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From Abuse to Base Erosion, How did we get there?
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TABLE OF CONTENT

Co-existence and conflict between concepts of tax avoidance in the EU:

Tax avoidance & Abuse in ECJ case law

- There are two separate trends of tax avoidance in ECJ case law:

- as a **justification** for measures restricting the exercise of the fundamental freedoms based on the **need of fiscal supervision**.
- as a specific case of **abuse of EU law** justifying not to apply the fundamental freedoms.

Tax avoidance as justification

- Under the “rule of reason” fiscal supervision became a **justification** also for tax measures restricting the exercise of the fundamental feedoms.
- Gradually tax avoidance replaced fiscal supervision and the two were used interchangeably as justification.
- However there was no EU concept of tax avoidance, **only national concepts of tax avoidance were used to justify.**

Tax avoidance as justification 1986

- Initial reluctance of the ECJ to accept tax avoidance as justification for restricting a taxpayer in the exercise of his fundamental freedoms.

- C-270/83, Avoir fiscal, par. 25: "… the risk of tax avoidance cannot be relied upon in this context. Article 52 of the EEC treaty does not permit any derogation from the fundamental principle of freedom of establishment on such a ground".

Tax avoidance as justification 1998

- C-264/96, ICI, par. 26: “As regards the justification based on the risk of tax avoidance, suffice it to say that the *(national)* legislation … does not have the specific purpose of preventing wholly artificial arrangements, set up to circumvent UK tax legislation … but applies to all situations …”

Tax avoidance as justification 2005

- **<u>Breakthrough</u>** for tax avoidance as justification: C-446/03: **<u>Marks & Spencer</u>** par.49: "As regards … the risk of tax avoidance it must be accepted that the possibility of transferring losses incurred by a non-resident company to a resident company entails the risk that within a group of companies losses will be transferred to companies established in MS which apply the highest rates of taxation …"

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Tax avoidance as justification

- Breakthrough for tax avoidance as justification C-446/03: Marks & Spencer, par. 51:

- "In the light of those three justifications, taken together, it must be observed that restrictive provisions such as those at issue … pursue legitimate objectives which are compatible with the Treaty..."

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Abuse of Community Law 1974

- Long before tax avoidance cropped up as a justification to restrict the fundamental freedoms in income tax, abuse of ommunity law was developed as a parallel non-tax concept separate from the justification of fiscal supervision: C-33/74, Van Binsbergen, 03.12.1974.

Abuse of Community Law 1974

C-33/74, Van Binsbergen, 03.12.1974

- 13: "… a MS cannot be denied the right to take measures to prevent the exercise by a person providing services whose activity is entirely or principally directed towards its territory of the freedom guaranteed by art.59 for the purpose of avoiding the professional rules of conduct which woud be applicable to him of he were established within that state…"

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Abuse of Community Law

C-33/74, Van Binsbergen, 03.12.1974

- 15:"That cannot … be the case when the provision of certain services in a MS is not subject to any sort of qualification or professional regulation and when the requirement of habitual residence is fixed by reference to the territory of the state in question."
- 17:"… the … law of a MS cannot, by imposing a requirement as to … residence in that state, deny persons established in another MS the right to provide services, where the provision of services is not subject to any special condition…"

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Abuse of Community Law in customs

C-110/99, Emsland Stärke, 14.12.2000

- Export and sale of starch from the EC to Switzerland immediately followed by re-exportation by purchaser to another. All customs formalities were correctly implemented, including payment of import duties upon re-importation. Profit = import duties < export refund.
- Commission argued that **abuse of law** was a national principle accepted by many MS.

Abuse of Community Law in customs

C-110/99, Emsland Stärke, 14.12.2000

- 39: Commission: abuse of right contains "a subjective element, namely the fact that the commercial operation was carried out **essentially** to obtain a **financial advantage incompatible with the objective of the Community rule**."

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Abuse of Community Law in customs

C-110/99, Emsland Stärke, 14.12.2000

- 43: Commission: anti-abuse rule: “By virtue of the legal principle of abuse of right in force in Community law financial advantages are not to be granted, if it is shown that the commercial operations at issue were for the purpose of obtaining an advantage which is incompatible with the objectives of the applicable Community rule in that the conditions for obtaining that advantage were created artificially.”

Abuse of Community Law in customs

C-110/99, Emsland Stärke, 14.12.2000

- 51: “In that regard it is clear from the case law of the Court that the scope of Community regulations must in no case be extended to cover abuses on the part of the trader.”

Abuse of Community law in VAT & CIT

- **Breakthrough** of the concept of abuse of law in taxation: **Halifax** & **Cadbury Schweppes**.
- C-255/02, Halifax: opinion AG, Poiares Maduro in a VAT case, par. 69: "… this notion of **abuse operates as a principle governing the interpretation of Community law**".

Abuse of Community law in VAT

C-255/02, Halifax, 21.02.2006

- 86: “For it to be found that an abusive practice exists, it is necessary, first, that the transactions concerned, notwithstanding formal application of the conditions laid down by the relevant provisions of the 6th. Directive and of the national provisions transposing it result in the accrual of a tax advantage the grant of which would be contrary to the purpose of the provision.”

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Abuse of Community law in VAT

C-255/02, Halifax, 21.02.2006

- 86: “ Second it must also be apparent from a number of objective factors that the **essential aim** of the transactions concerned is to attain a tax advantage.”

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Abuse of Community law in direct tax

- Cadbury Schweppes confirmed in direct tax the Halifax decision that abuse of law was a principle governing interpretation of EU law for the application to the fundamental freedoms.

- It also consecrated the concept of "Abuse of (Community) Law" as the **standard of justification** legitimizing a restriction of the fundamental freedoms in national taks law.

Abuse of Community law in direct tax

C-196/04, Cadbury Schweppes, 12.09.2006

- The mere fact that a taxpayer moves to another MS or engages in a cross-border transaction with the avowed purpose of paying less tax does not in itself establish abuse, provided the move is genuine.
- 36: "…the fact that a Community national whether a natural or a legal person, sought ot profit from tax advantages in force in a MS other than his State of residence cannot in itself deprive him of the right to rely on the provisions of the Treaty."

Abuse of Community law in direct tax

- This behaviour constitutes only abuse of freedoms, on the ground that the cross-border move is not effective and genuine, but not on the ground that the taxpayer benefits from a lower tax rate. The latter is a consequence of national tax sovereignty.
- The standards of abuse of the freedoms under Community Law used by the ECJ are narrower than the standards of abuse used by national tax administrations under tax law. The ECJ has the obligation to protect the freedoms.

Tax avoidance as abuse of law

- C-196/04, Cadbury Schweppes, 12.09.2006

- 55: "… in order for a restriction on the freedom of establishment to be justified on the grounds of prevention of abusive practices, the specific objective of such restriction must be to prevent conduct involving the creation of **wholly artificial arrangements which do not reflect economic reality, with a view to escaping the tax** normally due on the profits generated by activities carried out on national territory."

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Tax avoidance as abuse of law

C-196/04, Cadbury Schweppes, 12.09.2006

- 64: "In order to find that there is such an arrangement there must be, in addition to a subjective element consisting of the intention to obtain a tax advantage, objective circumstances showing that, despite formal observance of the conditions laid down by Community law, **the objective pursued by the freedom of establishment has not been achieved** … "

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Tax avoidance as abuse of law

C-196/04, Cadbury Schweppes, 12.09.2006

- The difference in the concept of tax avoidance between the ECJ and tax administrations resides in the "**commensurateness**" between the importance of the economic activity and the amount of taxable profits generated by such activity. The ECJ accepts a minimal "threshold" of effective activity to justify implementation of the freedoms. Tax administrations reject acivity as "genuine", when it is not **commensurate** to taxable profits.

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Tax avoidance in EU tax directives

- Art. 1.2. Directive 2011/96/EU: dividends

  “This directive shall not preclude the application of domestic or ageement-based provisions required for the prevention of *(tax evasion, tax)* fraud or abuse”.

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Tax avoidance in EU tax directives

- Directive 2015/121/EU of 27.01.2015 amending Art. 1.2. directive 2011/96/EU:

  “MS 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 and purpose of this Directive, are not genuine having regard to all relevant facts and circumstances.”

Tax avoidance in EU tax directives

- Directive 2015/121/EU of 27.01.2015 amending Art. 1.2. directive 2011/96/EU:

  “For the purposes of paragraph 2, an arrangement or 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.”

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Tax avoidance in EU tax directives

- Art. 5.1 & 2. Directive 2003/49/EC: interest & royalties:

- Domestic or agreement based provisions **+**
- "MS may, in the case in which the principal motive or **one of the principal motives** is tax evasion, tax avoidance or abuse, withdraw the benefits of this directive or refuse to apply this Directive."

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Tax avoidance in EU tax directives

- Art. 15.1.(a) Directive 2009/133/EC: merger:

- Principal or one of the principal motives (see 1990 directive) **+**
- "the fact that the operation is not carried out for valid commercial reasons such as restructuring or rationalisation ... may constitute a presumption that the operation has tax evasion or tax avoidance as … one of its principal objectives".

Tax avoidance in EU tax directives

Commission recommendation for a general anti-abuse rule C(2012) 8806 final of 06.12.2014

- Recommendation to harmonise national GAAR's of all Member States
- "An artificial arrangement or an artificial series of arrangements which has been put into place for the **essential purpose** of avoiding taxation and leads to a tax benefit shall be ignored"

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Tax avoidance in BEPS

- New objective in the preamble of tax treaties: “CS do not intend the provisions of the convention to create opportunities for non-taxation or **reduced** taxation through tax avoidance or tax evasion.”

- SAAR in tax treaties: anti abuse provisions for PE in third states, MAP decides conflict of double corporate residence, new LOB provision in art. 29 MC.

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Tax avoidance in BEPS

- New LOB provision: treaty benefits are denied, unless taxpayer is a **qualified resident** (many conditions and owning at least 50% of the co.)

- Disqualified resident taxpayer can claim treaty benefit by submitting a **request** to competent authority (CA) of the state granting the treaty benefit.

Tax avoidance in BEPS

- **Discretionary relief:** the CA **can** grant the treaty benefit, after investigation of all the facts and circumstances, if the establishment, acquisition or maintenance of the residence and the conduct of the resident's operation **does not have as one of its principal purposes the obtaining of treaty benefits**. CA shall consult other CS: what of both CS disagree?
- Tax treaty benefits are always important factor of establishment.

Tax avoidance in BEPS

- **Base erosion prevails on tax avoidance:** valid and genuine business purposes do not offset important tax considerations.

- OECD report: “notwithstanding the fact that there may also be **other principal purposes** for changing residence, suchg as facilitating the sale of property, or the reinvestment of the proceeds of the alienation”.

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Tax avoidance in BEPS

PPT test as GAAR in new art. 29.9 MC:

- "… a benefit under this Convention shall not be granted in respect of an item of income or capital, if it is reasonable to conclude, having regard to all relevant facts and circumstances that obtaining a benefit was one of the principal purposes of any arrangement or transactions that resulted directly or indirectly in that benefit, unless it is established that granting that benefit ..would be in accordance with the object and purpose of the relevant provisions of this Convention." Preamble?

PPT test in GAAR, art. 6 ATAD

- "… a Member State shall ignore an arrangement or a series of arrangements, which, having put into place for **the main purpose of one of the main purposes of obtaining a tax advantage** that defeats the object and purpose of the applicable tax law, are not genuine having regard to all relevant facts and circumstances."
- "… an arrangement … shall be regarded as non-genuine to the extent that they are not put into place for valid commercial reasons **that reflect economic reality**."

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Comparison art. 29.9 MC – art. 6 ATAD

- Similarity in PPT: **the main purpose of one of the main purposes of obtaining a tax advantage** that defeats the object and purpose of the applicable tax law”

- Difference: ATAD only applies to non genuine arrangements, i.e. **to the extent** that there are valid commercial reasons **that reflect economic reality** GAAR art.6 does not apply.

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Questions on art. 6 ATAD

- What does “to the extent mean”? Can an arrangement be partially genuine? What does “that reflects economic reality mean”? Is it that taxable income reflects the concept of value creation with BEPS? Cfr. position of HMRC in Cadbury Schweppes: economic activity in Dublin was not “commensurate” with the taxable profits.
- Is a valid commercial reason that does not reflect economic reality not a contradictio in terminis?

The ATAD in the EU Legal Order

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The ATAD and…

…EU legislative competence

…the relationship between primary and secondary EU law

…the relationship between secondary EU law and national law

…the relationship between secondary EU law and tax treaty law

…the application of EU Fundamental Rights.

ATAD and EU Legislative Competence

- **Was the EU competent to adopt the ATAD?**
  - The internal market competence of Article 115 TFEU and ATAD's contribution
  - Three ATAD objectives: (1) "ensure fair and effective taxation", (2) "prevent fragmentation" and (3) "provide legal certainty"
  - Critique: (a) "Fair taxation" as condition of the internal market, (b) going beyond BEPS requirements, (c) covering internal situations, (d) minimum standard counterproductive
  - Subsidiarity and Proportionality
- **What is the impact of its adoption for balance of competences?**
  - Minimum harmonisation: no underride of EU standard
  - But no general pre-emption of competing national legislation in the same field (in contrast to complete harmonisation)
  - Pre-emption of bilateral treaties: complex structure of external competence rules (Art 3(2) and 216 TFEU) and potential conflict between ATAD and DTTs may curb MS' power to conclude DTTs alone (even if only 'minimum harmonisation'!)

ATAD and the relationship between primary and secondary EU law

- **A constitutional legal order built on hierarchy: secondary EU law must comply with primary EU law**
  - Secondary law derives from primary law is subject to the **procedural, formal,** and **substantive limits** set by the EU treaties
  - The CJEU applies a **different standards of scrutiny** to those categories of limits (procedural: strict standard; formal: lenient standard; substantive: varied approach)
- **Substantive limits to secondary EU law**
  - Secondary law is subject to the **fundamental freedoms** (including non-discriminatory restrictions), but wider discretion for justifications and proportionality tests apply (*Schmelz*)
  - Step-by-step harmonisation recognised as legitimate/necessary: obstacles arising from **incomplete harmonisation** are not restrictions (*Gaz de France*) (Consistency?)
  - Secondary law is *indirectly* subject to **state aid law** where Member States are granted **options**; obligatory rules cannot be attributed to Member State (*Puffer*)

ATAD and the relationship between secondary EU law and national law

- **Interpretation and scrutiny of national law**
  - National law needs to be in line with both secondary and primary law, but in cases of ***"exhaustive harmonisation"*** the CJEU tests exclusively against secondary law
  - Options granted to MS remain subject to review by primary law (***Bosal***; ***Groupe Steria***): such options need to comply with fundamental freedoms and state aid law (but: **C-475/01 *"Ouzo"***)
- **Direct effect of directives**
  - Directives require implementation (even if de facto exhaustive) to become effective; however, case law accepts direct effect on three conditions
  - ***Cussens*** as a paradigm shift from ***Kofoed***?
  - Application to ATAD?
- **Analogous application of directives**
  - ***Gaz de France*** denies (need for) such analogy; contrary indications in other fields
  - Relevance for ATAD?

ATAD and the relationship between secondary EU and tax treaty law

- **Hierarchy or pluralism?**
  - Member States need to comply with EU law when concluding bilateral treaties
  - **Article 351 TFEU** protects pre-accession treaties from overriding effect of 'the provisions of the Treaties' (both primary and secondary law?)
  - Most direct tax directives cannot violate tax treaties (see however Art 1(2) PSD); but ATAD (e.g. Arts 5, 6 and 7) can
  - 'Analogous' application of Article 351 to protect treaties in place prior to adoption of the ATAD?

ATAD and the application of EU fundamental rights

- **EU fundamental rights application in tax law**
  - Article 51 ChFR implementing principles of CJEU case law: fundamental rights bind (1) institutions, bodies, offices and agencies of the Union and (2) Member States when they implement Union law
  - When do Member States ‘implement Union law’? Acting ‘within the scope’ of EU law – does it require an obligation under EU law to act in a certain manner or is acting in a field for which EU rules *can* be relied upon enough?
  - Case: ***Berlioz*** (precise obligation), ***Åkerberg*** (loose obligation), ***Sabou*** (optional application), ***Burzio*** (no application)
- **Impact of the ATAD**
  - Member States need to impose burdens b/o the ATAD – within the scope of the directive, **national constitutional guarantees are overridden** due to supremacy of EU law
  - EU fundamental rights act as backstop in this situation – full applicability!

Thank you for listening!

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FACHBEREICH RECHTSWISSENSCHAFT

Abuse of Law as a General Principle of EU Tax Law

FACT

Overview

A. The Prohibition of Abuse in Indirect Taxation
B. Selected Recent CJEU Case Law on Direct Taxation
C. Double Standards between Direct and Indirect Taxation?
D. The Way Forward
E. Conclusion

A. Prohibition of Abuse in Indirect Taxation

I. ECJ of 14 December 2000, C-110/99, Emsland Stärke

- Although previous case-law, Emsland Stärke as **seminal case for the anti-abuse doctrine**
- Relief for exports under Common Agricultural Policy; export of starch to Switzerland and immediate re-import
- **Two-step test for abuse by ECJ:**

52. A finding of an abuse requires, **first**, a combination of objective circumstances in which, despite formal observance of the conditions laid down by the Community rules, the purpose of those rules has not been achieved.
53. It requires, **second**, a subjective element consisting in the intention to obtain an advantage from the Community rules by creating artificially the conditions laid down for obtaining it. The existence of that subjective element can be established, *inter alia*, by evidence of collusion between the Community exporter receiving the refunds and the importer of the goods in the non-member country.

II. CJEU of 21 February 2006, C-255/02, Halifax

- Lead case for VAT
- Complex transaction so as to insure VAT input credit for bank, even though it used inputs in tax-exempt transactions
- Court developed two-step test for abuse

74 For it to be found that an abusive practice exists, it is necessary, **first**, that the transactions concerned, notwithstanding formal application of the conditions laid down by the relevant provisions of the Sixth Directive and of national legislation transposing it, result in the accrual of a tax advantage the grant of which would be contrary to the purpose of those provisions.

75 **Second**, it must also be apparent from a number of objective factors that the essential aim of the transactions concerned is to obtain a tax advantage….

III. CJEU of 22 November 2017, C-251/16, Cussens

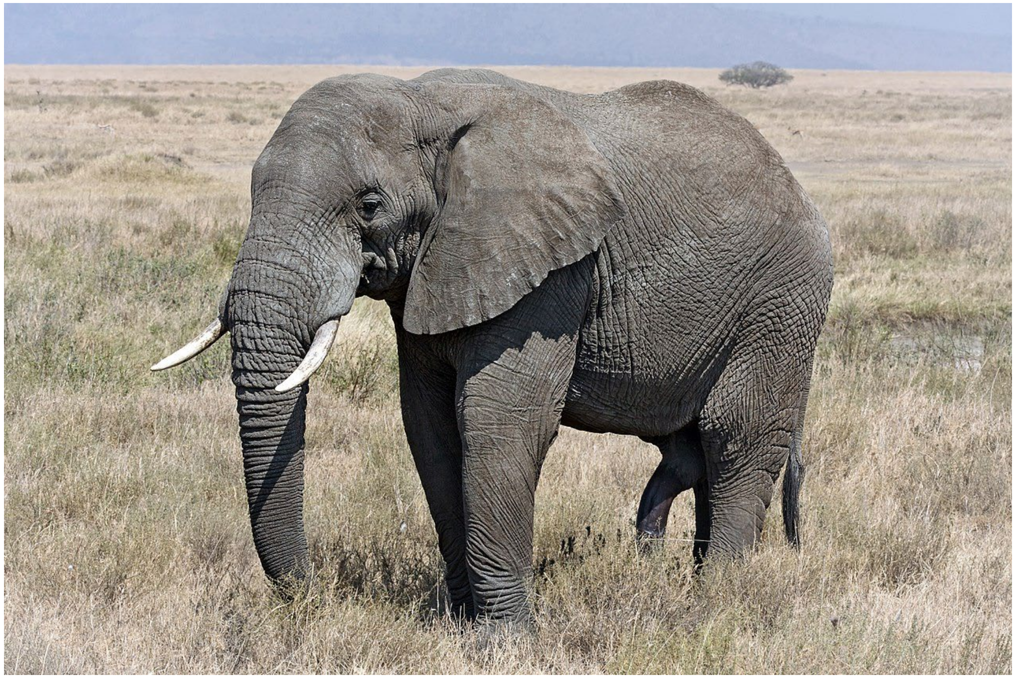
– Prohibition of abuse as general principle of law

30 … It is thus apparent that that principle is not of the same nature as the rights and advantages to which it applies.

31 The principle that abusive practices are prohibited, as applied to the sphere of VAT by the case-law stemming from the judgment in Halifax, thus displays the general, comprehensive character which is naturally inherent in general principles of EU law.

III. Cussens - Comments

- Prohibition of abuse evidently reasonable
- So is (primary law) status a principe général du droit
- Danger of amounting to an elefant Test: Can we really **define** abuse?



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IV. Proportionality as Limitation to Anti-Abuse-Provisions

- Extensive case-law, in particular developed under VAT Directive for VAT fraud
- Principle of proportionality as principe général du droit limits anti-abuse provisions

B. Recent Case Law on Direct Taxation

I. CJEU of September 12, 2006, C-194/04, Cadbury-Schweppes

– CJEU considered low-tax Irish finance subsidiary not abusive

55 … in order for a restriction on the freedom of establishment to be justified on the ground of prevention of abusive practices, the specific objective of such a restriction must be to prevent conduct involving the creation of wholly artificial arrangements which do not reflect economic reality …

II. CJEU of September 2017, C-6/16, Eqiom and Enka

- reference for a preliminary ruling on interpretation of Articles 49 and 63 TFEU, and of Article 1(2) of PSD
- Facts: Cross-border dividend from French subsidiary to Luxembourg parent, the ultimate owner of which is a Swiss company.
- Withholding tax on dividends prohibited by PSD and Freedom of establishment?

II. CJEU of September 2017, C-6/16, Eqiom and Enka

- CJEU saw no abuse

32. In order to determine whether an operation pursues an objective of fraud and abuse, the competent national authorities **may not confine themselves to applying predetermined general criteria**, but must carry out an individual examination of the whole operation at issue. The imposition of a general tax measure automatically excluding certain categories of taxpayers from the tax advantage, without the tax authorities being obliged to provide even *prima facie* evidence of fraud and abuse, would go further than is necessary for preventing fraud and abuse.

…

38. Therefore, by subjecting the exemption … to the condition that that parent company establish that … **one of the principal purposes of the chain of interests is not to take advantage of that exemption**, without the tax authorities being required to provide even *prima facie* evidence of fraud and abuse, the legislation at issue in the main proceedings introduces a **general presumption of fraud and abuse** and undermines the objective pursued by the Parent-Subsidiary Directive, namely the prevention of double taxation of profits distributed by a subsidiary to its parent company.

II. CJEU of 22 December 2017, Joint Cases C-504/16 and C-613/16, Deister and Juhler

- Similar case from Germany with ultimate shareholders German or from third countries that were not entitled to refund of withholding tax. Refund denied by German tax authorities.
- Compatibility with PSD and Freedom of establishment?
- CJEU again saw no abuse; refutability of presumption from LOB not sufficient, as LOB was not sufficient for prima facie assumption of abuse

I. Danish cases, e.g. C-115/16 – N Luxembourg 1 (pending)

- Series of Danish cases (C-115/16 – C-119/16; C-299/16) currently pending; Opinion of AG Kokott of 1 March 2018; decision by CJEU will be published on 26 February 2019
- Facts: Share deal in Danish company with PEC financing from Luxembourg; no taxation of interest in Luxembourg; in addition to questions who was beneficial owner also question whether double non-taxation abusive?

I. Danish cases, e.g. C-115/16 – N Luxembourg 1 (pending)

- AG Kokott: Abuse not limited to artificial arrangements, but also circumvention of tax laws; requires analysis of the reasons for structure; avoidance of taxation of interest income by Luxembourg entity in Denmark as such not abusive; using third-country partnership may be abusive, where purpose is to avoid EU income taxation at hands of owners by using deficits in the exchange of information
- Suggests that securing tax revenue from third countries is not a valid purpose (?)

C. Double Standards between Direct and Indirect Taxation?

I. Different Standards?

- At first glance, stricter control for direct taxes
- Seemingly different concepts between
    - Cadbury Schweppes (only artificiality) and
    - Halifax as well as Cussens (prohibition of abuse)

II. Opinion by AG Kokott, C-115/16 – N Luxembourg 1

- Different standards regarding direct applicability

105. This does not conflict with judgment delivered by the Court (50) in *Italmoda* and *Cussens*, in which the Court ruled that the prohibition in principle on abusive practices must be interpreted as being capable, regardless of a national measure giving effect to it in the domestic legal order, of being applied directly in order to refuse exemption from VAT, without conflicting with the principles of legal certainty and legitimate expectation.
106. However, those two judgments referred exclusively to value added tax (VAT), which differs from the subject matter at issue here. First, VAT is much more harmonised under EU law and, as it is coupled to the funding of the Union, has far more of an impact on interests under EU law than national income tax.
107. Second, EU law (Article 325(1) and (2) TFEU) requires the Member States to take (effective) measures to collect VAT, (51) whereas the same does not apply under income tax law. Moreover, VAT law is particularly susceptible to fraud; therefore particularly effective enforcement of tax claims is required. In that sense, the Court itself drew a distinction in a recent judgment between VAT law and secondary EU law, which contains an express authority to prevent abuse. (52) Therefore, direct application of Article 5 of Directive 2003/49 to the detriment of the taxable person is out of the question. (53)

III. Prohibition of Abuse as Common Concept

- **Halifax approvingly quoted** in Cadbury-Schweppes
- **central non-sequitur** in Cadbury-Schweppes, paras. 54 and 55 means there is scope for concretization:

54 Having regard to that objective of integration in the host Member State, the concept of establishment within the meaning of the Treaty provisions on freedom of establishment involves the actual pursuit of an economic activity through a fixed establishment in that State for an indefinite period (see Case C-221/89 Factortame and Others [1991] ECR I-3905, paragraph 20, and Case C-246/89 Commission v United Kingdom [1991] ECR I-4585, paragraph 21). Consequently, it presupposes actual establishment of the company concerned in the host Member State and the pursuit of genuine economic activity there.

55 It follows [???] that, in order for a restriction on the freedom of establishment to be justified on the ground of prevention of abusive practices, the specific objective of such a restriction must be to prevent conduct involving the crea-tion of wholly artificial arrangements which do not reflect economic reality,

IV. Explaining the Differences

- Difference between less harmonized direct and more harmonized indirect taxes; stricter proportionality test for Member States measures (no longer true for ATAD)
- Halifax doctrine developed for all cases, not just for particularly sensible cross-border cases
- Halifax doctrine as direct prohibition of abuse, whereas Eqiom and Enka case law about indirect indicators of abuse (proxies)

D. The Way Forward

I. Unified Theory of Abuse (yet another convergence)

- There should be **one theory of abuse**
- **Strictness of proportionality test** may depend on whether member states or European Union acts are involved
- CJEU will have to help develop criteria on what constitutes abusive

II. Importance of Teleological Reasoning

- Finding abuse of law has a **teleological component**, see Saydé, Yearbook of European Law, Vol. 33, No. 1 (2014), 138, at 153 ff.
- More effort needs to be made to find out what is the purpose of the rule?
- **Particularly relevant for third country situations**, which do not benefit from internal market/integration logic
- Example: Parent/Subsidiary-Directive

II. Importance of Teleological Reasoning – example of PSD

- Recital no. 3 is quite blunt: "The objective of this Directive is 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." (see Tavarez/Bogenschneider, Intertax 2015, 484)
- Recital no. 2 to Directive 2014/86/EU, which amended the Parent Subsidiary Directive: "The benefits of Directive 2011/96/EU should not lead to situations of double non-taxation and, therefore, generate unintended tax benefits for groups of parent companies and subsidiaries of different Member States when compared to groups of companies of the same Member State
- Distinction between intra-EU and third country beneficiaries; in line with BEPS recommendation of and CJEU's acceptance (in ACT GLO) of LOB clauses

III. Limitations of Anti-Abuse Rules by Proportionality Principle

- **Limit to true cases of abuse**: motive test; appropriate proxies for prima facie abuse
- **No fiscal double or triple dip**: secure single tax principle, but no further punishment

E. Conclusion


Notbremse
Handgriff nur bei Gefahr ziehen Jeder Mißbrauch wird bestraft
Alarme
Ne tirer la poignée qu'en cas de danger Tout abus sera puni
Freno d' emergenza
Tirare la maniglia solo in caso di pericolo Ogni abuso verrà punito
СТОП КРАН
РУКОЯТКУ ПРИВОДИТЬ В ДЕЙСТВИЕ ТОЛЬКО В СЛУЧАЕ ОПАСНОСТИ КАЖДОЕ ЗЛОУПОТРЕБЛЕНИЕ НАКАЗЫВАЕТСЯ

THANK YOU FOR YOUR ATTENTION!

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The MLI Principal Purposes Test & its interaction with the EU ATAD GAAR

Prof. dr. Stef van Weeghel
University of Luxembourg, February 2019

Agenda

- Overview of improper use of tax treaties
- The MLI Principal Purposes Test (PPT)
- The EU ATAD GAAR
- Relationship between the PPT and EU GAAR

Overview of improper use of tax treaties

Improper use of tax treaties

Two themes:

- Abuse of the tax treaty
  - Treaty Shopping
  - Rule Shopping
- Application of domestic anti-avoidance rules and tax treaties
  - Relationship domestic general anti-avoidance rule (GAAR) and tax treaty
  - Relationship domestic specific anti-avoidance rule (SAAR) and tax treaty
- Thin-cap
- CFC
- Etc.

OECD BEPS Action 6 – Structure

A. Treaty provisions and/or domestic rules to prevent the granting of treaty benefits in inappropriate circumstances
   1. Cases where a person tries to circumvent limitations provided by the treaty itself
      a. Treaty shopping
      b. Other situations where a person seeks to circumvent treaty limitations
   2. Cases where a person try to abuse the provisions of domestic law using treaty benefits

B. Clarification that tax treaties are not intended to be used to generate double non-taxation

C. Tax policy considerations for tax treaties

OECD BEPS Action 6 – Treaty Shopping

The first requirement that must be met by a person who seeks to obtain benefits under a tax treaty is that the person must be "a resident of a Contracting State", as defined in Article 4 of the OECD Model Tax Convention. There are a number of arrangements through which a person who is not a resident of a Contracting State may attempt to obtain benefits that a tax treaty grants to a resident of that State. These arrangements are generally referred to as "treaty shopping".

OECD Position – Evolution of the Commentary

- See Commentary, Art. 1, par. 54 et seq., on Improper Use of the Convention
- Note that the Commentary has changed overtime!
- From ‘pacta sunt servanda’ to ‘States do not have to grant the benefits of a double taxation convention where arrangements that constitute an abuse of the provisions of the convention have been entered into.’ (2003 Addition to Comm. Par. 9.4)

The Guiding Principle since 2003

61. It is important to note, however, that it should not be lightly assumed that a taxpayer is entering into the type of abusive transactions referred to above. A guiding principle is that the benefits of a double taxation convention should not be available where a main purpose for entering into certain transactions or arrangements was to secure a more favourable tax position and obtaining that more favourable treatment in these circumstances would be contrary to the object and purpose of the relevant provisions. That principle applies independently from the provisions of paragraph 9 of Article 29, which merely confirm it.

Remedies to treaty shopping

- Sham/Substance-over form/Fraus legis/Abuse of law/GAAR
  - Aiken Industries
  - Northern Indiana Public Service Company
  - BNB 1994/253
  - MIL (Investments) SA v Canada
  - A Holding ApS v Federal Tax Administration
  - Yanko Weiss Holdings (1996) Ltd. V Holon Assessing Office
  - Various cases by Dutch Hoge Raad
  - Azadi Bachao Andolan
  - Alta Energy
  - Etc.etc.
- Beneficial Ownership in post '77 treaties
- Principle Purpose Test (PPT), Limitation on benefits (LOB)

Treaty Shopping – Commentary on Art. 1 2017 OECD MC

55. The extension of the network of tax conventions increases the risk of abuse by facilitating the use of arrangements aimed at securing the benefits of both the tax advantages available under certain domestic laws and the reliefs from tax provided for in these conventions.

56. This would be the case, for example, if a person (whether or not a resident of a Contracting State), acts through a legal entity created in a State essentially to obtain treaty benefits that would not be available directly.

Relationship domestic general anti-avoidance rule (GAAR) and tax treaty

- See Commentary on Improper Use, par. 54-80
- How tax avoidance is dealt with:
  - Sham, simulation, substance over form
  - Characterization, possibly for tax purposes only (example: a loan is characterized as equity)
  - Extensive interpretation
  - Fraus legis/Abuse of Law/GAAR
    - ➢ Actions
    - ➢ Contrary to object and purpose of the law
    - ➢ Tax avoidance as motive

The MLI Principal Purposes Test

Article 29 (9) OECD MC – Principal Purposes Test (PPT)

9. Notwithstanding the other provisions of this Convention, a benefit under this Convention shall not be granted in respect of an item of income or capital if it is reasonable to conclude, having regard to all relevant facts and circumstances, that obtaining that benefit was one of the principal purposes of any arrangement or transaction that resulted directly or indirectly in that benefit, unless it is established that granting that benefit in these circumstances would be in accordance with the object and purpose of the relevant provisions of this Convention.

Article 29 (9) OECD MC – Commentary

169. Paragraph 9 mirrors the guidance in paragraphs 61 and 76 to 80 of the Commentary on Article 1. According to that guidance, the benefits of a tax convention should not be available where one of the principal purposes of certain transactions or arrangements is to secure a benefit under a tax treaty and obtaining that benefit in these circumstances would be contrary to the object and purpose of the relevant provisions of the tax convention. Paragraph 9 incorporates the principles underlying these paragraphs into the Convention itself in order to allow States to address cases of improper use of the Convention even if their domestic law does not allow them to do so in accordance with paragraphs 76 to 80 of the Commentary on Article 1; it also confirms the application of these principles for States whose domestic law already allows them to address such cases.

Note: Art. 29(9) effectively reverses ‘the burden of proof’

Article 29 (9) OECD MC – Commentary

171. Paragraph 9 supplements and does not restrict in any way the scope or application of the provisions of paragraphs 1 to 7 (the limitation-on-benefits rule) and of paragraph 8 (the rule applicable to a permanent establishment situated in a third jurisdiction): a benefit that is denied in accordance with these paragraphs is not a "benefit under the Convention" that paragraph 9 would also deny. Moreover, the guidance provided in the Commentary on paragraph 9 should not be used to interpret paragraphs 1 to 8 and vice-versa.

172. Conversely, the fact that a person is entitled to benefits under paragraphs 1 to 7 does not mean that these benefits cannot be denied under paragraph 9. Paragraphs 1 to 7 are rules that focus primarily on the legal nature, ownership in, and general activities of, residents of a Contracting State. As illustrated by the example in the next paragraph, these rules do not imply that a transaction or arrangement entered into by such a resident cannot constitute an improper use of a treaty provision.

The EU ATAD GAAR

Article 6 ATAD – EU GAAR

1. For the purposes of calculating the corporate tax liability, a Member State shall ignore 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 the applicable tax law - are not genuine having regard to all relevant facts and circumstances. An arrangement may comprise more than one step or part.

2. For the purposes of paragraph 1, an arrangement or a series thereof shall be regarded as non genuine to the extent that they are not put into place for valid commercial reasons which reflect economic reality.

EU GAAR - Interpretation of abuse

ATAD

1. "non-genuine arrangement has 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 the applicable tax law".

2. "an arrangement is regarded as non-genuine to the extent that it was not put into place for valid commercial reasons which reflect economic reality".

Open issues

- Relationship between para 1 and para 2
- What is "not genuine"?
- One or more commercial reasons?
- Non-tax reasons?
- How should "valid " be interpreted?
- Main purpose test?

Consider case law

- Reference to national law could raise further interpretation issues

How did we get to an EU GAAR?

Notion of abuse is fundamental to other EU directives

PSD – Art. 1 (2) (3)

"non-genuine arrangement has 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."

" 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."

Merger Directive – Art 15

"absence of valid commercial reasons for the operation as a typical example of such motivation"

Case law

"to prevent conduct involving the creation of wholly artificial arrangements which do not reflect economic reality, with a view to escaping the tax normally due on the profits generated by activities carried out on national territory"

How did we get to an EU GAAR?

- Notion of abuse is also inherent in general principles of EU law
- One common concept → to be derived from case law of the CJEU
- Interpretation of Art 6 ATAD (GAAR) has to be in line with case law

➢ Application of GAAR in a non-discriminatory way

➢ Consistent application of GAAR to domestic and cross-border situations

Relationship PPT and EU law?

- Fundamental freedoms
- Art. 1(2) - (4) PSD, Art. 5 IRD and Art. 15(1)(a) MD (ECJ, 7 September 2017, C-6/16, *Eqiom*, EU:C:2017:641)
- Other relevant case: ECJ, 20 December 2017, C-504/16 and C-613/16 *Deister and Juhler Holding*
- Conclusion AG Kokott in Danish BO cases
- EU Commission recommendation C(2016) 271 (re Action 6):

"Notwithstanding the other provisions of this Convention, a benefit under this Convention shall not be granted in respect of an item of income or capital if it is reasonable to conclude, having regard to all relevant facts and circumstances, that obtaining that benefit was one of the principal purposes of any arrangement or transaction that resulted directly or indirectly in that benefit, unless it is established that it reflects a genuine economic activity or that granting that benefit in these circumstances would be in accordance with the object and purpose of the relevant provisions of this Convention."

That’s it. (for now.)

Controlled Foreign Company Legislation

Art. 7 and 8 ATAD

Prof. Dr. Alexander Rust

Historical Overview

- US introduced its Subpart F legislation in 1962. Many other countries followed (Germany 1972: Art. 7 et seq. AStG, France 1980: Art. 209B CGI, United Kingdom 1984: Sec. 747 ICTA.)

- Corporate rates are declining, Companies are doing an inversion, Cadbury/Schweppes judgment of the CJEU of 12.09.2006, C-196/04, ECLI:EU:C:2006:544.

- BEPS Action 3 of 5 October 2015: Strengthening CFC Rules; Art. 7 ATAD of 12 July 2016; Art. 59 of the Proposal of a CCTB-Directive of 25 October 2016.

Rationale for CFC Regimes

- Prevent Deferral / Deterrent Effect
- Combat profit shifting through transfer-pricing
- Treat subsidiaries and permanent establishments alike / Equality of the legal form
- Achieve Capital Export Neutrality / w-w taxation
- Fight against the conversion of ordinary income into tax privileged income

Policy Objectives

- Avoidance of double taxation (actual dividend distribution / capital gain)
- Reducing administrative and compliance burdens
- Maintaining competitiveness / risk of relocation / inversions (application of similar CFC rules by all countries)

Art. 7 – 8 ATAD

Three Requirements:

- Control: Art. 7(1)(a)
- Low taxation: Art. 7(1)(b)
- Passive income: Art. 7(2)(a)

Art. 7 – 8 ATAD

Tax Consequences:

- Income of CFC is included in tax base of the shareholder in proportion to its participation: Art. 8(3)
- Income of CFC is calculated in accordance with the tax rules of the parent state.
- Measures against double taxation:
  - Real distributions: Art. 8(5); Alienation of Shares: Art. 8(6); Indirect credit for taxes paid by subsidiary: Art. 8(7)

Shareholder / CFC

Shareholder:

“**Taxpayer**”: Entities subject to corporate tax; also corporations resident in third country with permanent establishment in MS of EU.

Minimum standard: MS may extend CFC legislation to individuals.

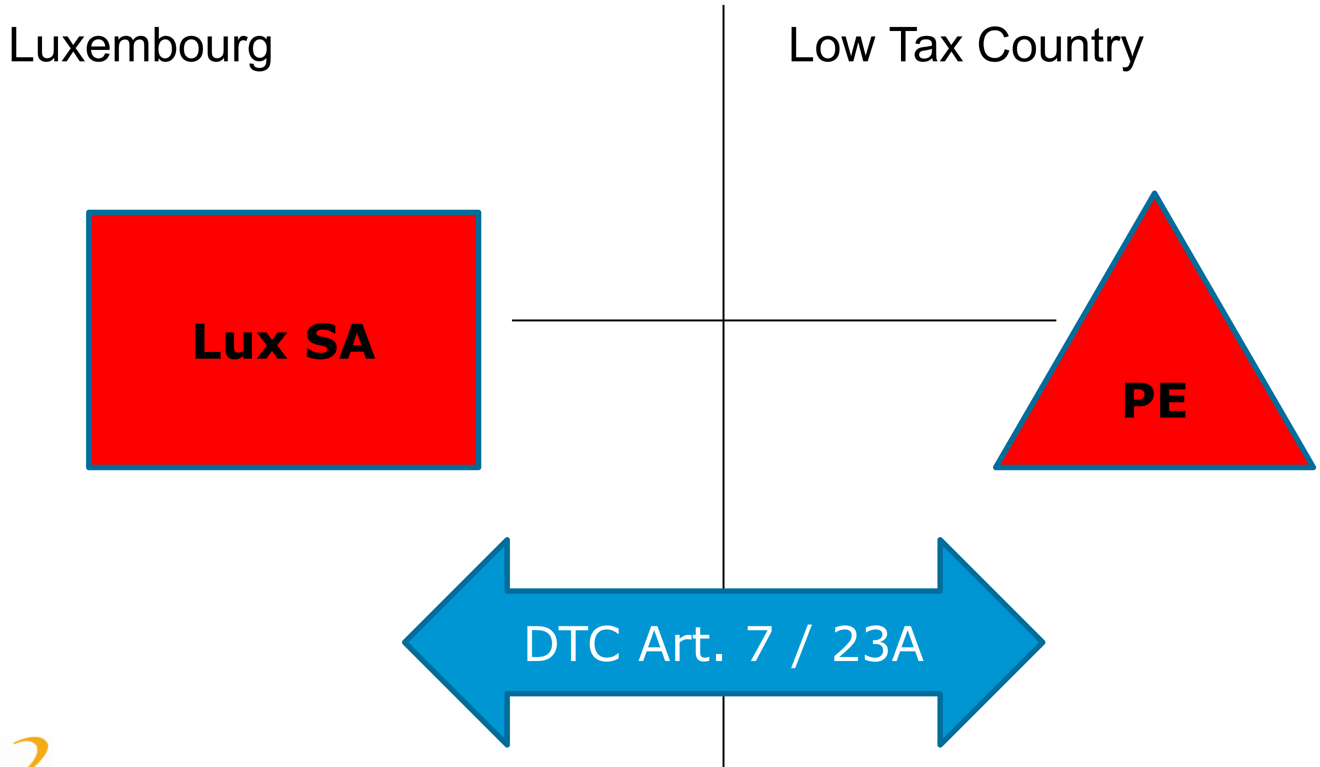
Shareholder / CFC

CFC:

Entities: companies, partnerships, trusts, foundations…

Permanent establishments: If profits are exempt in MS of taxpayer.

Treaty Override



Control

Taxpayer (together with associated enterprises Art. 2(4)) directly or indirectly

- holds >50% of the **voting rights**
- owns >50% of the **capital**
- is entitled to >50% of the **profits** of that entity

=> Minimum standard

Control

Luxembourg

LuxCo
60% Voting Rights

FranceCo
60% Profit Entitlement

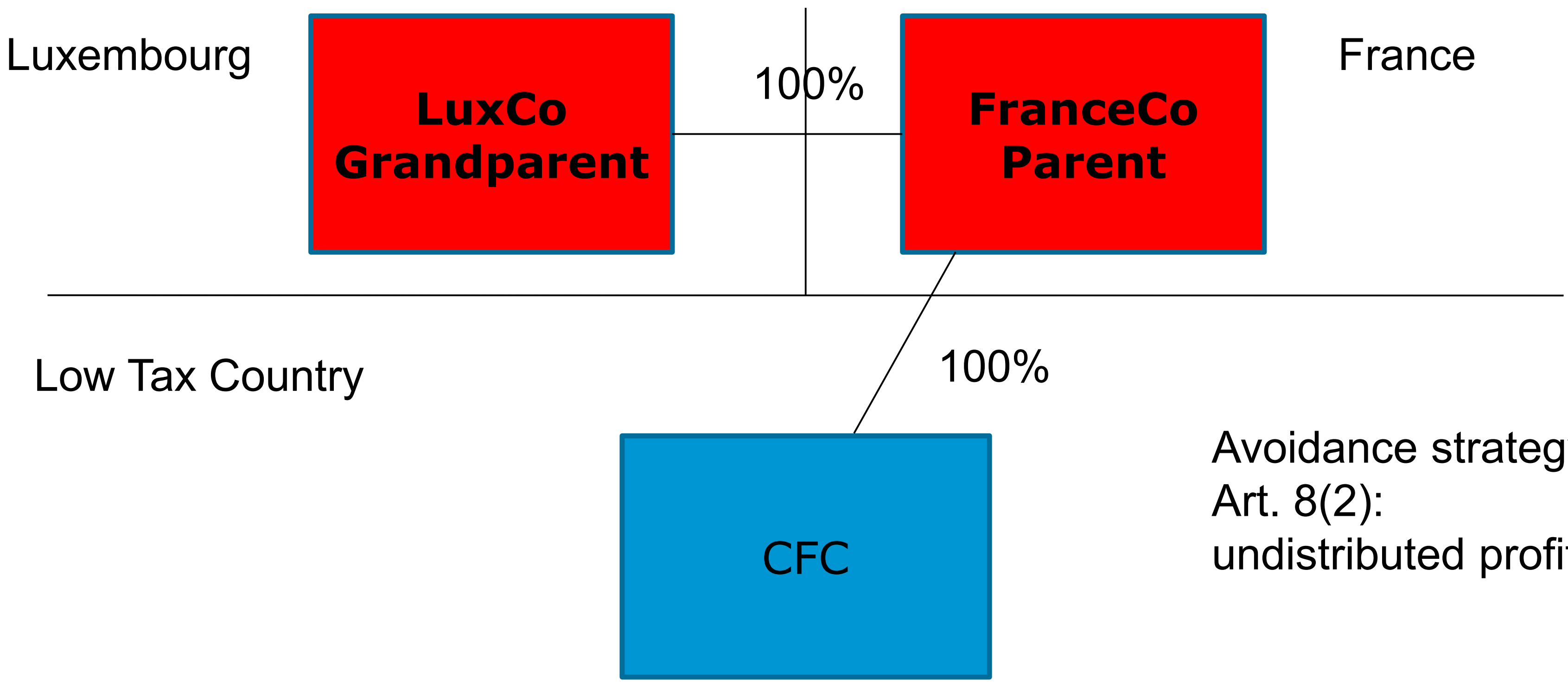
France

Low Tax Country

CFC

Art. 8(3): in proportion to the taxpayer‘s **participation** in the entity

Control



Avoidance strategy:
Art. 8(2):
undistributed profits

Low Taxation

Art. 7(1)(b):

The actual corporate tax paid on its profits by the entity…is lower than the difference between the corporate tax that would have been charged on the entity…under the applicable corporate tax system in the Member State of the taxpayer and the actual corporate tax paid on its profits by the entity…

Low Taxation

Actual tax paid < fictitious tax – actual tax paid

<=> 2*actual tax paid < fictitious tax

<=> actual tax paid < 50% fictious tax

- Minimum Standard
- Effective tax rate sometimes difficult to calculate
- Preamble allows listing approach (black or white list)

Low Taxation

How to calculate the effective corporate tax rate?

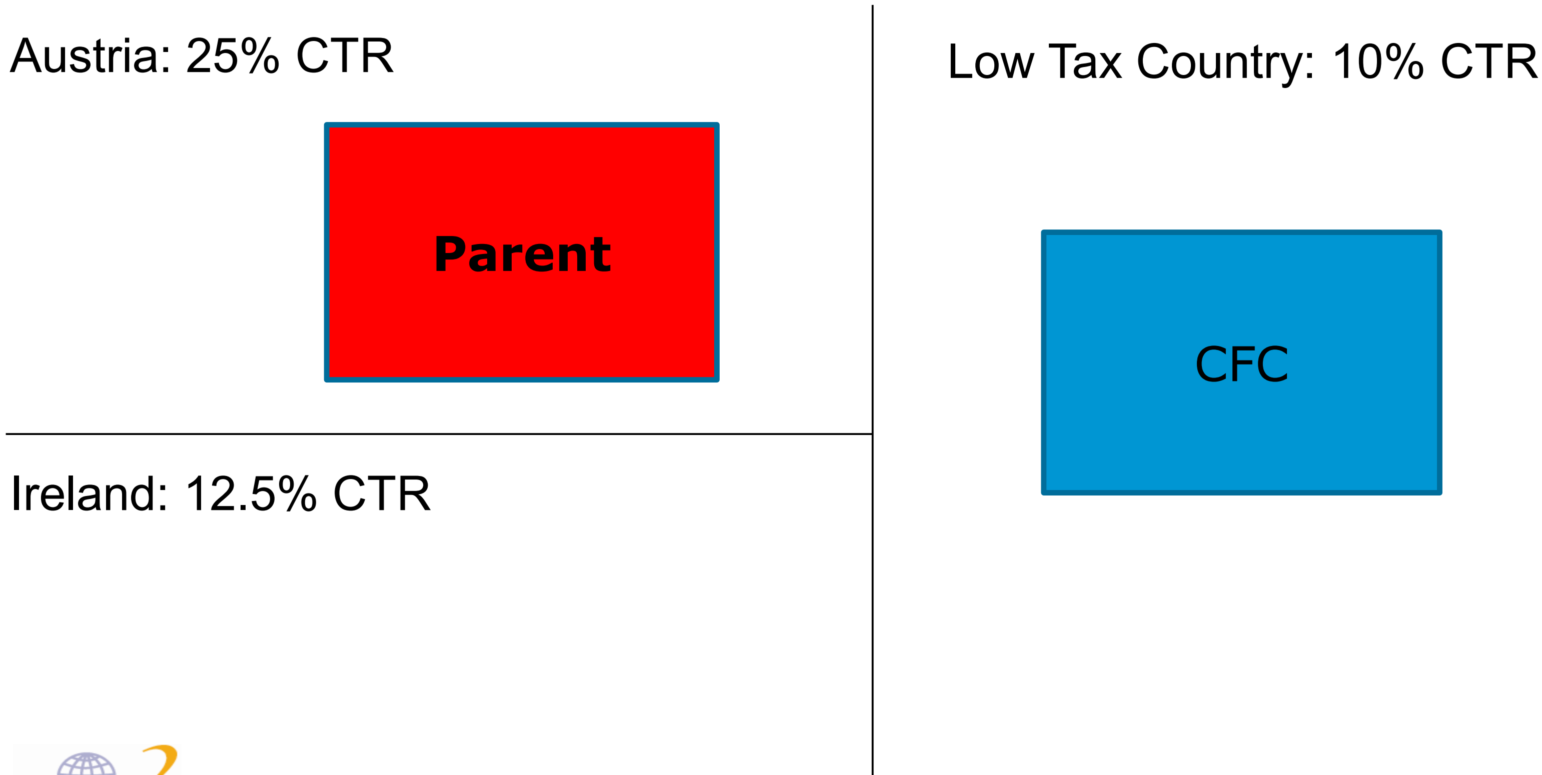
1) Entity approach: Corporate tax on all the income of the CFC

2) Transactional approach: Corporate tax on all passive income

3) Transactional approach: Corporate tax on each item of income.

=> Corporate tax paid **on its profits**; systematic argument

Low Taxation



Passive Income

Art. 7(2)(a):

Interest, royalties, dividends, capital gains, financial leasing, insurance and banking activities, transactions between associated enterprises;

=> Transactional approach (no infection) but minimum standard

Cadbury Schweppes exception for EU States, optional for third countries (Wording is different)

Diversion of income

Art. 7(2)(b):

Income arising from non-genuine arrangements:

CFC owns assets or undertakes risk but in reality the significant people at the level of the parent are instrumental in generating the CFC income.

De Minimis Rules

Art. 7(3): De minims rules for Art. 7(2)(a)

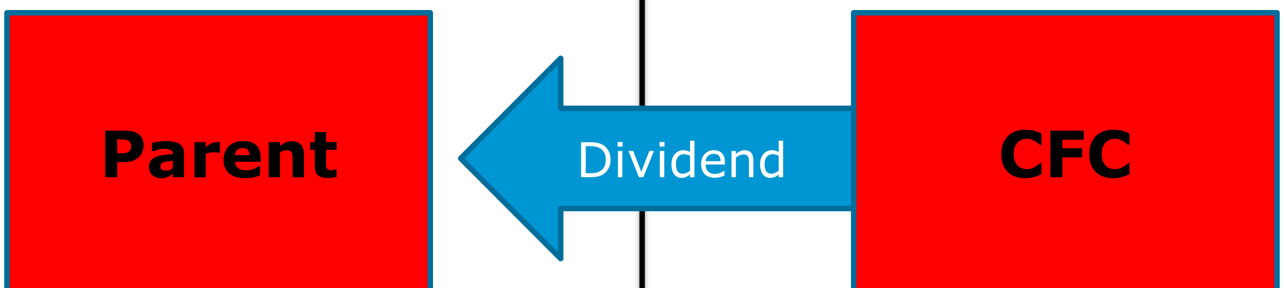
Art. 7(4): De minimis rules for Art. 7(2)(b).

Avoidance of Double Taxation

EU MS: 25%

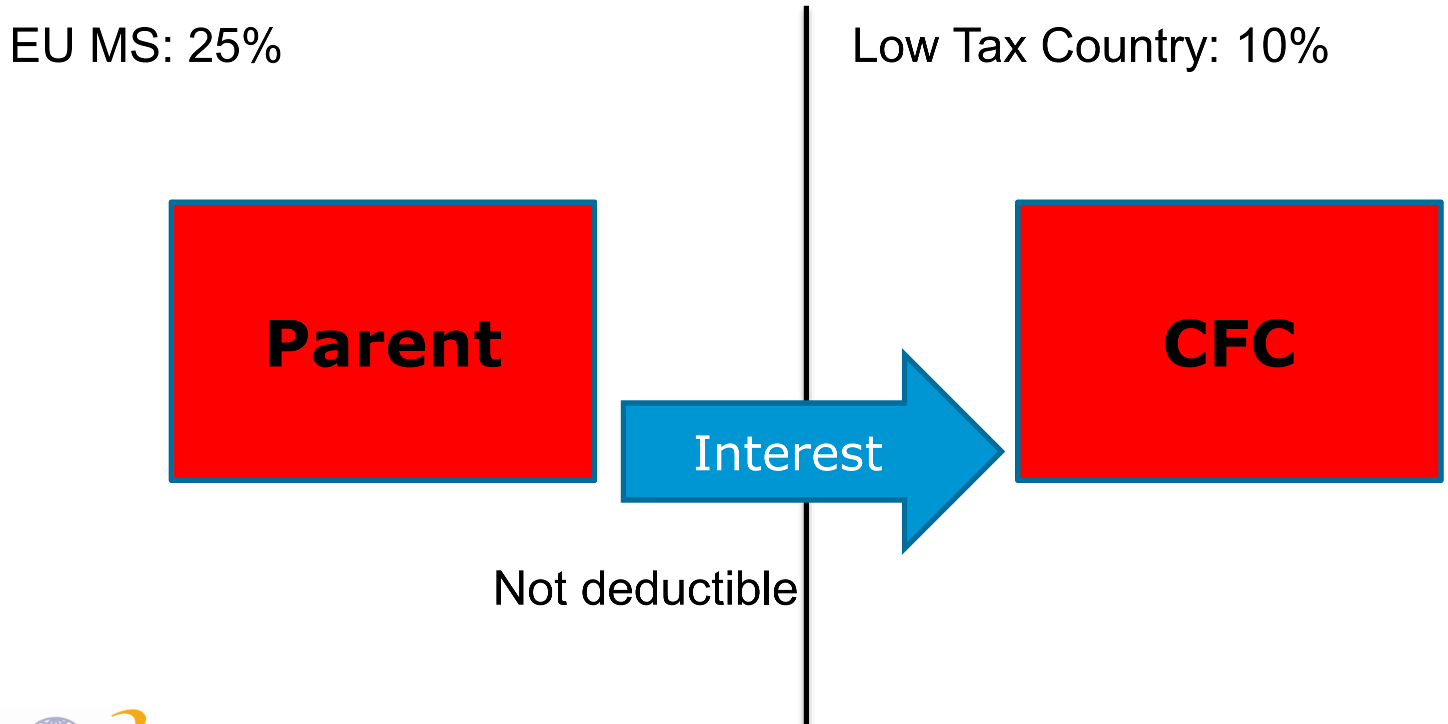
Low Tax Country: 10%

Profit: 100



Withholding Tax 10% = 9

Avoidance of Double Taxation



Evaluation Art. 7 – 8 ATAD

WIRTSCHAFTS UNIVERSITÄT WIEN VIENNA UNIVERSITY OF ECONOMICS AND BUSINESS

- No Harmonization: Options and Minimum Standard
- Double Taxation: Several MS will simultaneously apply CFC legislation, Source Taxes are not creditable
- Treaty Override: PEs in third countries with exemption method in tax treaty
- Huge administrative burden
- CFC-legislation can be easily avoided: real distributions can be exempt; shift to EU MS with low taxation, Cadbury Schweppes exception

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Interest limitation

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Introductory words

- Interest limitation in a post-BEPS world
- The new « tax mix » : OECD soft law + EU directive + domestic law
- Structural issues related to new rules regarding interest limitation
- Technical problems relating to the interpretation of the new rules

WHAT IS THE TRUE GOAL OF THE NEW RULES?

Art. 4 as a tool for harmonization

- Starting point : many different ways of limiting interest deduction in EU MS
- ATAD as a structural change for a number of countries
- ATAD as a moderate change for countries which already had a similar system
  - However, « similar » does not mean « identical »
    - Concept of EBITDA
    - Safe harbour rules
    - Carry forward of exceeding borrowing costs
    - Etc.

However harmonization is far from complete

- Article 4 ATAD is not applicable in every country
  - Transposition process still ongoing in several countries
  - Art. 4 model postponed until 2024 in some countries

- Choices made by states may differ significantly

- True harmonization with CCTB (art. 13)?

The minimum level of protection theory

- Harmonization is incomplete because of Art. 3 ATAD
  - This Directive shall not preclude the application of domestic or agreement-based provisions aimed at safeguarding a higher level of protection for domestic corporate tax bases.

- Art. 4 should therefore be understood as a minimum
  - True goal of ATAD : not harmonization but protection of revenue
  - Consequences
    - Art. 4 may be transposed in a way that is not foreseen by the authors of the directive : see for example the dual cap established by the French legislation depending whether a company (or a group) is thinly capitalized
    - The « model » of Art. 4 may coexist with other interest limitation rules
      - Earlier law may subsist to a certain extent
      - Combination issues

The minimum level of protection theory does not account for every difference

- Countries may actually « play » with Article 4

  - Taking into account group taxation may make Article 4 less harsh than it seems
  - Safe harbor rules perform the same function

TECHNICAL ISSUES RELATING TO ART. 4. ATAD

Definition of interest / OECD approach

- OECD Report, Action 4, § 34
- “At its simplest, interest is the cost of borrowing money. However, if a rule restricted its focus to such a narrow band of payments, it would raise three broad issues:
  - It would fail to address the range of base erosion and profit shifting risks that countries face in relation to interest deductions and similar payments.
  - It would reduce fairness by applying a different treatment to groups that are in the same economic position but use different forms of financing arrangements.
  - Its effect could be easily avoided by groups re-structuring loans into other forms of financing arrangement. »
- « In deciding whether a payment is economically equivalent to interest, the focus should be on its economic substance rather than its legal form”.

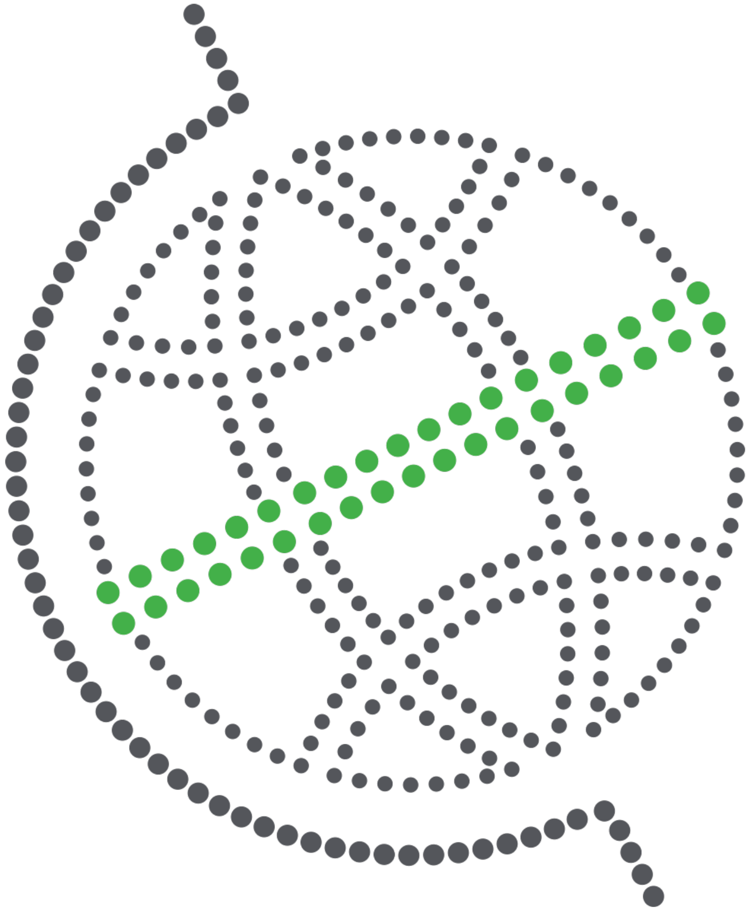
The scope of Art. 4 is not obvious

- “interest expenses on all forms of debt”
- “other costs economically equivalent to interest and expenses incurred in connection with the raising of finance as defined in national law”
- “including, without being limited to”
- “amounts under alternative financing arrangements, such as Islamic finance”
- “capitalised interest included in the balance sheet value of a related asset”
- “amounts measured by reference to a funding return under transfer pricing rules where applicable”
- “guarantee fees for financing arrangements, arrangement fees and similar costs related to the borrowing of funds”

Other issues relating to definitions

- EBITDA
- How to implement the safe harbour rules applying to consolidated group for financial accounting purposes?

Deloitte.



Conference “Anti-Tax Avoidance Directive”

Hybrid entities in the ATAD

Luxembourg, 15 February 2019

Dr. Karoline Spies

AGENDA

- Hybrid entities: what is it?
- Hybrid entities: are they covered by the ATAD?
- Hybrid entities: legal consequences of mismatches

2

Hybrid entities: what is it?

- Art 2(9) ATAD: definition

  "**hybrid entity**" means any entity or arrangement that is regarded as a taxable entity under the laws of one jurisdiction and whose income or expenditure is treated as income or expenditure of one or more other persons under the laws of another jurisdiction"

- **Reverse hybrid entity**: treated transparent in the jurisdiction where it was formed, and non-transparent in another jurisdiction (COM(2016) 687 final) → Art 9a ATAD
- **Simple hybrid entity**: treated non-transparent in the jurisdiction where it was formed, and transparent in another jurisdiction → Art 9 ATAD
- Examples: partnerships (e.g. Hungarian *Betéti társaság [Bt.]*, Croatian *komanditno društvo [k.d.]*, Slovakian *Komanditná spoločnosť [kom. spol.]*), investment funds, trusts, …

Hybrid entities: are they covered by the ATAD?

- Art 1(1) ATAD: "This Directive applies to all **taxpayers** that are **subject to corporate tax in one or more Member States**, including permanent establishments in one or more Member States of entities resident for tax purposes in a third country"
  - No Annex with legal forms (as e.g. in Parent-Subsidiary, Interest-and-Royalties, and Merger Directives)
    → less legal certainty, but more flexibility!
  - Inconsistent terminology: "taxpayer" vs "taxable person" (Art 9a) vs "entity" vs "enterprise"
- **Unclear wording:** Subject to CIT in which Member State?
  - Member State of residence/establishment?
  - Member State who applies the ATAD in a given case?
  - Any Member State? Third state?
- Hybrid entities with corporate entities as partners vs **hybrid entities with individuals as partners**

Hybrid entities: are they covered by the ATAD?

- Option 1: hybrid entity is covered, if treated as CIT entity in "*one*" of the 28 Member States
  - Literal reading of Art 1, most comprehensive way to combat tax planning and abuse
  - But: complex assessment (law of 27/28 MS needs to be tested)
- Option 2: hybrid entity is covered, if treated as CIT entity in its Member State of residence/establishment
  - But: No Annex with legal forms comparable to other direct tax directives
- Option 3: hybrid entity is covered, if treated as CIT entity in one Member State of activity
  - But: complex assessment and unsystematic results, changing over time
- **Option 4: hybrid entity is covered, if treated as CIT entity in the MS which applies the ATAD**
  - Most practical solution, respecting sovereignty of Member States
  - Art 1(2) ATAD, added by ATAD 2: "Article 9a also applies to all entities that are treated as transparent for tax purposes by a Member State" → a contrario: reverse hybrids are in general not covered by the ATAD
  - But: Why "*one or more*" MS in Art 1? Heterogeneous application leads to unsystematic results (e.g. Art. 5(5))?

Hybrid entities: special rules in the ATAD

- Introduced by ATAD 2 (2017)
- To be implemented by January 2020 or 2022
- Rather short rules in Arts 9 and 9a
- Great number of definitions in Art 2 → important to understand scope and legal consequences
- Aid to interpretation: BEPS Action 2:

Recital 28: "*In implementing this Directive, Member States should use the applicable explanations and examples in the OECD BEPS report on Action 2 as a source of illustration or interpretation to the extent that they are consistent with the provisions of this Directive and with Union law*"

Hybrid entity mismatches: overview

double deduction (Art 9(1))

- simple hybrids
- EU and third country
- Associated enterprises (50%)
- January 2020

primary rule

investor jurisdiction:
deny deduction

secondary rule

payer jurisdiction:
deny deduction

deduction without inclusion (Art 9(2))

- simple/reverse hybrids
- EU and third country
- Associated enterprises (50%)
- January 2020

primary rule

payer jurisdiction:
deny deduction

secondary rule

payee jurisdiction:
include in income

non-taxation (Art 9a)

- reverse hybrids
- limited to EU hybrids
- Associated enterprises (50%)
- takes priority over Art 9(2)
- January 2022

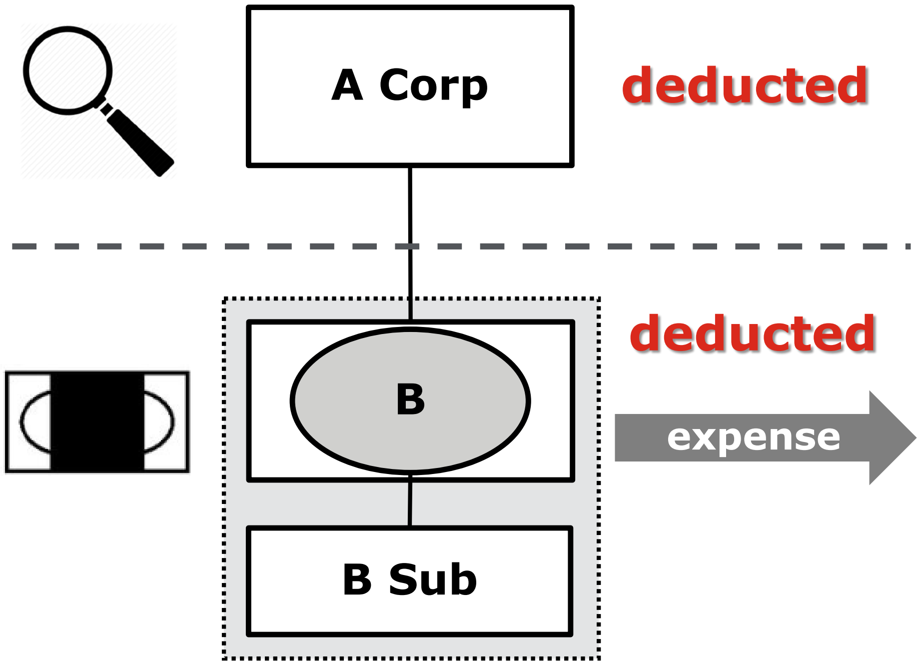
coordination rule

regard as resident and tax income

Hybrid mismatch: double deduction (DD)

The problem: double deduction

State A = investor jurisdiction



State B = payer jurisdiction

The solution: Art 9(1): denial of deduction

To the extent that a hybrid mismatch results in **a double deduction**

primary rule

(a) the deduction **shall be denied** in the Member State that is the **investor jurisdiction**

secondary rule

(b) where the deduction is **not denied** in the investor jurisdiction, the deduction **shall be denied** in the Member State that is the **payer jurisdiction**

*Nevertheless, any such deduction shall be eligible to be **set off against dual inclusion income** whether arising in a current or subsequent tax period.*

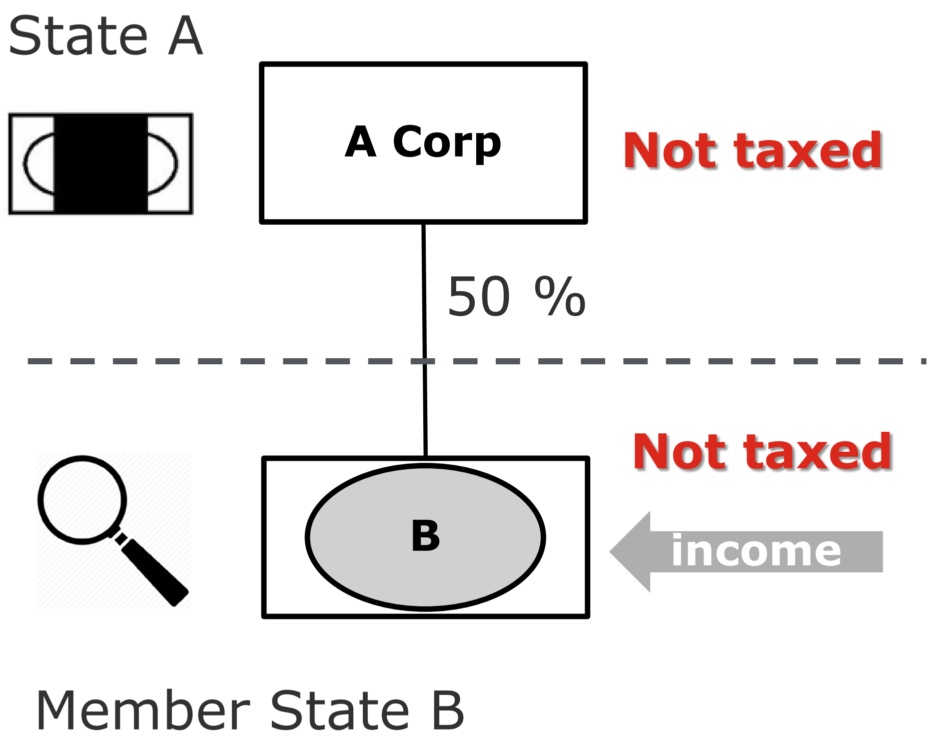
Hybrid mismatch: double deduction (DD)

- **Scope**: double deduction
  - the "**same** payment, expense or loss" is **deducted** in the jurisdiction where the hybrid entity is established ("payer jurisdiction") and in "another jurisdiction (investor jurisdiction)"
    What is really the "same"? Different qualifications, timings, fictions (e.g. leasing, depreciation)
  - "deducted" = "set off against non-dual inclusion income" in payer state (Art 2(9)(2)(b); recital 21)
    Group taxation regimes, disparities?

- **Legal Consequences**: deny deduction to the extent no dual inclusion income
  - "*Set off against* **dual inclusion income** *whether arising in a* **current or subsequent tax period**"
    Retrospectively allow deduction? Refrain from taxation in subsequent year? Deferred expense?
  - Dual inclusion = "**any item of income included** under the laws of both jurisdictions"
    "included" = "taken into account in the taxable income"
    Credit method? WHT? Payment of taxes? Special exemptions under domestic law (disparities)?

Hybrid mismatch: non-taxation

The problem: non-taxation



The solution: Art 9a: re-qualification

"Where one or more associated **non-resident entities** holding in aggregate a direct or indirect **interest in 50 per cent** or more of the voting rights, capital interests or rights to a share of profit in a hybrid entity that is incorporated or established in a Member State are located in a jurisdiction or jurisdictions **that regard the hybrid entity as a taxable person**,

the hybrid entity **shall be regarded as a resident of that Member State [*Member State of the entity*] and taxed on its income**

to the extent that that income is not otherwise taxed under the laws of the Member State or any other jurisdiction"

10

Hybrid mismatch: non-taxation

- **Scope:** EU reverse hybrid whose income is (partly) non-taxed
  - "**income not taxed otherwise**": *CFC? Dividend taxation? WHT on passive income? Minimum tax?*
  - **Does Art 9a have a relevant scope at all?**
    - Art 9a does as a general rule not apply, if the EU hybrid entity establishes a PE or owns real estate → in fact limited to hybrid entities with mere passive income, no substance, low tax → CFC
    - EU investor state: CFC in Art 7 applies and obliges the investor state to tax (recital 30 ATAD 2)
    - Third-country investor state: ATAD only applies to PEs of third-country entities (Art 1(1))!

- **Legal Consequences:** regard the entity "**as resident**" and "**tax its income**"
  - Obligation to treat entity as separate CIT taxpayer contrary to domestic qualification?
    Follow-up: dividends, grouping, treaty entitled, Parent-Subsidiary Directive, CCCTB? Rollover rules?
  - "**to the extent**" necessary to avoid non-taxation: *partial allocation of income, expenses and assets?*
    Better over-implementation: full taxation combined with credit of foreign taxes?
  - Alternative: Sufficient if income is (partly) taxed as deemed PE of the partners?
    But: Conflict with old tax treaties in relation to third country shareholders (Art 351 TFEU)?

Conclusion

- **More questions than answers …**
  - Complexities, lack of definitions, lack of coherent rules
  - Administrative burden: verify foreign tax law
  - Worth the work? in fact only a rather limited number of cases covered
  - Relationship to other ATAD rules not fully clear (CFC, interest limitation)
- “Copying” of the wording of Arts 9 and 9a into domestic law not advisable
  - **Over-implementation as better and simpler solution** (re-qualification)?
  - Focus on other ATAD rules?

Thank you!

The author may be contacted at kspies@deloitte.at

Hybrid Financial Instruments and the EU Anti-Tax Avoidance Directive (ATAD)

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Conference on Anti-Tax Avoidance Directive (ATAD)
University of Luxembourg
15 February 2019

UNIVERSITÀ DEGLI STUDI DI TORINO
DM DIPARTIMENTO DI MANAGEMENT

AGENDA

1. Introduction
2. Hybrid Financial Instruments and the scope of ATAD I and II
3. The ATAD solution on HFIs = *Linking rules*
4. Critical Analysis
5. Back to the roots = “coordination rule”? = Art. 10(2) ATAD (first draft)
6. Final remarks

1. Introduction

- **OECD BEPS Action 2 – *Hybrid Mismatch Arrangements***
  - Disparities in the tax characterization of instruments/entities
  - DD and D/NI outcomes
  - Domestic and tax treaty recommendations ("linking rules")

- **European response: (2 Directives)**
  - **ATAD I** = BEPS implementation /mismatches within the EU
  - **ATAD II** = BEPS implementation /mismatches with third countries

2. Hybrid Financial Instruments and ATAD

Hybrid mismatch arrangements "…exploit differences in the tax treatment of an entity or instrument under the laws of two or more jurisdictions **to achieve double non-taxation**, including long term deferral" **(OECD Action Plan 2)**

"Hybrid mismatches are the consequence of differences in the legal characterization of payments (financial instruments) or entities and those differences surface in the interaction between legal systems of two jurisdictions. The effect of such mismatches is often a double deduction (i.e. deduction in both states) or a deduction of the income in one state without inclusion in the tax base of the other […]". **(ATAD I)**

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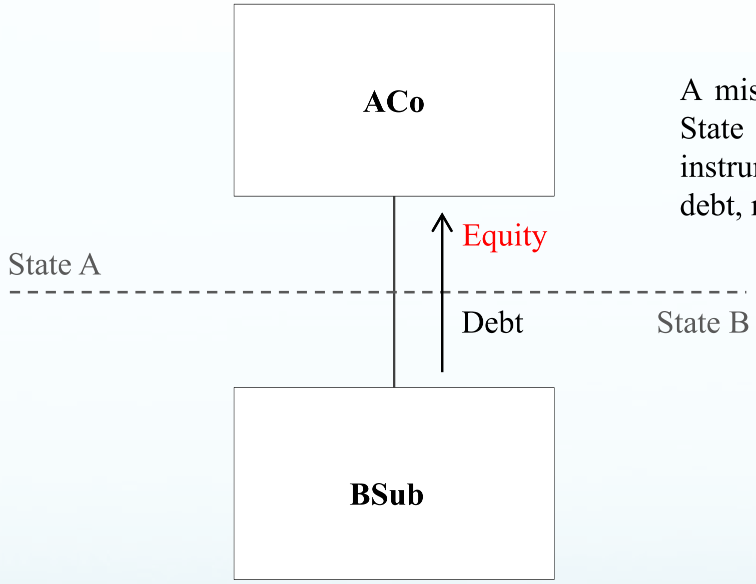
Scope of ATAD as regards Hybrid Financial Instruments

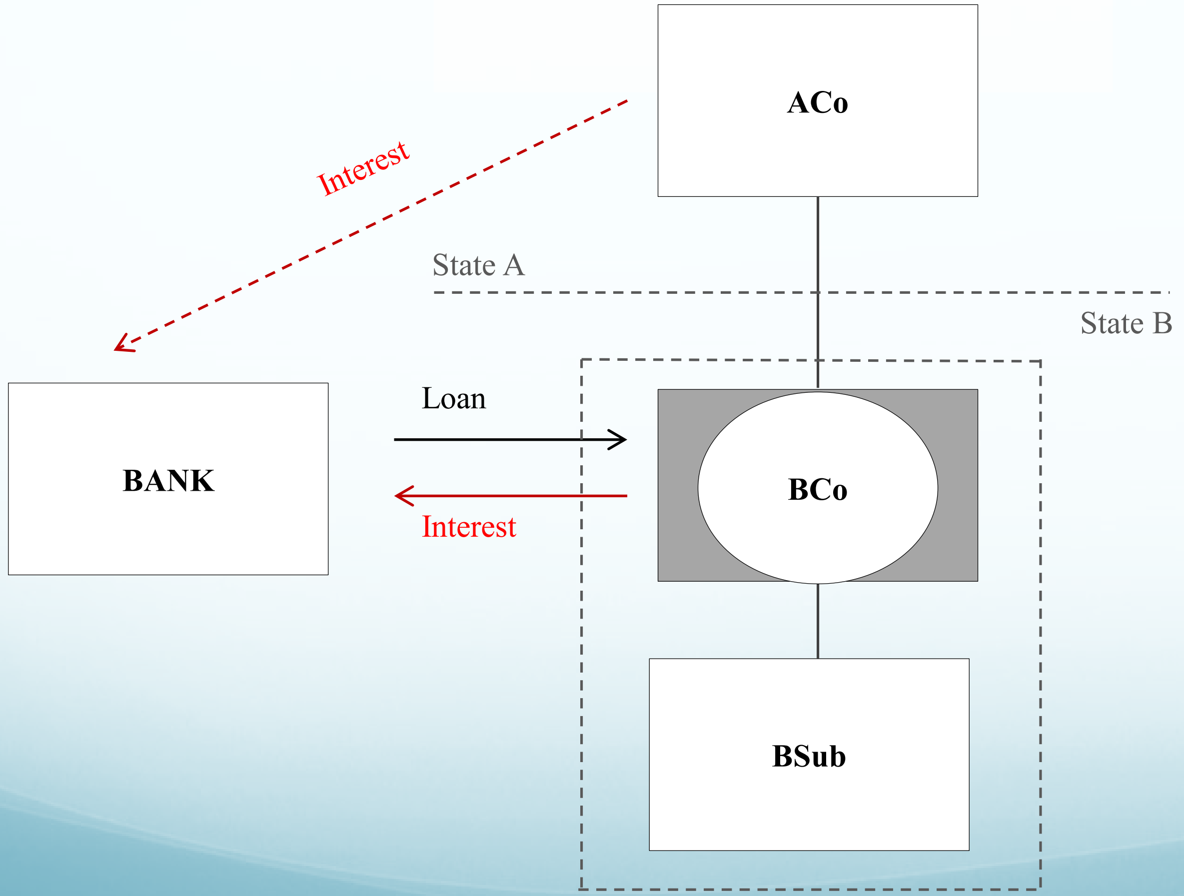
ATAD I	ATAD II
Hybrid Mismatches inside the EU	Hybrid Mismatches outside the EU
DD and D/NI outcomes	DD and D/NI outcomes
Associated Enterprises	+ Structured arrangements and 'acting together'
Conflicting characterization of HFIs (**not** payments)	HFIs + hybrid payments
No opt-out rule	Opt-out rule

Deduction/ Non-inclusion (D/NI)



A mismatch is created since State A and B treats the instrument as equity and debt, respectively.

Double Deduction (D/D)



3. The ATAD Solution: *Linking Rules*

Article 9 of the ATAD I states as follows:

"1. To the extent that a hybrid mismatch results in a double deduction, the deduction shall be given only in the Member State where such payment has its source.

2. To the extent that a hybrid mismatch results in a deduction without inclusion, the Member State of the payer shall deny the deduction of such payment."

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Article 9(2) of the ATAD II states as follows:

"1. To the extent that a hybrid mismatch results in a double deduction:

(a) the deduction shall be denied in the Member State that is the **investor jurisdiction**; and

(a) where the deduction is not denied in the investor jurisdiction, the deduction shall be denied in the Member State that is the payer jurisdiction.

Nevertheless, any such deduction shall be eligible to be set-off against dual inclusion income whether arising in a current or subsequent period.

2. To the extent that a hybrid mismatch results in a deduction without inclusion:

(a) the deduction shall be denied in the Member State that is the **payer jurisdiction**; and

(b) where the the deduction is not denied in the payer jurisdiction, the amount of the payment that would otherwise give rise to a mismatch outcome shall be included in income in the Member State that is the payee jurisdiction."

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4. Critical Analysis

- **<u>A result-oriented approach</u>**

- Coordinating outcomes may create presumptions of abusive practices.

- Focusing on tax outcomes simply disregards the core of the issue as regards hybrid instruments, i.e. disparities.

- An approach to hybrids based on tax outcomes might be defendable in a pure international context. However, such an argument lacks relevancy in a context such as the EU internal market.

- **<u>Complexity</u>**

- “Deduction”/ “Inclusion of Income” = dif. MS/ dif. Interpretations

  <u>For example</u>:

- What to do with tax losses? (ATAD I)
- WHTs at source are not considered as “inclusion of income” under BEPS Action 2 — Same interpretation for ATAD II?
- BEPS Action 2 (soft law)

- **<u>Risk of Economic Double Taxation</u>**

- No carry forward (*primary response*) — D/NI cases
- Lack of coherence =avoiding DNT, but creating double taxation
- Circularity and the undecided positions from payor and payee State

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5. Back to the roots: Article 10(2) ATAD (*first text*)

"Where two Member States give a different legal characterisation to the same payment (hybrid instrument) and this leads to a situation where there is a deduction in the Member State in which the payment has its source without a corresponding inclusion of the same payment in the other Member State, the legal characterisation given to the hybrid instrument by the Member State in which the payment has its source shall be followed by the other Member State".

Proposal: to replace *linking rules* in ATAD I and II for this 'coordination rule'.

This proposal is in line with the original recommendation of the European Parliament to the European Commission of December 2015:

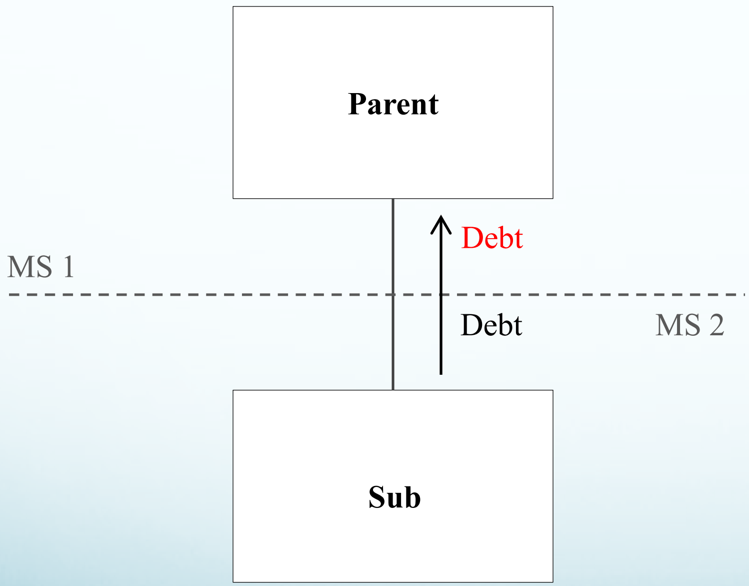
“The European Parliament calls on the European Commission to bring forward a legislative proposal to either:

- harmonize national definitions of debt, equity, opaque and transparent entities, harmonize the attribution of assets and liabilities to permanent establishments, and harmonize the allocation of costs and profits between different entities within the same group; or

- prevent double non-taxation, in the event of a mismatch.

Testing Article 10(2) ATAD (first draft released)

1. **Hybrid instruments mismatches among MSs**



ADVANTAGES/ DISADVANTAGES

- The debt/equity disparity disappears.
- Interest are taxed in the MS of the Parent Co (single taxation).
- Reduced transaction costs.
- Coherent rule in a regional context such as the EU internal market.
- No risks of double taxation.

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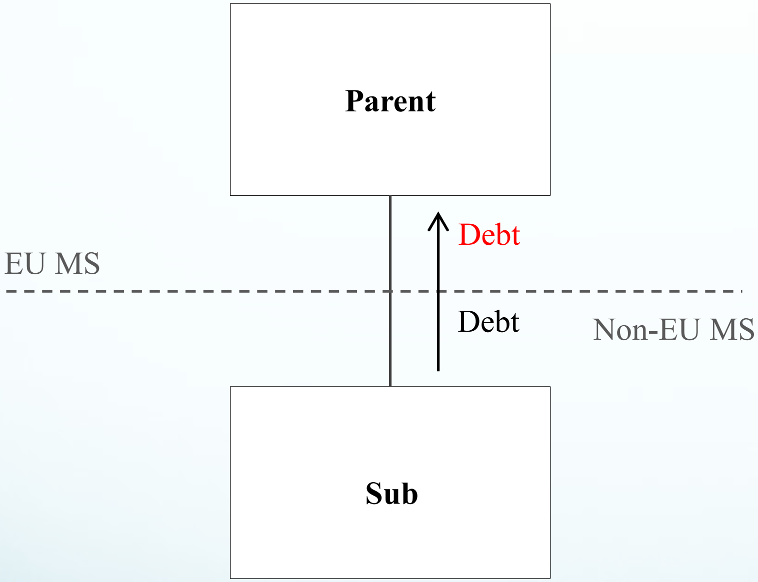
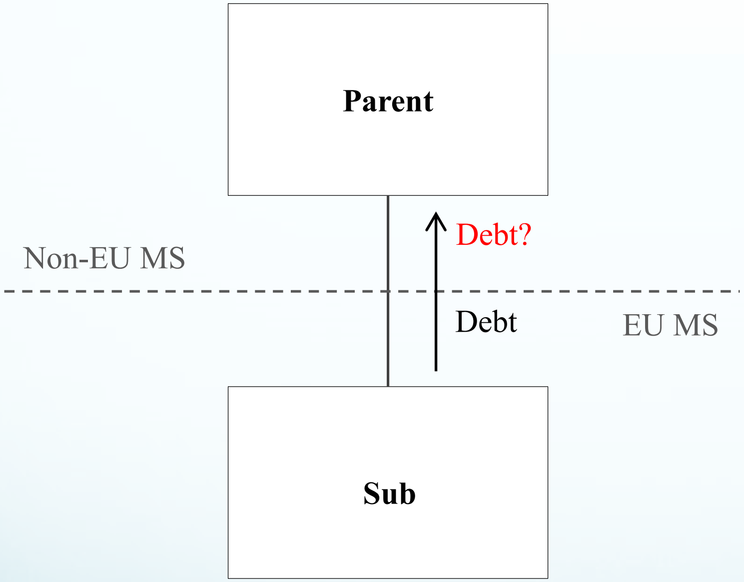
2. Hybrid instruments mismatches with third countries



ADVANTAGES/ DISADVANTAGES

- The debt/equity disparity disappears.
- Interest are taxed in the EU (single taxation).
- Reduced transaction costs.
- Still risk of double taxation if a deduction is denied.

2. Hybrid instruments mismatches with third countries



ADVANTAGES/ DISADVANTAGES

- Not enforceable in third countries i.e. disparity will remain.
- No risk of double taxation.
- Reduced transaction costs anyway.

6. Final Remarks

- Neither ATAD I nor ATAD II truly address the cause of hybrid mismatches using HFIs.

- Addressing just the symptoms (DD and D/NI outcomes) through *linking rules* is not only result-oriented, but also more complex and may derive in new cases of double taxation.

- A rule similar to Article 10(2) ATAD (first draft released) makes more sense in a regional context, such as the EU.

Questions?

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ATAD & Double tax agreements

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Partner PwC France

Introduction

The issue:

What if MS implement the directive in domestic tax law without modifying their DTA and that there is a conflict between domestic tax law / ATAD and DTA?

- The issue arises only if there is a clear incompatibility between the DTA and ATAD:

”all authorities of a Member State [including judges], in applying national law, are required to interpret it as far as possible in the light of the wording and purpose of the Community directives in order to achieve the result pursued by those directives.”

BUT: it cannot lead to an interpretation that is *contra legem*

Introduction

I. The principles: articulation of Directive and DTA

A. Hierarchy of norms

B. Consequences of an incompatibility

II. Application of the principles: ATAD and DTA

A. “Compulsory” breach of the DTA

B. ”Optional” breach of DTA

I. The principles: articulation of Directives and DTA

- New debate in tax matters

- Until 2014, Directives provided advantages to taxpayer and MS were allowed to give more advantageous treatment to taxpayers

  ➔ Divergences between Directive and tax treaties did not raise any conflict (or conflict solved through the direct effect of Directives)

- Until ATAD, Directives had effects within the EU only
  - With some debates re. the merger directive

I. The principles: articulation of Directives and DTA

A. Hierarchy of norms
   1. Facing a compulsory provision of directives
   2. Facing an optional provision of directives

B. Consequences of an incompatibility
   1. Obligations to amend DTA
   2. Effects in the relationship between MS and taxpayer if DTA still in force

I. The principles: articulation of Directives and DTA

A. Hierarchy of norms

1. Hierarchy of norms facing a compulsory provision of Directives

1.1. DTA between MS: Directive prevails over DTA

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- EU secondary law prevails over multilateral convention as regards their effects between MS (14 February 1984, Rewe, case 278/82)

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1. Hierarchy of norms facing a compulsory provision of Directives

1.2. DTA between MS and Third States

- Article 351 TFEU:

  "The rights and obligations arising from agreements concluded before [the entry into for of the Treaties] between one […] MS […] and one […] Third country […], shall not be affected by the provisions of the Treaties.

  To the extent that such agreements are not compatible with the Treaties. The MS concerned shall take all appropriate steps to eliminate such incompatibilities."

- ECJ, Burgoa (C-812/79):

  "[T]he purpose of that provision is to lay down, in accordance with the principles of international law, that the application of the Treaty does not affect the duty of the Member State concerned to respect the rights of non-member countries under a prior agreement and to perform its obligations thereunder. […]"

- Does art. 351 applies to secondary legislation ? and if so how?
  - In case law: ECJ refers to the fact that agreements were concluded prior to the entry into force of the EU Treaties to justify compatibility with secondary legislation
  - AG Kokott proposed an application by analogy of article 351 TFEU in the cases where the treaty is anterior to the directive (C-188/07)

I. The principles: articulation of Directives and DTA
A. Hierarchy of norms
2. Hierarchy of norms facing an optional provision (opt in / opt out) of Directives

- In case of optional provisions, does the primacy of EU secondary legislation apply?

  - The option once exercised is assimilated to an EU obligation?

    ➔The provision implemented can rely upon the primacy of EU law over DTA

  - The option once exercised does not derive *stricto sensu* from an EU obligation, it is a measure taken by a MS ?

    ➔ The provision implemented cannot rely upon the primacy of EU law over DTA

- Must MS exercise this option in conformity with DTT obligations ?

I. The principles: articulation of Directives and DTA
B. Consequences of an incompatibility
1. Obligation to amend existing treaties?

- Obligation clearly stated when agreement is protected by article 351 TFEU (with the uncertainty of the reasoning by analogy)

➔This is to put an end to the incompatibility

- For others, the primacy of EU law could solve the issue… BUT
  - By leaving a provision in their domestic tax law that is contrary to EU law, even if it is not applied, MS create legal uncertainty
    - Case law confirms that the measures should be abrogated due to this legal uncertainty
    - The provision creates ambiguity as to the obligations of the taxpayer

    ➔ Need to renegotiate DTA to ensure a correct implementation?

I. The principles: articulation of Directives and DTA
B. Consequences of an incompatibility
2. Effect in the relationship between MS and taxpayer if DTA still in force

- Article 351 TFEU: Agreements concluded priori to the entry into force of EU Treaties can be applied only to the extent necessary to preserve the rights of the Third States (and taxpayer rights should not be affected)

- For all other treaties:
  - Article 288 TFEU: 'A directive shall be binding, as to the result to be achieved, <u>upon each Member State </u>to which it is addressed'

  - When the directive is more protective for the taxpayer than DTA

    ➔ EU law (when direct effect) should lead to set aside the incompatible provisions of agreements

  - But when the directive create obligation for the taxpayer, e.g. less protective than DTA?
    - ECJ, 5 July 2007, C-321/05, Kofoed: 'the principle of legal certainty precludes directives from being able by themselves to create obligations for individuals. Directives cannot therefore be relied upon per se by the Member State as against individuals'.
    - Is the situation different because domestic law has implemented the Directive but the convention has not been amended?

    ➔Should the solution be found in international law, EU law or MS constitutional law?

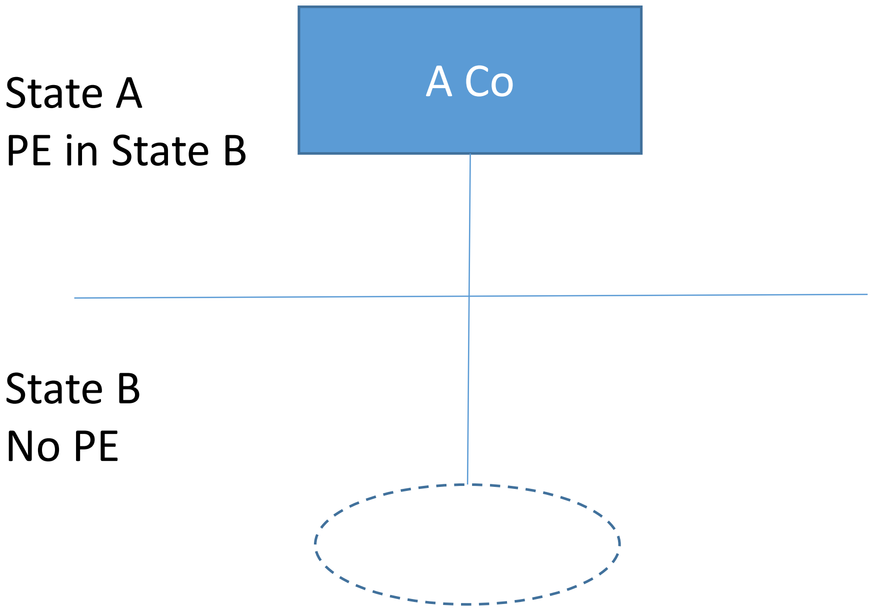
II. Application of the principles
A. “Compulsory” breach of the DTA

- Article 9.5: Disregarded PE

« To the extent that a hybrid mismatch involves disregarded permanent establishment income which is not subject to tax in the Member State in which the taxpayer is resident for tax purposes, that Member State shall require the taxpayer to include the income that would otherwise be attributed to the disregarded permanent establishment. This applies unless the Member State is required to exempt the income under a double taxation treaty entered into by the Member State with a third country.”

- DTT: If the PE is disregarded in State B not due to a diverging qualification but due to either:
    - **disagreement** between CS on the **facts of the case** OR
    - **diverging interpretation** by CS of the **provision** of DTT

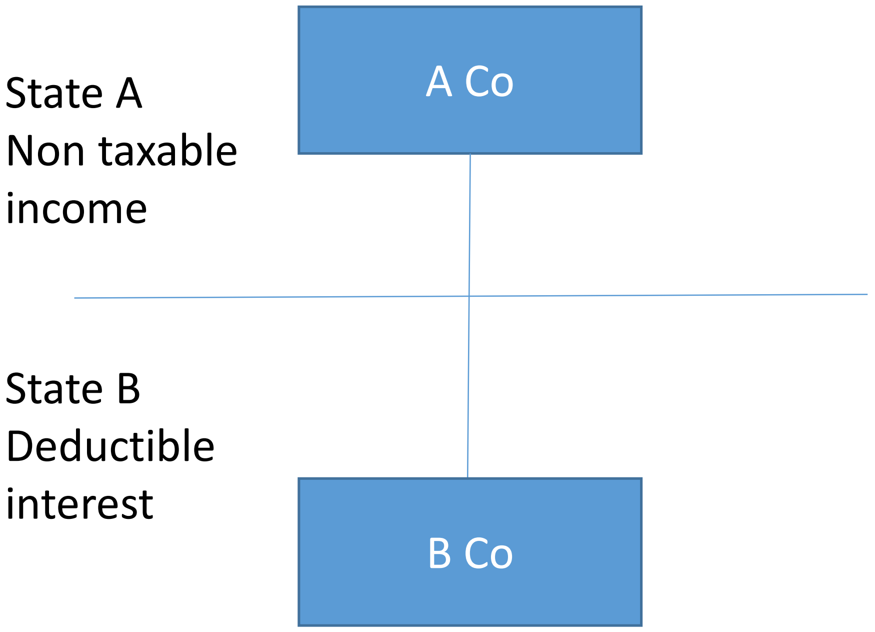
➔Conflict if DTA does not contain Art. 23.4 OECD MC



II. Application of the principles
A. “Compulsory” breach of the DTA

- Hybrid financial instrument (art. 2.9 a + article 9.2b)
- In case of a D/NI due to hybrid financial instrument
  - PR: Deduction denied in the State of residence of the payer
  - DR: Taxation required in the State of residence of the beneficiary (within the EU, PSD exemption could apply first)
- DTT: Art. 23 OECD MC does not provide for elimination of EDT, however a lot of DTA provide for such elimination through e.g. exemption method
  - OECD commentaries (2000), art. 23.1 requires MS of residence to follow the qualification of the source country
  - Relevance of the OECD Commentaries varies from one State to another (especially when posterior to the DTA)

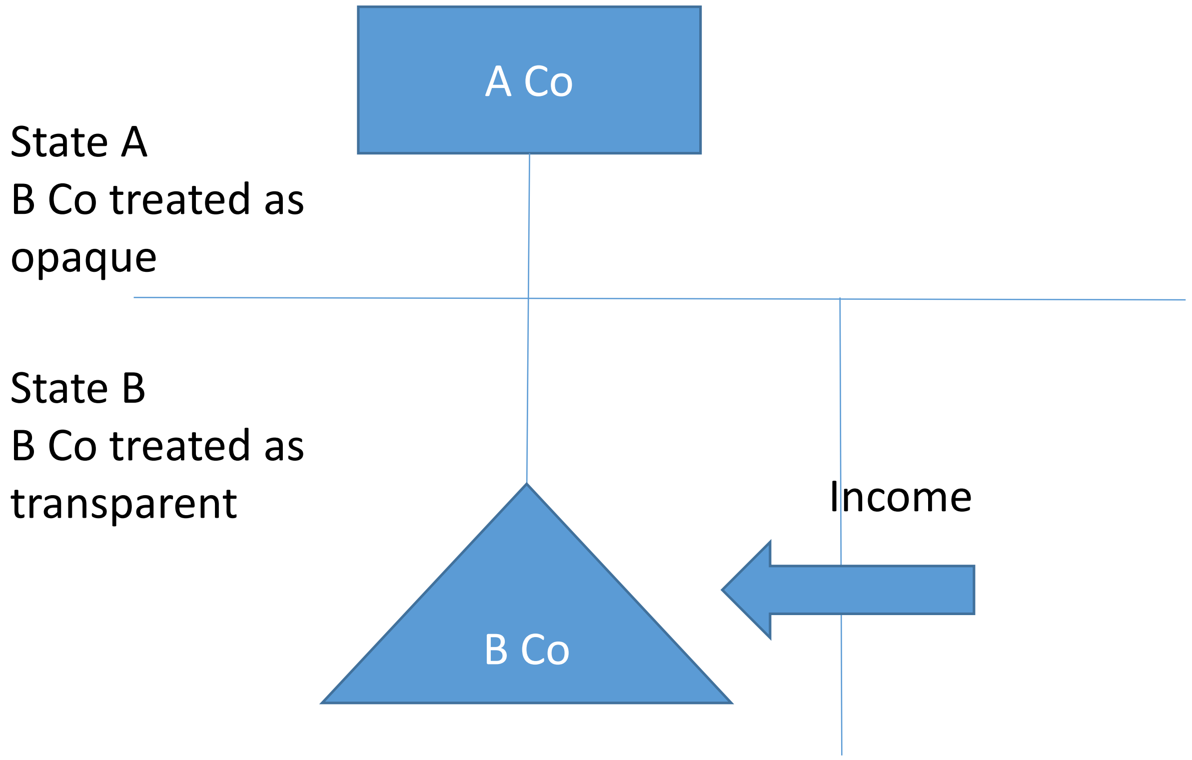
➔ Conflicts could be avoided through the interpretation of the DTA in the light of the Directive



II. Application of the principles
B. "Optional" breach of the DTA

- Transparent entity (art. 2.9 b + article 9.2 a)
- In case of a D/NI due to transparent entity
  - PR: Deduction denied in the State of residence of the payer
  - DR: Taxation required in the State of residence of the beneficiary (which is B Co or A Co: see ATAD art. 2.9, definition of deduction w/o inclusion: "The payee jurisdiction is any jurisdiction where that payment or deemed payment is received, or is treated as being received under the laws of any other jurisdiction")
- DTT:
  - State B cannot tax the income (art. 7 of OECD MC) if no PE of A Co in State B
  - State A cannot tax the income of B Co in State B (article 7 of OECD MC)

  ➔ Article 23.1 OECD MC could lead to State A to tax (see previous example)

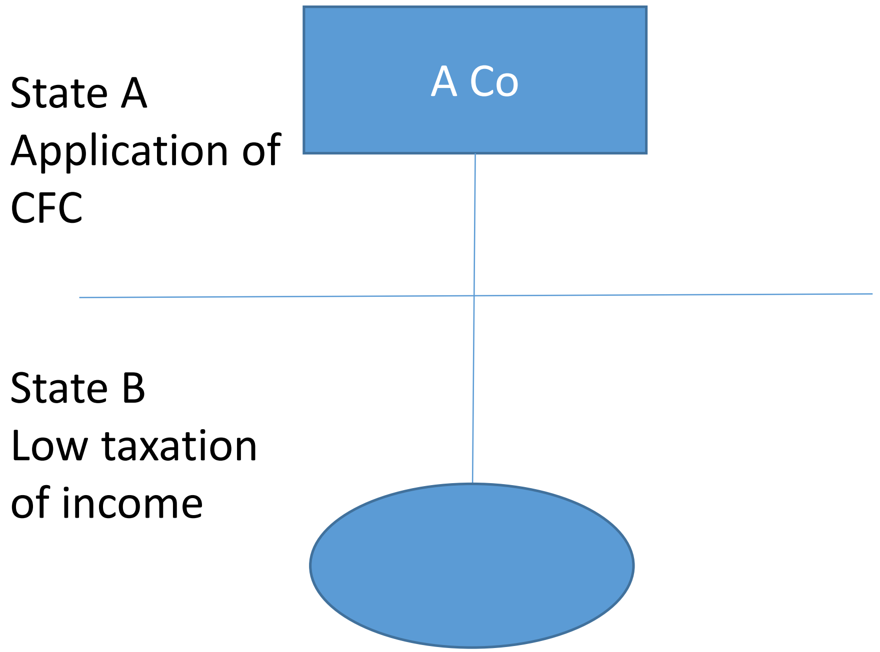


II. Application of the principles
B. “Optional” breach of the DTA

- In case of a CFC:
  - Art. 7 2 a: Taxation of tainted income of the CFC in the hand of the Parent
  - Art. 7.2 b: Allocation of income of the CFC through TP approach
- Article 23 A of the OECD MC prohibits taxation of the PE income by State A
  - OECD Com.: CFC rules are compatible with DTA

  ➔Interpretation of DTA in the light of the directive?

  ➔What if CFC rules (based on this framework) has been ruled incompatible with DTA?



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ATAD: DOUBLE TAXATION, DISPUTE RESOLUTION & TAXPAYER PROTECTION

Prof. Dr. Isabelle RICHELLE

Co-Chair – Tax Institute of the University of Liège

HEC- Business School – Law Faculty

1. ATAD, creating double taxations?
2. Remedies to double taxation?
3. Conclusions

1. ATAD, creating double taxations?

1. ATAD, creating double taxations?

- Example 1 - Exit taxation

State B

State A

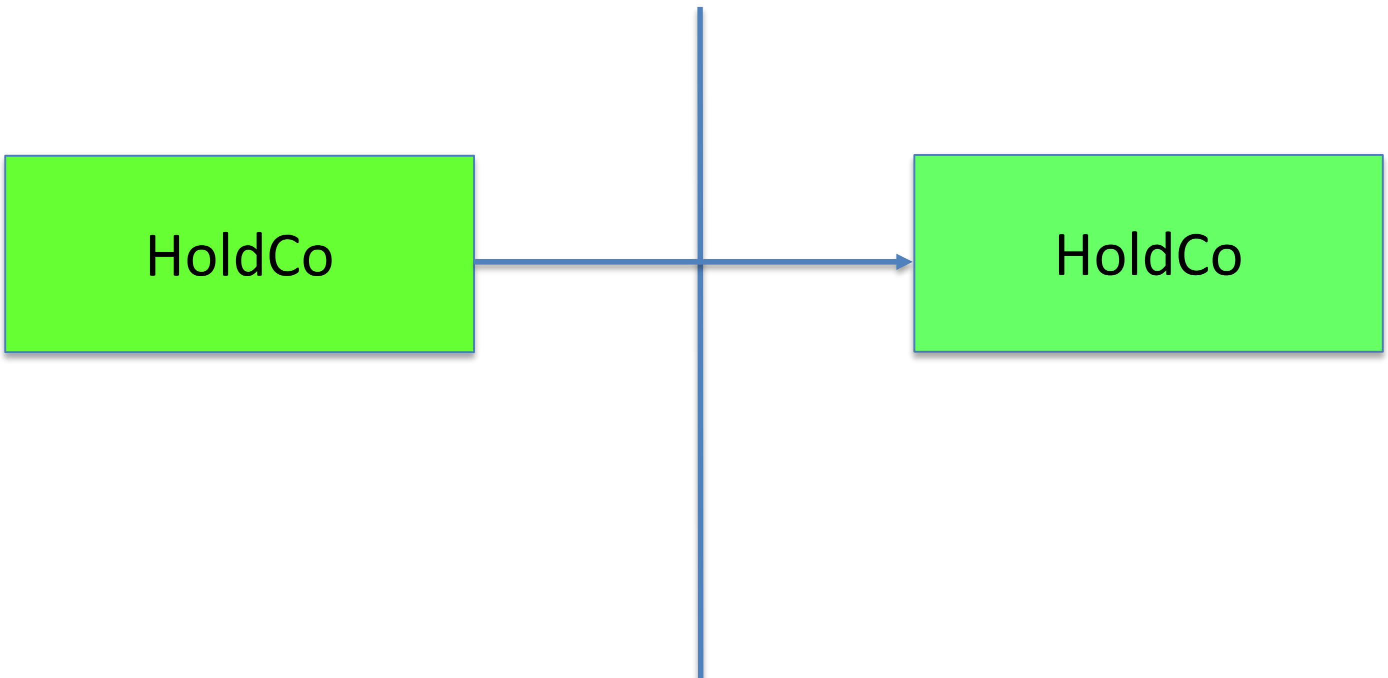
« entry » value: market value
MS can challenge market value

Exit tax: market value – fiscal value

MV: 100
B challenges to 80
➔ Double taxation?
➔ Yes, potentially, but compensated by depreciations
A challenges to 120: does B have to accept?

1. ATAD, creating double taxations?

- Example 1 – Exit taxation



Shares: MV: 100
Challenged to 80
➔ Double taxation?
➔ Yes

1. ATAD, creating double taxations?

- Example 2 - Hybrids

Interest: deduction → Dividends: non-inclusion

ATAD 1 – art. 9.2: the extent that a hybrid mismatch results in a deduction without inclusion, the Member State of the payer shall deny the deduction of such payment.

ATAD 2 – new art. 9.2: « To the extent that a hybrid mismatch results in a deduction without inclusion: (a) the deduction shall be denied in the Member State that is the payer jurisdiction; and (b) where the deduction is not denied in the payer jurisdiction, the amount of the payment that would otherwise give rise to a mismatch outcome shall be included in income in the Member State that is the payee jurisdiction.

1. ATAD, creating double taxations?

- Example 2 – Hybrids

→ How does MS of the payee know about action taken or not by the MS of the payer?

→ Interest paid in 2019

→ Audit in payer's MS in 2021

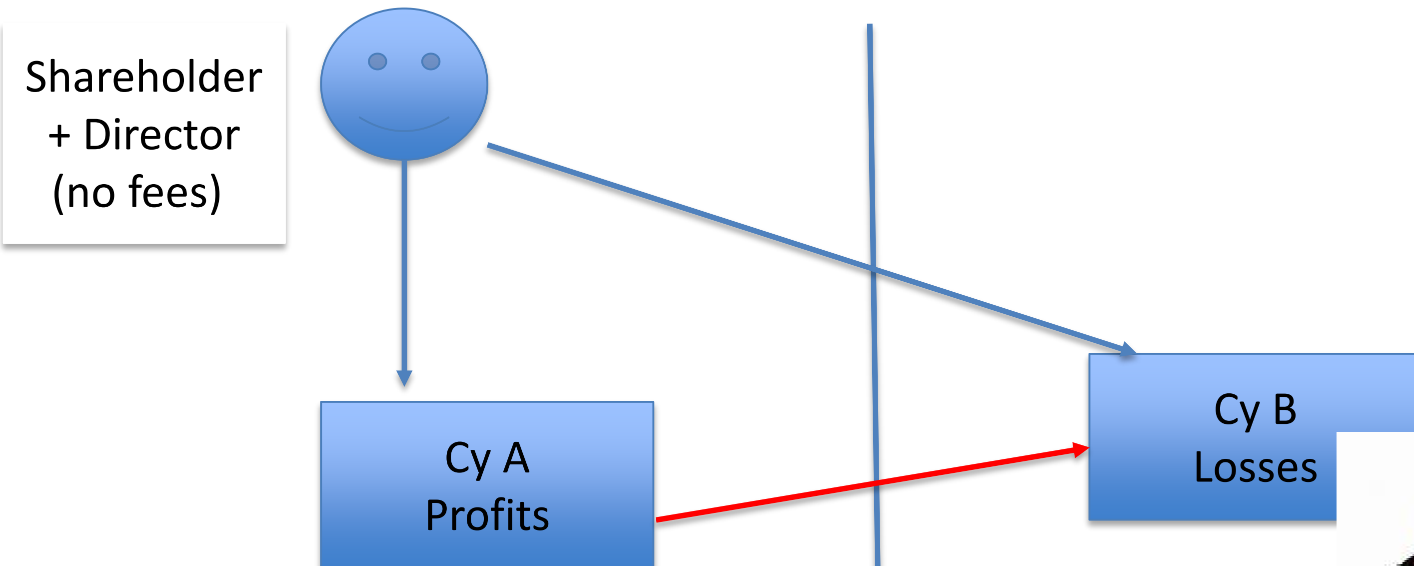
→ Audit in payee's MS in 2020

  → No « priority rule »

  → Risk of double taxation

1. ATAD, creating double taxations?

- Example 3 – the GAAR



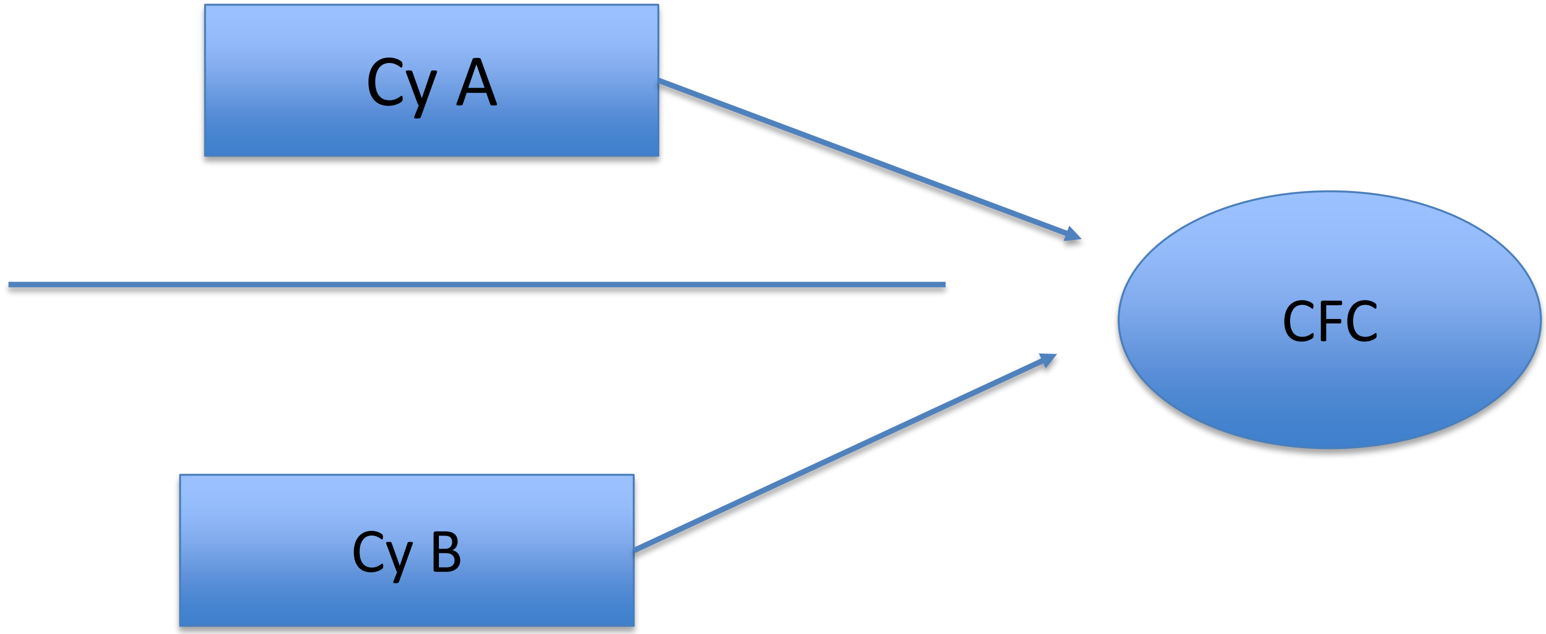
Payment of management fees:

- In B: loss compensation
- In A: deductible expense
- State A denies deduction, based on GAAR

1. ATAD, creating double taxations?

Example 4 – CFC Rules

« one of the fundamental policy considerations raised by CFC rules is to ensure that these rules do not lead to double taxation, which could pose an obstacle to international competitiveness, growth and economic development » (Beps, Action 3)



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2. Remedies to double taxation?

2. Remedies to double taxation?

- Finding: ATAD creates new situations of double or multiple international taxes

➔ remedies?

2. Remedies to double taxation?

- Atad recitals: no reference to risk of double taxation

1) Legality control of the directive

- Subsidiarity: ok
- Proportionality:

"according to the Court's settled case-law, the principle of proportionality requires that acts of the EU institutions should be ***appropriate for attaining the legitimate objectives pursued by the legislation at issue*** *and* ***should not go beyond what is necessary*** *in order to achieve those objectives.*

With regard to judicial review of compliance with those conditions, the Court has accepted that <u>*in the exercise of the powers conferred on it the EU legislature must be allowed a broad discretion in areas such as that at issue in which its action involves political, economic and social choices and in which it is called upon to undertake complex assessments and evaluations*</u>*. Accordingly, the criterion to be applied is not whether a measure adopted in such an area was the only or the best possible measure, since its* ***legality can be affected only if the measure is manifestly inappropriate having regard to the objective which the competent institutions are seeking to pursue****…"*

(ECJ, 22 Nov. 2018, C-151/17, Swedish Match, Para. 35-36)

→ Measures adopted: proportionate

→ But is it proportionate not to have introduced rules against double taxation or not to have written some of the provisions in such a way as to avoid risk of double taxation?

2. Remedies to double taxation?

- 2) Violation of TFEU?
  - Internal market
  - Fundamental freedoms

→ Double taxation is an obstacle to cross-border economic activities

→ Classical ECJ view:

→ Parallel exercise by MS of their taxing power: (juridical) double taxation accepted

→ But before repeal Art. 293 CE

→ Here: double taxation does not result from the MSs' tax sovereignty but from the implementation of an EU Directive

2. Remedies to double taxation?

- 3) exchange of information?
  - Obligation for MSs to exchange information before any taxation under Atad?
    - › No obligation under Atad or EoI Dir
      - Even if possibility to request information from another MS and possibility of spontaneous exchange of information
    - › Moral obligation?
      - What if no exchange of information?
      - Which argument for the taxpayer?
        - » No right to tax?
        - » MS liability?

2. Remedies to double taxation?

- 4) Tax Dispute Resolution Directive?
  - Draft Directive – art. 1.1.: "*This Directive lays down rules on the mechanisms to resolve disputes between Member States on how to eliminate double taxation of income from business and the rights of the taxpayers in this context*" AND
  - Art. 3.1: "*Any taxpayer subject to double taxation shall be entitled to submit a complaint requesting the resolution of the double taxation to each of the competent authorities of the Member States concerned within three years…*"

2. Remedies to double taxation?

- 4) Tax Dispute Resolution Directive?

Explanatory Memorandum: « *Fighting against tax avoidance and aggressive tax planning, both at EU and global level, must therefore go hand in hand with creating a competitive tax environment for businesses. They are the two sides of the same coin.* ***A fair tax system is not only one that ensures that profits are actually taxed where they are generated but also one that ensures that profits are not taxed twice***”.

2. Remedies to double taxation?

- 4) Tax Dispute Resolution Directive?
  - BUT Directive in force – art. 1.1: “*This Directive lays down rules on a mechanism to resolve disputes between Member States when those disputes arise from the interpretation and application of agreements and conventions that provide for the elimination of double taxation of income and, where applicable, capital*”

  ➔ no possibility of application in the case of international double taxation resulting from the directive, which is not a "convention for the elimination of double taxation“

  ➔ total inconsistency in the legislative process!!

2. Remedies to double taxation?

- 4) Resolution under the MLI?
  - MLI: taxation not conform to the DTA concerned
  - Not a global satisfactory solution

3. Conclusions

3. Conclusions

- Double taxation unacceptable (cf explan. Memorandum)
- Need to adapt the Tax Dispute Resolution Directive in order to open the Directive to cases of double taxation created through application of Atad
  - But in any case, long, difficult and expensive procedure ➔ need to amend the Directive with a view to simplification
- "Best solution":
  - amend Atad Directive so as to avoid double taxation
  - Or a Commission "technical" regulation?

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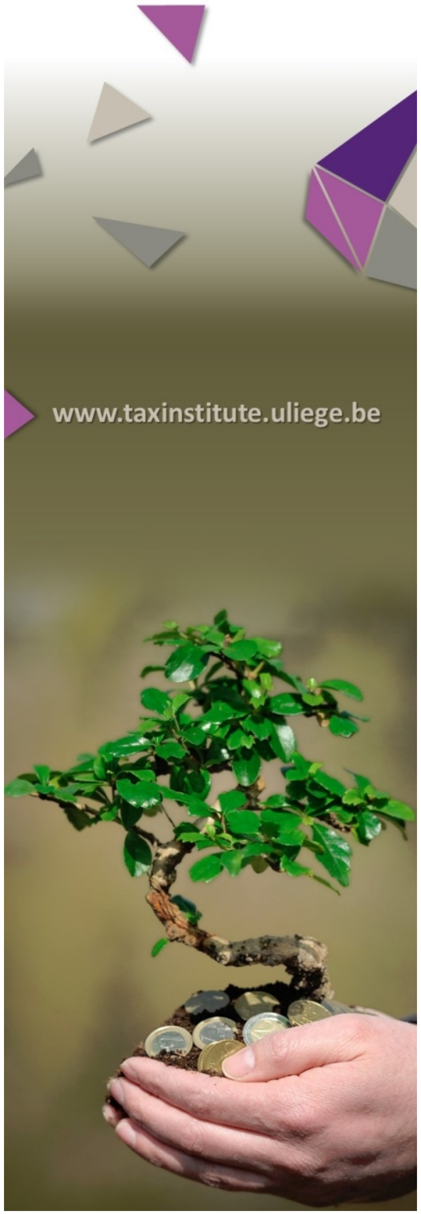

Thank you for your attention!

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ATAD & Double tax agreements

Emmanuel Raingeard de la Blétière

Associate Professor, University of Rennes

Partner PwC France

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  - The option once exercised is assimilated to an EU obligation?

    ➔The provision implemented can rely upon the primacy of EU law over DTA

  - The option once exercised does not derive *stricto sensu* from an EU obligation, it is a measure taken by a MS ?

    ➔ The provision implemented cannot rely upon the primacy of EU law over DTA

- Must MS exercise this option in conformity with DTT obligations ?

I. The principles: articulation of Directives and DTA
B. Consequences of an incompatibility
1. Obligation to amend existing treaties?

- Obligation clearly stated when agreement is protected by article 351 TFEU (with the uncertainty of the reasoning by analogy)

➔ This is to put an end to the incompatibility

- For others, the primacy of EU law could solve the issue… BUT
  - By leaving a provision in their domestic tax law that is contrary to EU law, even if it is not applied, MS create legal uncertainty
    - Case law confirms that the measures should be abrogated due to this legal uncertainty
    - The provision creates ambiguity as to the obligations of the taxpayer

    ➔ Need to renegotiate DTA to ensure a correct implementation?

I. The principles: articulation of Directives and DTA
B. Consequences of an incompatibility
2. Effect in the relationship between MS and taxpayer if DTA still in force

- Article 351 TFEU: Agreements concluded priori to the entry into force of EU Treaties can be applied only to the extent necessary to preserve the rights of the Third States (and taxpayer rights should not be affected)

- For all other treaties:
  - Article 288 TFEU: 'A directive shall be binding, as to the result to be achieved, <u>upon each Member State</u> to which it is addressed'

  - When the directive is more protective for the taxpayer than DTA

    ➔ EU law (when direct effect) should lead to set aside the incompatible provisions of agreements

  - But when the directive create obligation for the taxpayer, e.g. less protective than DTA?
    - ECJ, 5 July 2007, C-321/05, Kofoed: 'the principle of legal certainty precludes directives from being able by themselves to create obligations for individuals. Directives cannot therefore be relied upon per se by the Member State as against individuals'.
    - Is the situation different because domestic law has implemented the Directive but the convention has not been amended?

    ➔Should the solution be found in international law, EU law or MS constitutional law?

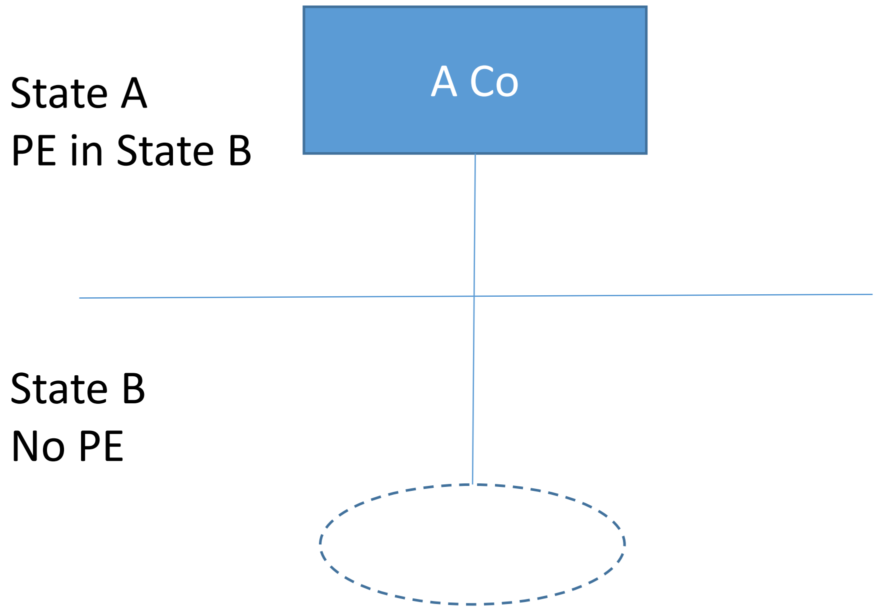
II. Application of the principles
A. “Compulsory” breach of the DTA

- Article 9.5: Disregarded PE

« To the extent that a hybrid mismatch involves disregarded permanent establishment income which is not subject to tax in the Member State in which the taxpayer is resident for tax purposes, that Member State shall require the taxpayer to include the income that would otherwise be attributed to the disregarded permanent establishment. This applies unless the Member State is required to exempt the income under a double taxation treaty entered into by the Member State with a third country.”

- DTT: If the PE is disregarded in State B not due to a diverging qualification but due to either:
    - **disagreement** between CS on the **facts of the case** OR
    - **diverging interpretation** by CS of the **provision** of DTT

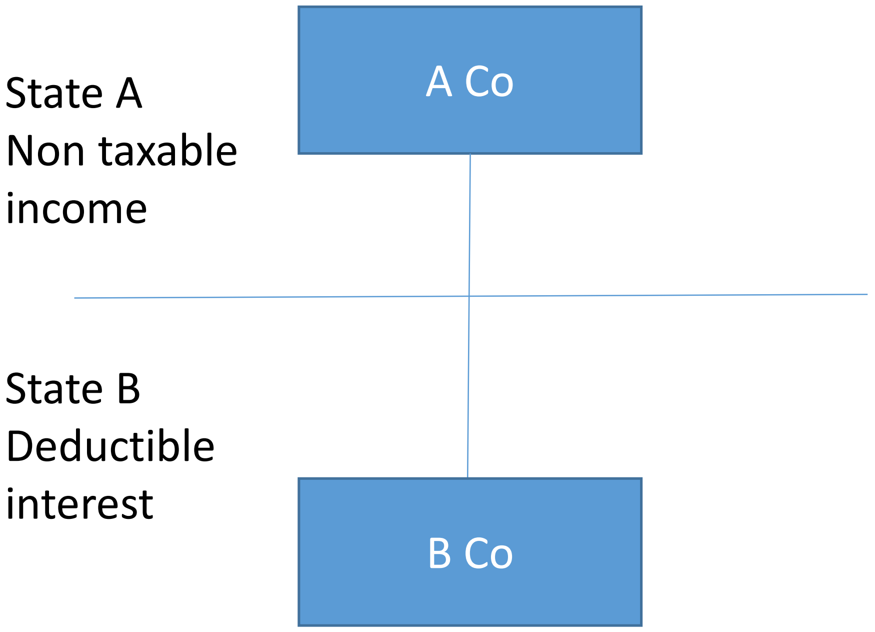
➔Conflict if DTA does not contain Art. 23.4 OECD MC



II. Application of the principles
A. "Compulsory" breach of the DTA

- Hybrid financial instrument (art. 2.9 a + article 9.2b)
- In case of a D/NI due to hybrid financial instrument
  - PR: Deduction denied in the State of residence of the payer
  - DR: Taxation required in the State of residence of the beneficiary (within the EU, PSD exemption could apply first)
- DTT: Art. 23 OECD MC does not provide for elimination of EDT, however a lot of DTA provide for such elimination through e.g. exemption method
  - OECD commentaries (2000), art. 23.1 requires MS of residence to follow the qualification of the source country
  - Relevance of the OECD Commentaries varies from one State to another (especially when posterior to the DTA)

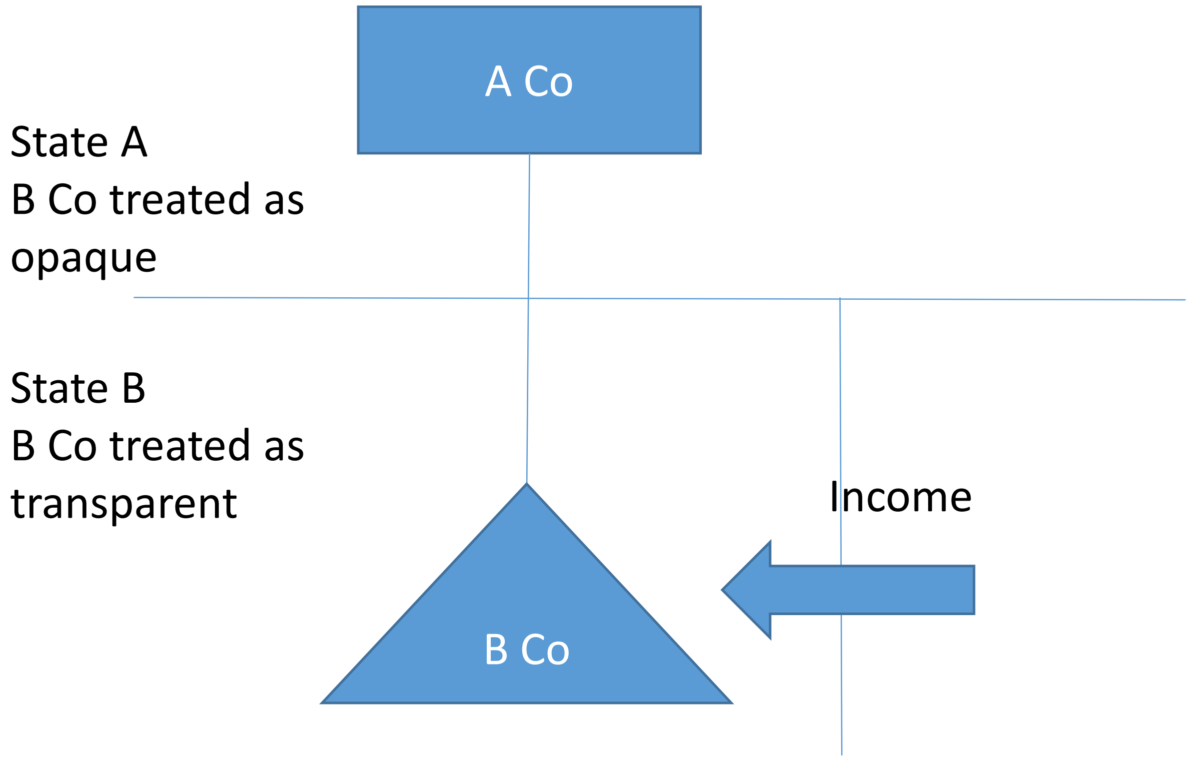
➔ Conflicts could be avoided through the interpretation of the DTA in the light of the Directive



II. Application of the principles
B. "Optional" breach of the DTA

- Transparent entity (art. 2.9 b + article 9.2 a)
- In case of a D/NI due to transparent entity
  - PR: Deduction denied in the State of residence of the payer
  - DR: Taxation required in the State of residence of the beneficiary (which is B Co or A Co: see ATAD art. 2.9, definition of deduction w/o inclusion: "The payee jurisdiction is any jurisdiction where that payment or deemed payment is received, or is treated as being received under the laws of any other jurisdiction")
- DTT:
  - State B cannot tax the income (art. 7 of OECD MC) if no PE of A Co in State B
  - State A cannot tax the income of B Co in State B (article 7 of OECD MC)

  ➔ Article 23.1 OECD MC could lead to State A to tax (see previous example)

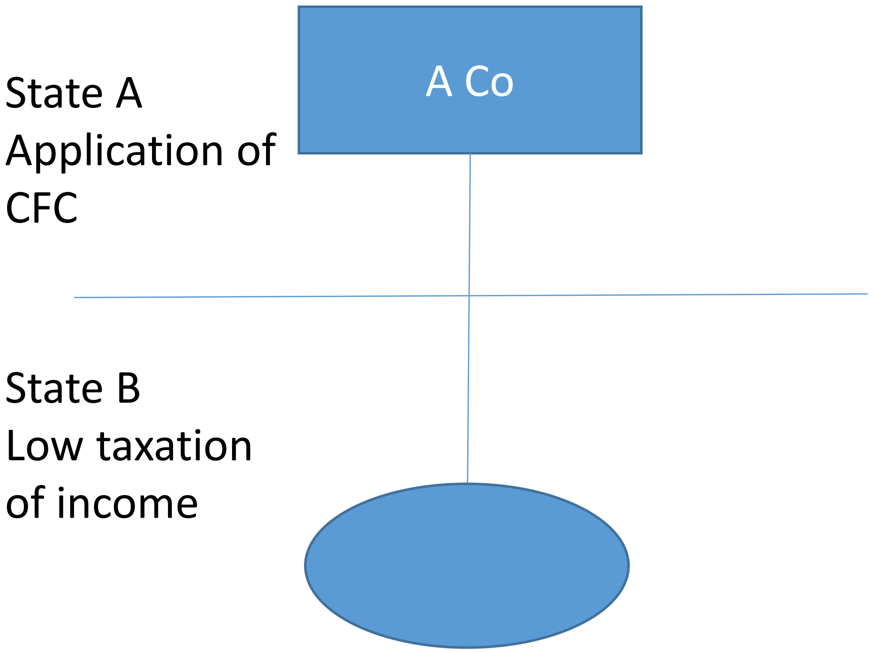


II. Application of the principles
B. "Optional" breach of the DTA

- In case of a CFC:
  - Art. 7 2 a: Taxation of tainted income of the CFC in the hand of the Parent
  - Art. 7.2 b: Allocation of income of the CFC through TP approach
- Article 23 A of the OECD MC prohibits taxation of the PE income by State A
  - OECD Com.: CFC rules are compatible with DTA

  ➔Interpretation of DTA in the light of the directive?

  ➔What if CFC rules (based on this framework) has been ruled incompatible with DTA?



ATAD & CCCTB

The Steady Move Towards a Common Corporate Tax Base

University of Luxembourg

15 February 2019

Disclaimer

The views expressed in these slides are the author's alone and do not purport to necessarily reflect those of the European Commission.

Anti-Tax Avoidance Directive (ATAD)

- *COM proposal of 28 January 2016.*
- *6 provisions:*
  - *Interest limitation (BEPS Action item 4)*
  - *Exit tax*
  - *Switch-over clause (Article 73 of 2011 CCCTB)*
  - *GAAR (Article 80 of 2011 CCCTB)*
  - *CFC (BEPS Action item 3 and Article 82 of 2011 CCCTB)*
  - *Hybrid mismatches (BEPS Action item 2)*

European Commission

ATAD

- *Compromise proposal of NL PR adopted by ECOFIN Council on 12 July 2016.*
- *Compared with COM proposal: more flexibility/options for Members States and no switch-over clause.*
- *Rules had to be implemented before 1 January 2019.*
- *Rule on exit tax before 1 January 2020.*
- *ATAD 2 on hybrid mismatches must be implemented before 2020.*
- *EL, ES, FR, SI and SK may postpone the implementation of the interest limitation rule until 1 January 2024.*

ATAD vs CCCTB

- *ATAD is a minimum standard, CCCTB is a holistic solution to creating a fair and efficient taxation.*
- *Differences in scope: ATAD applies to all corporate taxpayers in EU; CCCTB mandatory scope for large MNEs and optional scope for all other corporate taxpayers.*

Interest Limitation (i)

- *Article 4 ATAD vs Article 13 CCTB.*
- *Both rules apply to net interest payments ("exceeding borrowing costs").*
- *Article 13 not only applies to interest payments, but also to **deductible AGI increases**.*
- *Main difference: no optional group carve-out in Article 13 CCTB as in Article 4, para 5, ATAD.*
- *CCCTB is final objective; one tax base for all group members: no need for a group-carve out.*

Interest Limitation (ii)

Provisions taken over from Article 4 ATAD:

- *€ 3 000 000 safe harbour (€ 1 000 000 in COM proposal)*
- *Concept of a tax group*
- *Carve-out for standalone companies*
- *Waiver for loans concluded before the date of political agreement on the CCTB directive*
- *Waiver for loans for public infrastructure projects.*

Interest Limitation (iii)

- *Article 13 CCTB: carry forward of exceeding borrowing costs (indefinitely).*
- *No carry back nor carry forward of unused interest capacity as in Article 4 ATAD*

Exit Taxation (i)

- *Transfers of assets or tax residence out of the tax jurisdiction of a Member State; disposals of assets are not included in the scope.*
- ***Objective:** to prevent the risk whereby assets, expected to generate high income, are moved to low-tax jurisdictions to be sold later and realise a high capital gain which will be low-taxed.*
- *Critical element: **loss of taxing right** for the departing MS.*

Exit Taxation (ii)

- *Article 29 CCTB proposal: no clause "in so far as the MS of the head office no longer has the right to tax the transferred assets due to the transfer."*

- *Article 8(e) CCTB: PE income shall be tax exempt -> MS of head office no longer has the right to tax the transferred asset.*

Exit taxation (iii)

- *Right to defer payment not included in CCTB.*
- *Deferral is not related to tax base, but to collection of the exit tax.*

Exit taxation (iv)

- *MS of transferee shall accept the (market) value established by MS of transferor.*
- *Article 5, paragraph 5, ATAD: obligation does not apply if established value does not reflect market value.*
- *Not included in CCTB.*

- *Same exception for assets posted as collateral.*

Switch-over

- *One of provisions in COM proposal on ATAD.*
- *Not included in PR compromise proposal.*
- *ATAD is a minimum standard, CCTB is a comprehensive set of rules.*
- *Switch-over is an essential anti-avoidance provision.*

European Commission

GAAR

COM ATAD proposal

1. Non-genuine arrangements or a series thereof carried out for the ***essential purpose*** *of obtaining a tax advantage that defeats the object or purpose of the otherwise applicable tax provisions shall be ignored for the purposes of calculating the corporate tax liability. An arrangement may comprise more than one step or part.*

2. For the purposes of paragraph 1, an arrangement or a series thereof shall be regarded as ***non-genuine*** *to the extent that they are* ***not put into place for valid commercial reasons which reflect economic reality****.*

European Commission

GAAR

ATAD 2016/1164

*1. For the purposes of calculating the corporate tax liability, a Member State shall ignore 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 the applicable tax law, are **not genuine** having regard to all relevant facts and circumstances. An arrangement may comprise more than one step or part.*

*2. For the purposes of paragraph 1, an arrangement or a series thereof shall be regarded as non-genuine to the extent that they are **not put into place for valid commercial reasons which reflect economic reality**.*

European Commission

GAAR

CCTB proposal

*1. Non-genuine arrangements or a series thereof carried out for the **essential purpose** of obtaining a tax advantage that defeats the object or purpose of the otherwise applicable tax provisions shall be ignored for the purposes of calculating the corporate tax liability. An arrangement may comprise more than one step or part.*

*2. For the purposes of paragraph 1, an arrangement or a series thereof shall be regarded as **non-genuine** to the extent that they are **not put into place for valid commercial reasons which reflect economic reality**.*

European Commission

Controlled Foreign Company Rules (CFC) (i)

- ***Aim:*** *to discourage shifting large profits out of a highly-taxed parent company towards subsidiaries or permanent establishments in low-tax jurisdictions.*
- *Schemes often involve shifts of mobile passive income (e.g. royalties) within a group, based on transfers of intangible assets to CFCs.*
- ***Outcome:*** *to reduce overall tax burden of the group;*

CFC Rules (ii)

- *2 options in Article 7, paragraph 2, ATAD: a) a mechanical rule and b) a transfer pricing rule.*
- *Option b not included in Article 59 of CCTB.*

CFC Rules (iv)

- *Optional carve-outs **not** included in CCTB:*
- *Article 7, paragraph 3, ATAD: CFC rule does not apply if less than 1/3 is 'tainted' income.*
- *If CFC is financial undertaking if less than 1/3 of tainted income comes from transactions with taxpayer or associated enterprises.*
- *Article 7, paragraph 4, ATAD de minimis rules: accounting profits < € 750 000 and non-trading income < € 75 000; or accouting profit < 10% of operating costs*

European Commission

Hybrid mismatches (ATAD 2)

- *College adopted CCTB proposal on same day as ATAD 2.*
- *Wording of PR compromise proposal (EU 2017/952) significantly deviates from COM proposal.*

European Commission

Outlook

Recent developments:

- *Meseberg declaration of 19 June 2018*
- *FR-DE GLOBE initiative*

European Commission

Meseberg declaration

- *FR-DE common position paper on CCTB*
- *Amendments to anti-BEPS measures*

FR-DE common position paper

- *GAAR, hybrid mismatches and exit tax should be more consistent with the ATAD.*
- *Interest limitation rule: inclusion of group escape rule, carry-forward of unused interest capacity and deletion of carve-out for public infrastructure projects and financial undertakings.*

FR-DE common position paper

- *Switch-over rule with some modifications.*
- *Benchmark rate: a single rate for all MSs.*
- *Also income from EU-based entities.*

FR-DE common position paper

- *CFC rule not sufficient.*
- *Effective minimum taxation*
- *"Effective tool preventing unjustified exploitation of differing tax rates should be developed"*

European
Commission

FR-DE common position paper

- *"Limitation rule on deduction of interests, royalties and other remunerations paid in (to?) a country with a* ***favourable tax regime*** *(i.e. a tax regime leading to a tax rate below a certain percentage)."*

European Commission

ATAD: Effective Implementation: Information Collection, Exchange and Monitoring

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15 February 2019

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Anti-tax avoidance and exchange of information

- ATAD Package:

BEPS is built around three axes; the improvement of the coherence of tax rules across borders; the reinforcement of substance requirements; **and the enhancement of transparency and certainty.**
*** Exchange of information does not figure in the ATAD itself.**

“Leak – driven”* or “scandals’ – driven” law

1. UBS/ LGT [2007]
2. HSBC / ‘Swiss’ leaks [2009 – 2015]
3. Luxleaks [2014]
4. Panama Papers [2015 – 2016]
5. Paradise Papers [2017]

Increasing feeling of ‘injustice’, discontent => more legislation & ‘fast-track’ legislation

&

Financial crisis [2008]

substantial tax revenue losses due to capital leaking to tax havens

Background: (Relevant) BEPS Actions & International framework

- FATCA (2014)
- Common Reporting Standards (CRS) [OECD 2014]
- BEPS Action 5: Countering Harmful Tax Practices More Effectively, Taking into Account Transparency and Substance
- BEPS Action 12: Mandatory Disclosure Rules
- BEPS Action 13: Transfer Pricing Documentation and Country-by-Country Reporting

ATAD and information exchange: Where do we stand

- **DAC 1** (Directive 2011/16/EU); exchange of information on request; spontaneous exchanges and automatic exchanges. Information must be foreseeable relevant & no fishing expeditions;
- **DAC 2** (Directive 2014/107/EU); automatic exchange of financial account information.
- **DAC 3** (Directive (EU) 2015/2376); mandatory automatic exchange of tax information on advance cross-border rulings and APAs.
- **DAC 4** (Directive (EU) 2016/881); mandatory exchange of country-by-country reporting to tax authorities [BEPS (Action 13)]
- **DAC 5** (Directive (EU) 2016/2258); possibility to tax authorities to access beneficial ownership and due diligence information as those are collected in the context of the anti-money laundering legal framework.
- **DAC 6** (Directive (EU) 2018/822); mandatory disclosure rules for intermediaries on potentially aggressive tax-planning arrangements & automatic exchange on tax planning cross-border arrangements

DAC 6: Background

- ‘The EU has become the frontrunner when it comes to bringing more transparency to the world of aggressive tax planning[…] Today we are proposing to hold responsible the go-betweens who create and sell tax avoidance schemes. Ultimately, this will result in greater tax revenues for Member States.’ [V. Dombrovskis]

- Although Directive 2011/16/EU has been amended several times in order to enhance the **means** tax authorities can use to react to **aggressive tax planning**, there is still a need to reinforce certain specific **transparency aspects** of the existing taxation framework.
  - certain financial intermediaries and other providers of tax advice seem to have **actively** assisted their clients in **concealing money offshore**.

DAC 6: Background (II)

- It is therefore critical that Member States' tax authorities obtain **comprehensive** and **relevant** information about **potentially** aggressive tax arrangements. Such information would enable those authorities to react promptly against harmful tax practices and to close loopholes by **enacting legislation** or by undertaking adequate risk assessments and carrying out tax audits.

- In order to develop a more comprehensive policy, it would also be necessary that as a second step, following the reporting, the tax authorities **share information with their peers** in other Member States. Such arrangements should **also enhance the effectiveness of the CRS**. In addition, it would be crucial to grant **the Commission** access to a sufficient amount of information so that it can monitor the proper functioning of this Directive.

- It is acknowledged that the reporting of potentially aggressive cross-border tax-planning arrangements would stand a better chance of achieving its envisaged **deterrent effect** where the relevant information reached the tax authorities **at an early stage**, in other words before such arrangements are actually implemented.

DAC 6: Background (III)

- Minimum Directive with regard to reporting: A Member State could take further national reporting measures of a similar nature, but any information collected in addition to what is reportable in accordance with this Directive should not be communicated automatically to the competent authorities of the other Member States. That information could be exchanged on request or spontaneously according to applicable rules.

- A specific hallmark should be introduced to address arrangements designed to circumvent reporting obligations involving automatic exchanges of information. For the purposes of that hallmark, agreements on the automatic exchange of financial account information under the CRS should be treated as equivalent to the reporting obligations laid down in DAC 2.

- **ATAD Reference**: Moreover, it is appropriate to recall that **aggressive cross-border tax-planning arrangements**, the **main purpose or one of the main purposes of which is to obtain a tax advantage** that defeats the object or purpose of the applicable tax law, are subject to the general anti-abuse rule as set out in Article 6 of Council Directive (EU) 2016/1164.

  - Added value in comparison to domestic rules.

DAC 6: Scope

- Entry into force 1 July 2020.

- DAC 6 obliges intermediaries and taxpayers to report "potentially aggressive tax planning arrangements" to their respective national authorities.

- Wide scope; reporting obligations applying to both intermediaries and companies within the EU & multinational enterprises (MNEs) that advise their group companies could also be caught by the rules as intermediaries.
  - the reporting obligation should be placed upon **all actors** that are usually involved in designing, marketing, organising or managing the implementation of a reportable cross-border transaction or a series of such transactions, as well as those who provide assistance or advice. It should not be ignored either that, in certain cases, the reporting obligation would not be enforceable upon an intermediary due to **a legal professional privilege** or where there is **no intermediary because**, for instance, the taxpayer designs and implements a scheme **in-house**. It would thus be crucial that, in such circumstances, tax authorities do not lose the opportunity to receive information about tax-related arrangements that are potentially linked to aggressive tax planning. It would therefore be necessary to shift the reporting obligation **to the taxpayer who benefits** from the arrangement in such cases.

DAC 6: Scope (II)

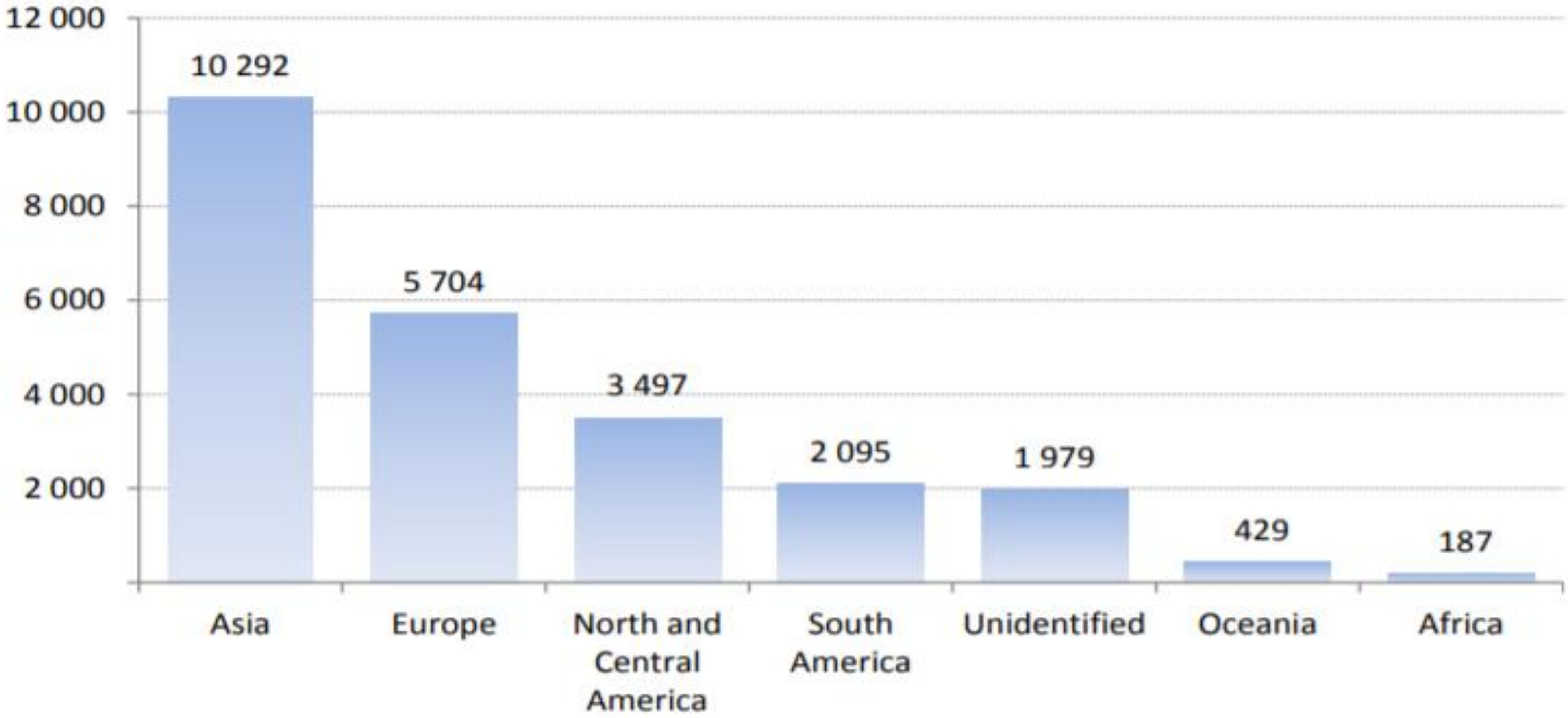
- ‘Promoters of the scheme’ & ‘service providers’ for the operation of the scheme.

- “intermediary” means any person that […] knows or could be reasonably expected to know that they have undertaken to provide, directly or by means of other persons, aid, assistance or advice with respect to designing, marketing, organising, making available for implementation or managing the implementation of a reportable cross-border arrangement. Any person shall have the right to provide evidence that such person did not know and could not reasonably be expected to know that that person was involved in a reportable cross-border arrangement.
  - ‘Knowledge test’ ≈ OECD MDR

- **Nexus requirement(s):** In order to be an intermediary, a person shall meet at least one of the following additional conditions: (a) be resident for tax purposes in a Member State; (b) have a permanent establishment in a Member State through which the services with respect to the arrangement are provided; (c) be incorporated in, or governed by the laws of, a Member State; (d) be registered with a professional association related to legal, taxation or consultancy services in a Member State.
  - Unlike the preliminary version: auditors not included.
  - If promoter outside the EU, obligation is with the service providers, or if other exceptions applicable < the taxpayer.
  - Order of priority

Impact?

Figure 2: Global distribution of intermediaries



Source: Study by the Greens/EFA Group (2017): "Usual Suspects? Co-conspirators in the business of tax dodging", p.9

DAC 6: Hallmarks (I)

- it would be more effective to endeavour to capture **potentially aggressive tax-planning arrangements** through the compiling of a **list of the features and elements** of transactions that present a strong indication of tax avoidance or abuse rather than to define the concept of aggressive tax planning. Those **indications** are referred to as **'hallmarks'.**
- Generic hallmarks and (certain) specific hallmarks may only be taken into account where they fulfil the **"*main* benefit test".** That test will be satisfied if it can be established that the **main benefit or one of the main benefits** which, having regard to all relevant facts and circumstances, a person may reasonably expect to derive from an arrangement is the obtaining of a tax advantage.
- **Hallmarks** [at least one hallmark must be met]
  A. **Generic hallmarks linked to the main benefit test**
  B. **Specific hallmarks linked to the main benefit test**
  C. **Specific hallmarks related to cross-border transactions**
  D. **Specific hallmarks concerning automatic exchange of information and beneficial ownership**
  E. **Specific hallmarks concerning transfer pricing**

- No presumption of tax avoidance?

DAC 6: Hallmarks (II)

- **A. Generic hallmarks linked to the main benefit test**
  - Compliance with condition of confidentiality on how the arrangement secures a tax advantage.
  - Premium or contingency fee fixed on the basis of the amount of the tax advantage.
  - Marketable arrangements: Standardised documentation.

- **B. Specific hallmarks linked to the main benefit test**
  - Use of (cross-border) losses to obtain a tax advantage
  - Converting income into other categories of revenue taxed at a lower level.
  - Circular transactions resulting in the round-tripping of funds.

DAC 6: Hallmarks (III)

- **C. Specific hallmarks related to cross-border transactions**
  - cross-border payments made between associated enterprises where either
  - (a) the recipient is not resident for tax purposes in any tax jurisdiction; **[no main benefit test needed]**
  - (b) although the recipient is resident for tax purposes in a jurisdiction, that jurisdiction either: (i) does not impose any corporate tax or imposes corporate tax at the rate of zero or almost zero **[+ MBT]**; or (ii) is included in a list of non cooperative jurisdictions **[no MBT]**.
  - (c) the payment benefits from a full exemption from tax in the jurisdiction where the recipient is resident for tax purposes **[+ MBT];**
  - (d) the payment benefits from a preferential tax regime in the jurisdiction where the recipient is resident for tax purposes**;[+MBT]**
  - (2) Same depreciation claimed on a specific asset inmore than one jurisidictions
  - (3) Relief from double taxation in respect of the same item of income or capital is claimed in more than one jurisdiction.
  - (3) Cross border transfer of asset and material difference in the amount treated as payable in consideration for the assets in the jurisdictions involved.

DAC 6: Hallmarks (IV)

- **D. AEOI & Beneficial Ownership**
  - Arrangements that may have the effect of undermining the reporting obligation under DAC 2 or any equivalent international agreements (including with 3rd countries) or by taking advantage of the absence of legislation or agreements.
- **E. Transfer Pricing**
  - An arrangement which involves the use of unilateral safe harbour rules.
  - An arrangement involving the transfer of hard-to-value intangibles.
  - An arrangement involving an intragroup cross-border transfer of functions and/or risks and/or assets, if the projected annual earnings before interest and taxes (EBIT), during the three-year period after the transfer, of the transferor or transferors, are less than 50 % of the projected annual EBIT of such transferor or transferors if the transfer had not been made.

DAC 6: Challenges (I)

- Going beyond BEPS Action 12; impact on international tax competition?
  - Disclosure **&** automatic exchange
  - Minimum standard
  - Binding legislation
  - Can we draw conclusions from (national) MDR? Regimes already in place; Ireland, Portugal and the UK. The UK being the no. 1 MS where intermediaries operate.
- Member States should lay down **penalties** against the violation of national rules that implement this Directive. Such penalties should be effective, proportionate and dissuasive.
  - Type of sanctions to be decided by Member States – level playing field? Contribution to tax planning?

DAC 6: Challenges (II)

- Implementation by MS: Different (?) reportable transactions? < level playing field?
- No ‘De minimis’ / ‘routine transactions’
- Hallmarks and the ‘main benefit test’: transactions must be disclosed under some hallmarks even if the arrangements are not tax-driven at all.
- Obstacles?
  - What is covered by *legal privilege*? Professional secrecy rules remain national.
  - Taxpayer and the principle of non self incrimination?
  - Protection of **taxpayers’ rights**? Compliance with (other) EU fundamental rights?
- Effectiveness/ Sanctions’ – based system (?): Underlying idea of DAC 6 is to dissuade intermediaries from designing and marketing aggressive tax planning schemes.
  - AEOI System already builts on the processes adopted in the context of earlier DACs.