to apply the Directive and of non granting or withdrawing the tax benefit provided by the Directive where the cross-border operations (e.g. merger) has as its objective tax evasion or avoidance and the conformity of the French law providing a prior approval procedure with the Merger Directive and the article 49 of the TFEU (freedom of establishment).

Case Euro Park Service – Facts

- Cairnbulg, a company governed by French law, was wound up in 2014, without going into liquidation, by and for the benefit of its sole shareholder, Euro Park, a company governed by Luxembourg law (merger by absorption).
- Cairnbulg opted in its profit and loss account, for the financial year ending 26 November 2004, for the special system for mergers provided for in Article 210 A et seq. of the CGI.
- The assets of Cairnbulg were valued at their net accounting value and on the same date, those assets were transferred by Euro Park.

Case Euro Park Service – Facts

- Cairnbulg did not declare, for the purposes of corporation tax, the net capital gains and profits generated by the assets which it had transferred to Euro Park.
- The tax authority called into question the use of the special system for mergers on the grounds:
  - 1. Cairnbulg had not sought the ministerial approval provided in CGI and
  - 2. that approval would not, in any event, have been granted, since that operation was not justified by commercial reasons but had been carried out for the purpose of tax evasion or avoidance.

Case Euro Park Service - Facts

- Euro Park was made liable for additional tax and tax contributions together with the penalties for deliberate infringement.
- Euro Park requested the tribunal administratif de Paris to order the cancellation of those taxes and penalties. The court rejected Euro Park's request.
- Europark appealed to the cour administrative d'appel de Paris, which upheld that rejection.
- **Euro Park brought an appeal in cassation before the Council of State arguing that**, by making only transfers made to non-resident legal persons, and not transfers made to resident legal persons, subject to a process of prior approval, **<u>Article 210 C(2) of the CGI introduced an unjustified restriction of Article 49 TFEU and, therefore, of the principle of the freedom of establishment</u>.**
- The Council of State decided to stay the proceedings and to refer the questions to the Court for a preliminary ruling.

CJEU decision in case Euro Park Service (C-14/16)

- The case: the preliminary request has been made in proceedings between company Euro Park, which has assumed the rights and obligations of the French company Cairnbulg, and the French tax authority' concerning the refusal of that authority to acknowledge Cairnbulg's entitlement to deferral of the taxation of the capital gains relating to that company's assets at the time of its merger through acquisition by a company established in Luxembourg, on the ground that the merging companies had not sought the prior approval of the tax authority provided by the General Code of taxes which has transposed Directive 90/434 into French law.

Case Euro Park Service – The French law (CGI)

Article 210 A of the CGI provides:

1. Net capital gains and profits generated by all assets transferred as a result of a merger shall not be subject to corporation tax.

Article 210 C of the CGI provides:

1. The provisions of Articles 210 A and 210 B shall apply to operations entered into exclusively by legal persons or organisations liable to corporation tax.

2. Those provisions shall apply to transfers made to foreign legal persons by French legal persons only where those transfers were approved beforehand in accordance with the conditions laid down in Article 210 B(3).

Case Euro Park Service – The French law (CGI)

Article 210 B(3) of the CGI provides:

Approval shall be granted where, having regard to the assets transferred:

a. the operation is justified for commercial reasons, resulting, inter alia, in the exercise by the company receiving the transfer of an independent activity, or in the improvement of structures, or in an association between the parties;

b. the operation does not have as its principal objective or as one of its principal objectives tax evasion or tax avoidance;

c. the manner in which the operation is carried out makes it possible for the capital gains deferred for tax purposes to be taxed in the future.

CJEU decision in case Euro Park Service (C-14/16)

- Question 1: EU law allows the assessment of the compatibility of national legislation in the light of primary law (article 49 TFEU), when that legislation was adopted to transpose into national law the option provided for in Article 11(1)(a) of Directive 90/434.

CJEU decision in case Euro Park Service (C-14/16)

- Any national measure in an area which has been the subject of **<u>exhaustive harmonisation</u>** at the level of the European Union must be assessed in the light of the provisions of that harmonising measure, and **<u>not in the light of the provisions of primary law</u>** (*Visnapuu*, C-198/14).
- Article 11(1)(a) of Directive 90/434/EEC carries out exhaustive harmonisation?

CJEU decision in case Euro Park Service (C-14/16)

- Article 11(1)(a) of Directive 90/434/EEC provides:
- "A Member State may refuse to apply or withdraw the benefit of all or any part of the provisions of Titles II, III and IV where it appears that the merger, division, transfer of assets or exchange of shares:
- (a) has as its principal objective or as one of its principal objectives tax evasion or tax avoidance; the fact that one of the operations referred to in Article 1 is not carried out for valid commercial reasons such as the restructuring or rationalisation of the activities of the companies participating in the operation may constitute a presumption that the operation has tax evasion or tax avoidance as its principal objective or as one of its principal objectives".

ejtn refj

CJEU decision in case Euro Park Service (C-14/16)

- Regarding the exercise of that option, in the absence of more detailed EU law provisions in that regard, it is for the Member States, observing the principle of proportionality, to determine the provisions needed for the purposes of applying Article 11(1)(a) of Merger Directive.
- Article 11(1)(a) of <u>Merger Directive does not carry out exhaustive harmonization</u>.
- Consequently, EU law **allows for the assessment of the compatibility of national legislation in the light of primary law**, <u>where that legislation was adopted to transpose into national law the **option provided**</u> for in provision of article 11 (1) (a) of the Merger Directive.

ejtn refj

CJEU decision in case Euro Park Service (C-14/16)

- Question 2: If national legislation that subjects the granting of tax benefits (deferral of the taxation of capital gains relating to assets transferred by a French company to a company to another Member State) to a process of prior approval of the cross-border merger, whereas in a national merger such deferral is granted without such a process, is conform with the freedom of establishment.

❖To be noted that a cross-border merger constitutes a particular method of exercise of the freedom of establishment (*SEVIC Systems, C-411/03*).

ejtn refj

Case Euro Park Service –
The existence of a preliminary procedure

- Directive 90/434 does not contain any procedural requirement with which the Member States are required to comply for the purpose of granting the tax advantages provided for in that directive.
- In the absence of relevant EU rules, the detailed procedural rules designed are a matter for the domestic legal order of each MS, in accordance with the principle of the procedural autonomy of the Member States, provided that:

➢ they are not less favourable than those governing similar domestic situations (principle of equivalence) and

➢ they do not render impossible in practice or excessively difficult the exercise of rights conferred by the EU (principle of effectiveness).

➢ The Court said that: the French legislation is not consistent with the principle of effectiveness, due to the fact that described procedure fail to satisfy the requirement of legal certainty (a decision of the tax authority refusing a tax advantage under the Directive must always be reasoned).

ejtn refj

Case Euro Park Service – The conditions to be satisfied to obtain the tax advantages under the Merger Directive

- In order to determine whether the operation concerned pursues the objective of tax evasion or avoidance, the competent national authorities may not confine themselves to applying predetermined general criteria (*see: Loeur-Bloem, C-28/95*),
- **but** must subject each particular case to a general examination of that operation, since the imposition of a general rule, would go further than is necessary for preventing such tax evasion or avoidance and would undermine the objective pursued by that directive (judgment of 10 November 2011, *Foggia* —C-126/10).

ejtn refj

CJEU decision in case Euro Park Service (C-14/16)

- However, the French legislation introduces a **general presumption of tax evasion or tax avoidance, since:**

❖ requires systematically and unconditionally the taxpayer to show that the operation concerned is justified on economic grounds and does not have as its principal objective tax evasion or tax avoidance, in order to grant the benefit of the deferral of the taxation of the capital gains under Merger Directive,

❖<u>without the tax authority being required to provide even prima facie evidence that there are no valid commercial reasons or evidence of tax evasion or tax avoidance.</u>

ejtn refj

CJEU decision in case Euro Park Service (C-14/16)

- The third condition laid down by the legislation (that the terms of the transaction make it possible for the capital gains deferred for tax purposes to be taxed in the future):

➢ is not provided for in Merger Directive and

➢ cannot be justified by the prevention of tax evasion or tax avoidance, since that objective is already expressly covered by the second condition set out in that legislation.

ejtn refj

CJEU decision in case Euro Park Service (C-14/16)

- Article 11(1)(a) of Directive 90/434 must be interpreted as precluding the adoption of national legislation such as that at issue in the main proceedings providing:

➢ a **<u>process of prior approval of the cross-border merger in order to</u>** grant the tax advantages (deferral of taxation on capital gains relating to the assets transferred by a French company to a company established in another Member State) under which, in order to obtain that approval the taxpayer must:

❖ show that the operation concerned is justified for commercial reasons,

❖ that it does not have as its principal objective, or as one of its principal objectives, tax evasion or tax avoidance and

❖ that its terms make it possible for the capital gains deferred for tax purposes to be taxed in the future,

✓ whereas in the case of a national merger such a deferral is granted without the taxpayer being made subject to such a process.

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Case Euro Park Service

To be noted that:

Article 11 (1) (a) of the Merger Directive must be subject to strict interpretation (*Modehuis A. Zwijnenburg, C-352/08*), since provides an exception to the general rules provided by the Merger Directive.

Only by way of exception and in specific cases the Member States may refuse to apply the benefit of the provisions of the Merger Directive.

Case Euro Park Service – Freedom of establishment

- It is only in the case of cross-border mergers that the grant of a deferral of the taxation of capital gains relating to the assets transferred by a French company to a company established in another Member State is subject to the requirements of the French legislation.
- French legislation treats cross-border mergers and national mergers differently.
- Such a difference constitutes an obstacle to the freedom of establishment.

Case Euro Park Service – Freedom of establishment

- Is there any overriding reason in the public interest (see: prevention of tax avoidance), to justify the restriction on the exercise of the freedom of establishment in the case at hand?
- The objective of the prevention of tax avoidance has the same scope whether it is relied on under Article 11(1)(a) of Directive 90/434 or as justification for an exception to primary law.
- Therefore, the considerations concerning the proportionality of the legislation at issue also apply to the analysis of the proportionality of that legislation in relation to the freedom of establishment.
- It follows that tax legislation, which introduces a general presumption of tax evasion or tax avoidance, goes beyond what is necessary to achieve that objective and cannot, therefore, justify an obstacle to that freedom.

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The Danish cases on beneficial ownership

"the dividend cases"

- T Danmark,
- Y Denmark Aps

joined cases C-116/16 and C-117/16

"the interest cases"

- N Luxembourg 1,
- X Denmark A/S,
- C Danmark I and
- Z Denmark ApS vs. the Danish Ministry of Taxation

(Joined Cases C-115/16, C-118/16, C-119/16 and C-299/16

The Danish cases on beneficial ownership – Facts

- The Danish companies were all owned by a parent company resident in another EU Member State (Luxembourg, Cyprus or Sweden).
- The EU parent companies were all directly or indirectly owned by companies resident in third countries (e.g. Bermuda or the Cayman Islands) or by private equity funds with unknown residency of the investors.
- The Danish companies paid out either dividends or interest to their EU-resident parent companies, and claimed that such payments of dividend or interest was free of withholding tax in accordance with the Parent-/Subsidiary Directive (PSD) or the Interest/Royalty Directive (IRD).
- The Danish tax authorities claimed that the withholding tax exemptions following from the PSD and IRD should not be granted, as the recipients were not the beneficial owners of the payments.
- The cases were appealed to the Danish High Court, which referred questions to the CJEU.
- The referred questions in the dividend and interest cases are generally the same, but the question on beneficial ownership (see below) was only asked in the interest cases, as it is a requirement in the IRD that the recipient is the beneficial owner of the interest, whereas this is not a requirement in the PSD.

CJEU judgement in the joined cases T Danmark (C-116/16) and Y Denmark Aps (C-117/16)

Danish cases on beneficial ownership

“the dividend cases”

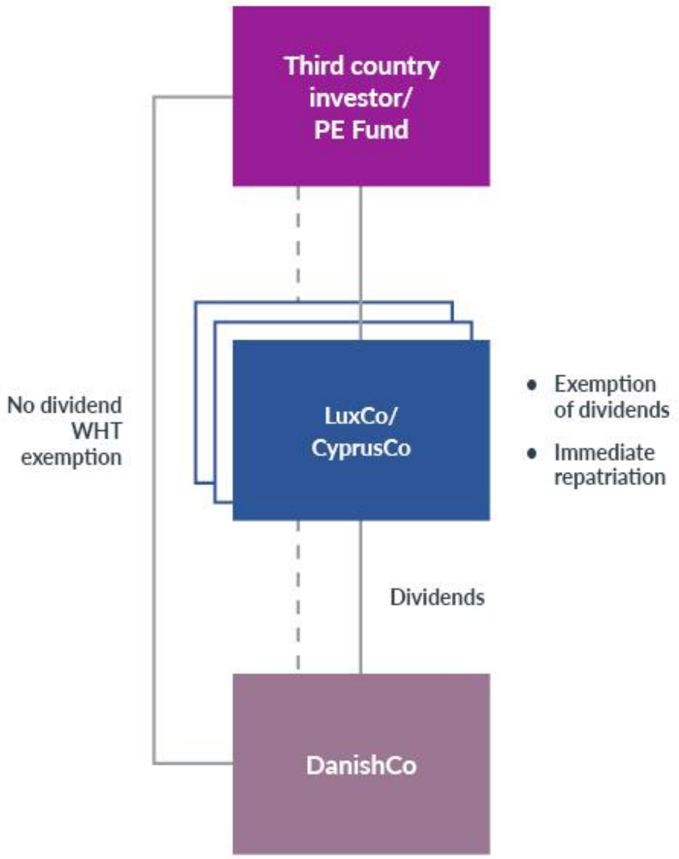
ejtn
refj

CJEU decision in the joined cases T Danmark (C-116/16) and Y Denmark Aps (C-117/16)

- The CJEU rendered on 26 February 2019 two judgments regarding the <u>non-application of the Parent Subsidiary Directive</u> [90/435/EEC of 23 July 1990, as amended by Directive 2003/123/EC of 22 December 2003](“PSD”) <u>and the Interest and Royalties Directive</u> (“IRD”) <u>in case of fraud or abuse.</u>
- The CJEU was requested to deliver its opinion on the possibility of denying the benefits of the PSD in abusive cases, absent any domestic anti-abuse provisions.

Joined cases T Danmark (C-116/16) and Y Denmark Aps (C-117/16) – Facts

- The **T Danmark case (**C-116/16) deals with a dividend distribution from a Danish company to a Luxembourg parent company that was indirectly owned by private equity funds through another Luxembourg company.
- The **Y Denmark Aps case (**C-117/16) deals with a dividend distribution from a Danish company to a Cyprus parent company which used the proceeds to repay interest and principal to its parent company in Bermuda which repatriated the income to the United States (US) parent company in the form of a dividend.
- In both cases, the main argument of the taxpayers was that Danish dividend withholding tax was not triggered by the distributions because of the participation exemption set forth in Article 5 of the Parent and Subsidiary Directive (90/435).



The base case: dividends

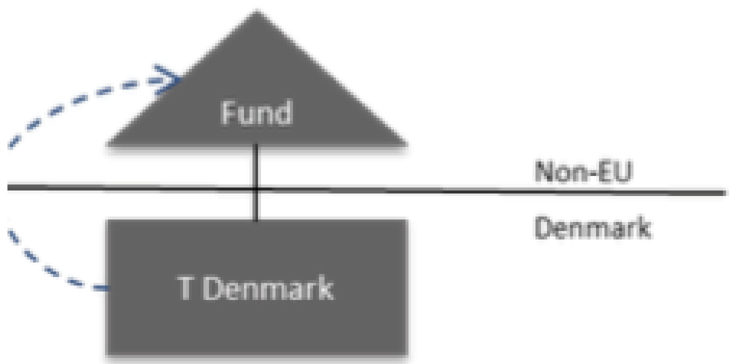

Fund
Non-EU
Denmark
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fig.1

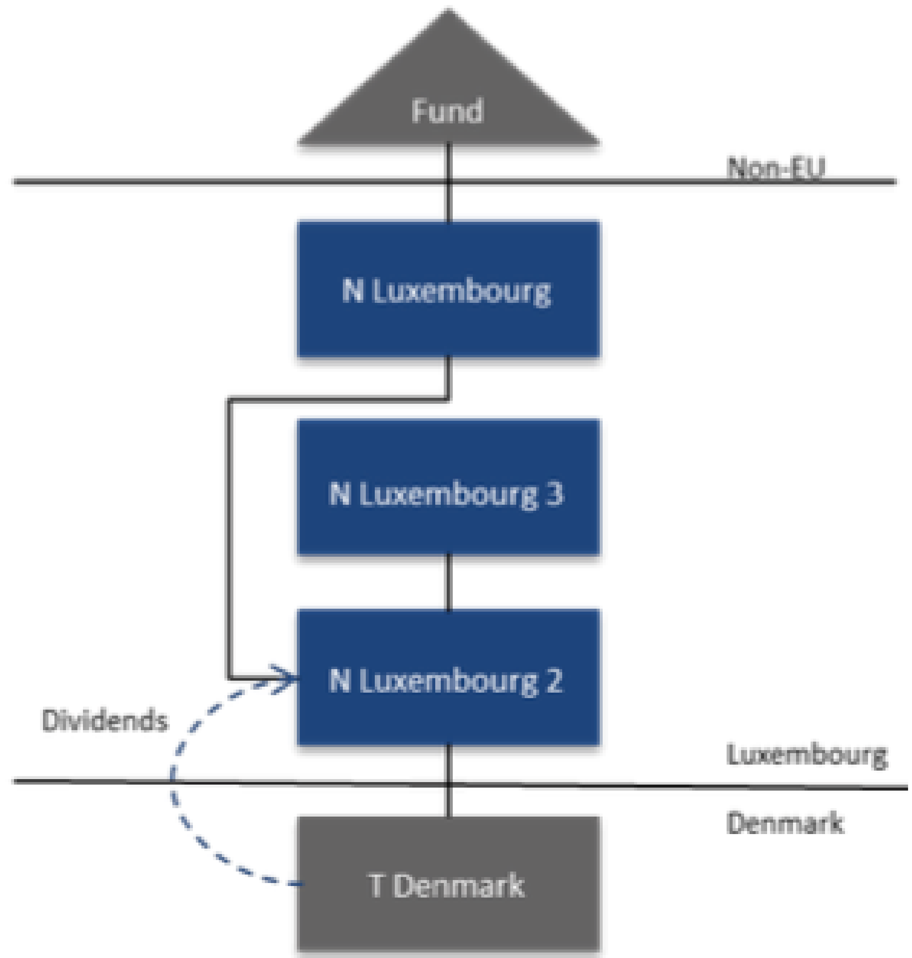
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fig.2

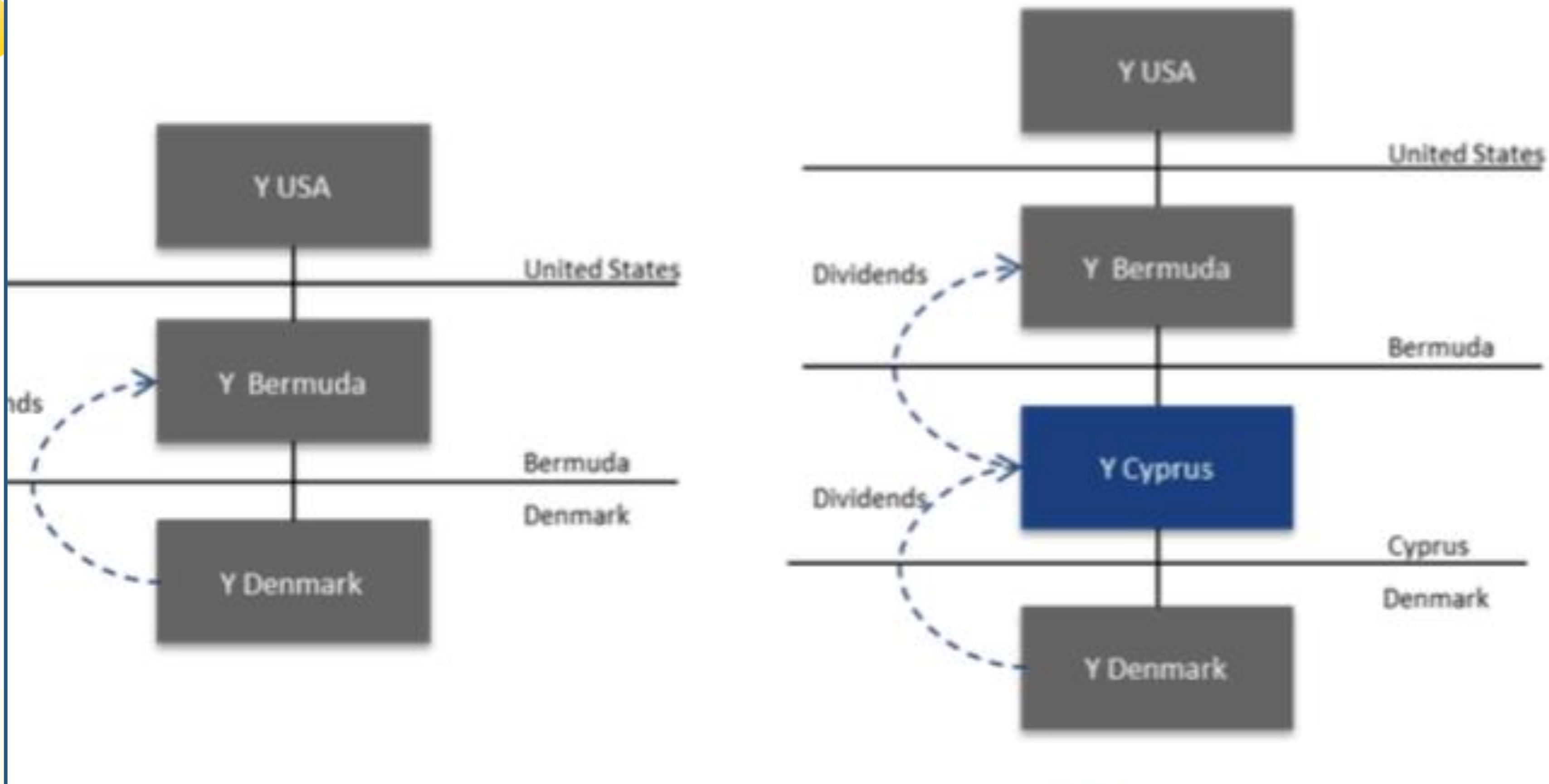


fig.3 *fig.4*

Y Denmark Aps (C-117/16)

Case T Danmark (C-116/16) – Facts

- A private equity funds (non-resident in a Member State or in a country with a DTC) set up companies in Luxembourg.
- In 2010 N Luxembourg 2, acquired a large holding in the capital of T Danmark, and it thus held more than 50% of T Danmark's shares during the period at issue in the main proceedings. T Danmark's remaining shares were held by thousands of shareholders.
- T Danmark paid its shareholders in the summer of 2011 dividends.
- The Luxembourg tax authorities drew up in a "residence certificate" certifying that <u>N Luxembourg 2</u> was subject to corporate income tax and <u>was the beneficial owner of all the dividends paid on the shares that it owned in T Danmark</u>.

Case T Danmark (C-116/16) – Facts

- In 2011 T Danmark submitted an application to SKAT (tax authority) for a binding answer in order to ascertain whether the dividends that it was distributing to N Luxembourg 2 were exempt on corporation tax and, accordingly, whether they escaped withholding tax.
- It was stated that it was not possible to ascertain in advance and with certainty whether and in what way the management of N Luxembourg 2 would in fact decide to use those dividends, since was an independent entity with its own management and own decision-making powers.
- It was also explained that a significant proportion of the ultimate investors were resident in the United States.

Case T Danmark (C-116/16) – Facts

- The dividends would be paid by T Danmark to N Luxembourg 2, which would itself distribute dividends to its own parent company.
- Further on, it could be assumed that N Luxembourg 2 would distribute part of those sums (as dividends and/or interest and/or debt repayment) to companies controlled by the various private equity funds or by its creditors.
- T Danmark also assumed that the sums paid by the parent company of N Luxembourg 2 to companies controlled by the various private equity funds would be transferred to the ultimate investors in the private equity funds, but T Danmark stated that it did not know how those transfers would be made or be treated for tax purposes.
- The Danish Tax Commission answered the request for a binding answer in the negative.

Case T Danmark (C-116/16) – Facts

- T Danmark lodged an appeal before the National Tax Appeals Commission.
- The Commission took the view that the dividends distributed by T Danmark to N Luxembourg 2 were exempt from tax pursuant to Directive 90/435.
- To note that Denmark had not (at the time) adopted legislative provisions to prevent fraud or abuse, as provided for by Article 1(2) of PSD directive.
- The Ministry of Taxation brought legal proceedings against that decision of the National Tax Appeals Commission.
- The latter decided to stay the proceedings and to refer the questions to the CJEU for a preliminary ruling.

Joined cases T Danmark (C-116/16) and Y Denmark Aps (C-117/16)

- Question: In case the conditions for obtaining the withholding tax exemption in the PSD (or the IRD) were formally met, is it necessary for an EU Member State to implement an anti-abuse provision in its domestic law in order to deny any benefit following from the PSD (or the IRD).

Joined cases T Danmark (C-116/16) and Y Denmark Aps (C-117/16) – Legal basis for refusing to grant an exemption provided in the PSD

- General principle of EU law: that EU law cannot be relied on for abusive or fraudulent ends.
- Where there is a fraudulent or abusive practice, the national authorities and courts are to refuse a taxpayer a benefit (the exemption from withholding tax on profits distributed by a subsidiary to its parent company provided for in article 5 of PSD), even if there are no domestic or agreement-based (Double Tax Treaties) provisions providing for such a refusal.

ejtn refj

Joined cases T Danmark (C-116/16) and Y Denmark Aps (C-117/16) – Legal basis for refusing to grant an exemption provided in the PSD

- Clarifications: the CJEU noted that event if Danish law does not contain rules which may be interpreted in compliance with article 1 (2) of PSD, this could not be taken that the national authorities and courts would be prevented from refusing to grant the advantage derived from the right of exemption provided in article 5 of the PSD in the event of fraud or abuse of rights (notwithstanding what the CJEU held in his judgement in case *Kofoed, C-321-05, par.42*).
- The principle of legal certainty precludes directives from being able by themselves to create obligations for individuals and therefore from being capable of being relied upon per se by the Member States as against individuals.

ejtn refj

Joined cases T Danmark (C-116/16) and Y Denmark Aps (C-117/16) – Legal basis for refusing to grant an exemption provided in the PSD

- To permit the setting up of financial arrangements whose <u>sole aim is to benefit from the tax advantages resulting from the application of PSD would not be consistent with objectives</u> and, on the contrary, would undermine the effective functioning of the internal market by distorting the conditions of competition.
- <u>PSD has the aim of facilitating the grouping together of companies at EU level</u> by introducing tax rules which are neutral from the point of view of competition, in order to allow enterprises to adapt to the requirements of the common market, to increase their productivity and to improve their competitive strength at the international level.

Joined cases T Danmark (C-116/16) and Y Denmark Aps (C-117/16) – Constituent elements of abuse of rights

- The CJEU does not assess the facts in the main proceedings.
- Nevertheless, the CJEU provided guidance to the national courts on when an arrangement constitutes abuse of rights ("indications").
- To be noted that: whilst the presence of a number of such indications could lead to the conclusion that there is an abuse of rights, it is for the referring court to establish whether those indications are objective and consistent and whether the defendants have had the opportunity to adduce evidence to the contrary.

ejtn refj

Joined cases T Danmark (C-116/16) and Y Denmark Aps (C-117/16) – Constituent elements of abuse of rights

- Proof of an abusive practice requires:
  - a combination of objective circumstances in which, despite formal observance of the conditions laid down by the EU rules, the purpose of those rules has not been achieved and
  - a subjective element consisting in the intention to obtain an advantage from the EU rules by artificially creating the conditions laid down for obtaining it

ejtn refj

Joined cases T Danmark (C-116/16) and Y Denmark Aps (C-117/16)

- Examination of a set of facts is therefore needed to establish whether the constituent elements of an abusive practice are present, and in particular whether economic operators have carried out purely formal or artificial transactions devoid of any economic and commercial justification, with the essential aim of benefiting from an improper advantage.
- The CJEU further noted that a group of companies may be regarded as being an artificial arrangement where it is not set up for reasons that reflect economic reality, its structure is purely one of form and its principal objective or one of its principal objectives is to obtain a tax advantage running counter to the aim or purpose of the applicable tax law.

ejtn refj

Joined cases T Danmark (C-116/16) and Y Denmark Aps (C-117/16) – Conditions for proving the abuse of rights

- ➢The presence of a certain number of indications may demonstrate that there is an abuse of rights, in so far as those indications are objective and consistent.
- ➢Such indications can include, in particular:
- ❖the existence of conduit companies which are without economic justification interposed in the structure of the group between the company that pays dividends and the company which is the beneficial owner (payment of tax on the dividends is avoided)
- ❖and the purely formal nature of the structure of the group of companies, the financial arrangements and the loans.

Joined cases T Danmark (C-116/16) and Y Denmark Aps (C-117/16) – Conditions for proving the abuse of rights

- An indication for abuse may be:

➢ If the funds are passed on wholly or partially shortly after they are received, and consequently the entity is a flow-through or conduit.

- If the recipient lacks substance or has been interposed in a structure that otherwise wouldn't be covered by the PSD (or IRD).
- On the other hand, the fact that the ultimate parent is resident in a third country, with which a tax treaty has been concluded, can neither prove nor disprove an abuse of rights.

ejtn refj

Joined cases T Danmark (C-116/16) and Y Denmark Aps (C-117/16) – Conditions for proving the abuse of rights

- It is an indication of the existence of an arrangement that all or almost all of the dividends are, very soon after their receipt, passed on by the company that has received them to entities which do not fulfil the conditions for the application of Directive 90/435 because:
  - they are not established in any Member State,
  - they are not incorporated in one of the forms covered by the directive,
  - they are not subject to one of the taxes listed in Article 2(c) of the directive,
  - do not have the status of "parent company" and do not meet the conditions laid down in Article 3 of the Directive.

Joined cases T Danmark (C-116/16) and Y Denmark Aps (C-117/16) – Conditions for proving the abuse of rights

- Indications of an artificial arrangement may be reinforced by the simultaneity or closeness in time:
  - of the entry in force of major new tax legislation and
  - the setting up of complex financial transactions and the grant of intragroup loans.

CJEU decision in joined cases T Danmark (C-116/16), Y Denmark Aps (C-117/16) – Burden of proof of the abuse of rights

- Clarifications regarding the burden of proof:
  - The authorities of an EU Member State are obliged to prove that an arrangement is abusive and conclude that the recipient of the income is not the beneficial owner.
  - However, in order to refuse to accord a company the status of beneficial owner of dividends, or to establish the existence of an abuse of rights, a national authority is not required to identify the entity or entities which it regards as being the beneficial owner(s) of those dividends.

CJEU decision in joined cases T Danmark (C-116/16), Y Denmark Aps (C-117/16) – Infringement of EU freedoms and abuse of rights

- In a situation where the system, laid down by Directive 90/435 of exemption from withholding tax on dividends paid by a company resident in a Member State to a company resident in another Member State is not applicable because there is found to be fraud or abuse, within the meaning of Article 1(2) of that directive,
- application of the freedoms (of establishment and of capital) enshrined in the TFEU cannot be relied on in order to call into question the legislation of the first Member State governing the taxation of those dividends.

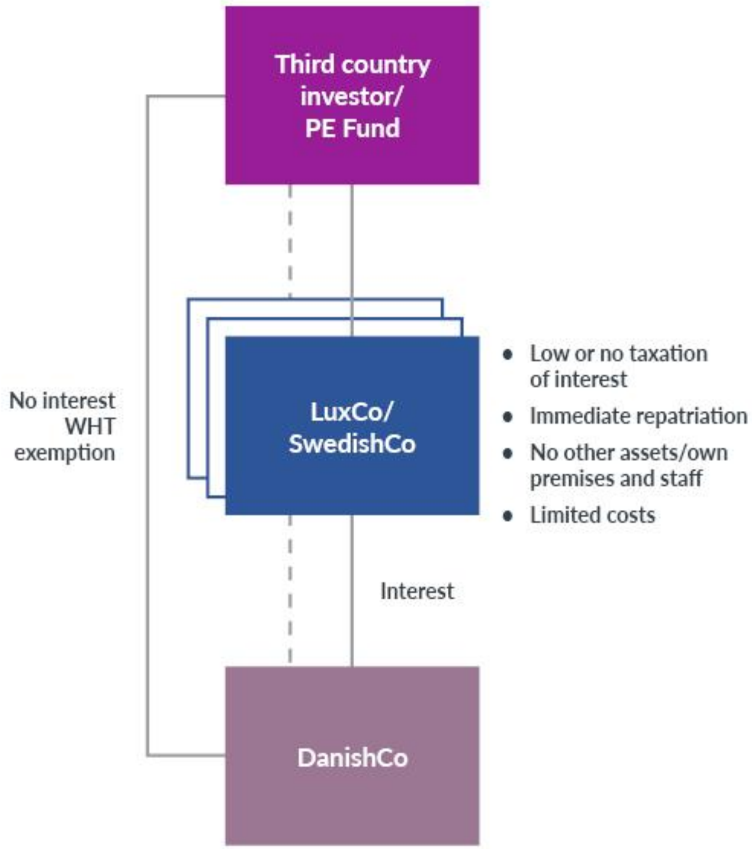
Joined cases N Luxembourg 1 (C-115/16), X Denmark A/S(C-118/16), C Danmark I (C-119/16) and Z Denmark ApS κατά Skatteministeriet (C-299/16)– Facts

- The CJEU issued decisions in four cases with respect to withholding tax on interest payments.

➢ Three cases, C-115/16, C-118/16 and C-299/16, deal with private equity funds that have granted loans to Danish companies through intermediary Luxemburg companies.

➢ The fourth case. C-119/16, deals with a US multinational group where a Cayman company had granted loans to a Swedish company which had granted loans to a Danish company.

➢ In all cases, the main argument of the taxpayers was that Danish interest withholding tax was not triggered by the interest because of the exemption set forth in Article 1 of the EU Interest and Royalty Directive (2003/49).



The base case: interest

“the interest cases”

CJEU decision in the Interest and Royalties Directive Danish cases

- The CJEU noted that:

➢ The exemption of interest payments from any taxes as provided for by the Interest and Royalties Directive is restricted solely to the beneficial owners of such interest.

➢ Such beneficial owner is the entity that economically benefits and has the freedom to use and enjoy the interest.

❖ The OECD Model Tax Convention and the commentaries are relevant for interpreting the concept of beneficial owner under the Interest and Royalties Directive, as the original directive's proposal is based on the OECD work in this matter.

ejtn refj

CJEU decision in the Interest and Royalties Directive Danish cases

- The general principle of EU law that EU law cannot be relied on for abusive or fraudulent ends must be interpreted as meaning that, where there is a fraudulent or abusive practice, the national authorities and courts are to refuse to grant entitlement to rights provided for by the Directive, even if there are no domestic or agreement-based provisions providing for such a refusal.
- It is left for the national court to determine whether the arrangement of a particular case amounts to an abuse of law. This must be determined based on the same criteria as mentioned above regarding the dividend cases.
- It is in principle for the companies which seek entitlement to the exemption from withholding tax to establish that they fulfil the objective conditions imposed by the Directive.
- On the other hand, where a tax authority of the source Member State seeks, on a ground relating to the existence of an abusive practice, to refuse to grant the exemption to a company that has paid interest to a company established in another Member State, it has the task of establishing the existence of elements constituting such an abusive practice while taking account of all the relevant factors, in particular the fact that the company to which the interest has been paid is not the beneficial owner.
- However, such an authority is not required to identify the beneficial owners of such interest but of establishing that the supposed beneficial owner is merely a conduit company through which an abuse of rights has been committed.

CJEU decision in the Interest and Royalties Directive Danish cases

- In the case X Denmark: the Court concluded that even if the Luxembourg SICAR investment fund is formally subject to corporate income tax in Luxembourg, it cannot benefit from the Directive if the interest income is in fact tax-exempt.
- The Court noted that the Danish withholding tax on interest paid to non-residents infringed EU law insofar as:

  - resident taxpayers receiving Danish sourced interest (1) benefit from a tax payment deferral,
  - (2) enjoy lower late payment interest rates and
  - (3) may take any business expenses directly related to the interest income received into account when assessing their taxable income.

CJEU decision in Danish cases

✓ To be noted that:

- ➢ In the Danish cases the taxpayers had amended their investment structures further to an change in Danish domestic law (Law 540 of 29 April 2015) and were not able to provide any economic rationale for such amendments other than tax reasons.
- ➢ The judgements of CJEU reiterate the importance of economic reasons for establishing an investment structure in a given jurisdiction as well as the functional profile of the various entities used.

Danish cases – final remarques

- The Danish cases are extremely important for:
  - ➢ the application of the PSD and IRD
  - ➢ the interpretation of terms such as “beneficial owner” or “abuse of rights”
- The Danish cases have a significant impact on flow of funds from EU subsidiaries to parent companies when the ultimate parent is resident in a third country.

❖ The notion of tax avoidance and abuse of rights is evolving.

❖ The test of abuse resembles the test to be carried out under the General Anti-Avoidance Rule (GAAR) set forth by the EU Anti-Tax Avoidance Directive (2016/1164/EU, amended by 1017/952/EU) that must be implemented in national laws of the Member States by 1 December 2019.

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Anti-Avoidance Package

- **The Anti-Tax Avoidance Package**

Thank you!

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With financial support from the Justice
Programme of the European Union