Application of Anti-Abuse Rules in the Context of Cross Border Transactions – The EU Context

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EU Anti-Tax Avoidance Package

- **EU Commission**
  - Some multinationals operating in Europe do not pay their fair share of tax
  - 20% of CIT lost in tax avoidance
  - Result of loopholes, complexities and inconsistencies
  - Time for fair and effective taxation for all Europeans

EU Parent-Subsidiary Directive - ATA Rules

EU Anti-Tax Abuse Directive

EU Parent-Subsidiary Directive - ATA Rules

- Tax relief (exemption/credit) available only if dividends are not deductible by the subsidiary (Directive 2014/86/EU)
  - To be implemented by 31 December 2015

- ATA rule (Directive 2015/121/EU)
  - Benefits of PSD not available to arrangements which, having been put in place for the main purpose or one of the main purposes of obtaining a tax advantage contrary to the purpose of the PSD, are not genuine having regard to all facts and circumstances
  - Arrangements are regarded as not genuine to the extent they are not put into place for valid commercial reasons which reflect economic reality
  - Application of domestic ATA rules not precluded
  - To be implemented by 31 December 2015

Anti-Tax Abuse Directive

- The ATA Directive (Directive 2016/1164/EU) contains several anti-abuse provisions:
  - Interest limitation rule
  - Exit taxation
  - GAAR
  - CFC rules
  - Hybrid mismatch
  - To be implemented by 31 December 2018 (2019 for exit tax)
- ATAD 2
  - Agreement reached on 21 February 2017

Countries overview

Austria: Existing Anti-Abuse Rules

- General principle: taxpayers are free to arrange their economic affairs in the manner they deem most beneficial, also from a tax perspective
- General anti-abuse rule (sec. 22 of the Federal Fiscal Procedures Act):
  - The tax liability cannot be avoided by an abuse of law (*Missbrauch*) regarding legal forms and structures available under civil law
  - Abuse = if a structure is unusual, inadequate and solely aimed at avoiding or reducing taxes
  - Abuse can normally be ruled out if the taxpayer manages to present at least one (valid) non-tax reason
  - Is also applied to double tax treaties
- Implementation of the anti-abuse rule under the PSD:
  - Austria had special anti-abuse provisions already before the respective change in the PSD and thus no implementation was necessary
  - Inbound dividends: switch-over from exemption method to credit method for dividends from low-taxed and passive subsidiaries
  - Outbound dividends: denial of the exemption from WHT at source in certain cases (instead: application for repayment > structure can be scrutinized)

Austria: ATAD

- Interest limitation rule (art. 4 ATAD):
  - No general interest limitation rule currently exists
- Exit taxation (art. 5 ATAD):
  - A similar Austrian provision already exists, but adaptations will be necessary (*e.g.,* payment of instalments over five instead of seven years)
- General anti-abuse rule (art. 6 ATAD)
  - An Austrian anti-abuse rule already exists
  - No implementation measures should be necessary in this respect
  - However, jurisprudence will have to change in certain aspects
- Controlled foreign company rule (arts. 7 and 8 ATAD)
  - No such instrument currently exists
- Hybrid mismatches (art. 9 ATAD)
  - A comparable Austrian provision already exists regarding hybrid instruments, but not regarding hybrid entities

Italy

- GAAR introduced in 2015
  - A transaction shall constitute an abuse of law if it (i) has no economic substance, (ii) gives rise to undue tax benefits, and (iii) the realisation of the undue tax benefits is the essential effect of the transaction.
  - The transaction is not abusive if the taxpayer proves the existence of non-marginal non-tax reasons
- Implementation of the anti-abuse rule under the PSD:
  - Non-deductibility requirement already existing
  - Specific anti-abuse rule repealed. Tax avoidance practices covered under the new GAAR.
- ATAD
  - All anti-abuse provisions already existing, save for the hybrid mismatch rule
  - Some adjustments may be needed

Spain: Existing Anti-Abuse Rules

- General anti-abuse rule based on the "abuse of law" principle*:*
  - Applies to transactions or arrangements that:
    - Are notoriously artificial or improper to achieve the intended result.
    - Do not produce relevant legal or economic effects, other than the tax saving and the effects that would have resulted from the proper or usual transactions.
  - Also applies to double tax treaties.

- Implementation of the anti-abuse rules under the PSD:
  - The benefits of the PSD do not apply where:
    - The EU parent is –directly or indirectly- controlled by non-EU / non-EEA residents.
    - Unless its incorporation and its operation are based on valid economic grounds and substantive business reasons.
  - Dividends are not exempt if deductible at source.

Spain: ATAD

- Interest limitation rule (art. 4 ATAD):
  - Existing rules are basically aligned with ATAD. Minor adjustments are required (*i.e.* exempt dividends to be excluded from EBITDA).
- Exit taxation (art. 5 ATAD):
  - Exit taxation exists under current law. Certain changes are needed; *e.g.* relocation of assets to foreign PEs, step-up in basis of assets, 5-year deferral period or rules on provision of guarantees.
- General anti-abuse rule (art. 6 ATAD)
  - No changes are expected.
- Controlled foreign company rule (arts. 7 and 8 ATAD)
  - CFC rules already in place. Their scope is generally broader than ATAD rules, so changes should be minimal.
- Hybrid mismatches (art. 9 ATAD)
  - Rules exist in relation to hybrid instruments. No rules on hybrid entities.

UK: Treatment of dividends / ATAD

1. **PSD / UK Treatment of dividends**
   - The UK in most cases exempts inbound dividends from being taxable (for "large" companies).
   - Where inbound dividends are taxable (more likely to be in the case of a "small" company) there may be a credit for tax paid in the underlying jurisdiction.
   - The UK does not impose withholding taxes on dividends. Therefore the UK PSD does not affect dividend payments to non-UK companies (but may apply to dividends paid from offshore to a UK recipient company).
2. **ATAD – Controlled Foreign Companies**
   - The UK has existing CFC rules.
   - It is assumed that there will be a "hard" Brexit – in which the UK leaves the EU entirely and will no longer be bound by any of its laws. However, if the UK is subject to ATAD under a "soft" Brexit (under which it remains bound by existing EU laws), <u>some</u> points of detail may need to be amended, including, for example, certain exemptions.
3. **ATAD – Interest Limitation Rule & Interest Deductibility**
   - The UK is introducing new restrictions on interest deductions where the UK net interest expense exceeds £2m per annum – applicable from 1 April 2017.
   - The new rules introduce interest deductions limited to a fixed ratio of 30% EBITDA by reference to the company (or on a group wide basis, if that has a better result for the taxpayer).
   - These new rules should meet the ATAD requirements.

UK: ATAD (continued)

4. ATAD – Exit Taxation

- Change of tax residence of company or a transfer of assets out of the UK gives rise to exit tax (based on deemed market value disposal).
- It may be possible to postpone the payment of the chargeable amount if the UK company becomes resident in an EU Member State and meets certain conditions – but in the case of a "hard" Brexit, it is likely that the possibility of deferral will fall away.

5. ATAD – GAAR

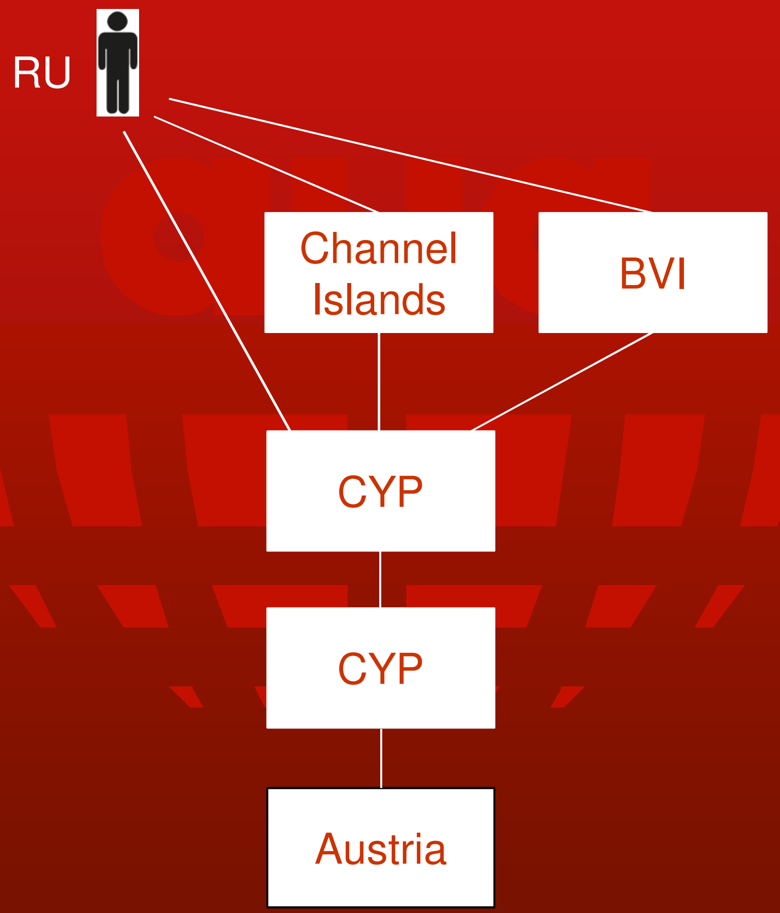
- UK has its own domestic general anti-abuse rule ("**GAAR**").
- It is likely that the UK GAAR would be viewed as compliant with ATAD.

6. ATAD – Hybrids

- UK had anti-arbitrage rules, which have been replaced by new anti-hybrid rules from 1 January 2017. The new rules follow BEPS Action 2 recommendations.
- The ATAD is more limited in the hybrid rules it requires to be introduced.
- The UK's anti-hybrid rules apply to third country transactions as well as to those involving entities in the EU Member States.
- Therefore, a "soft" Brexit is unlikely to result in any significant changes to the UK's anti-hybrid rules.

Case studies

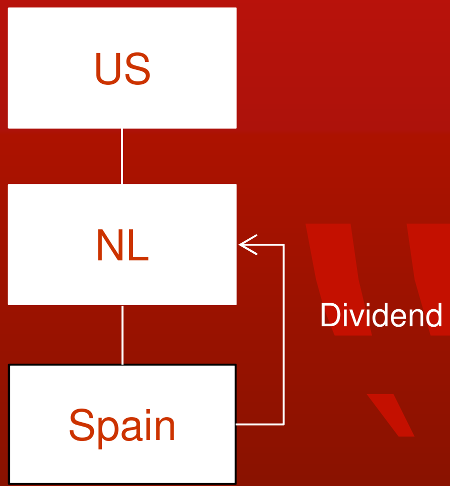
Austria: PSD Shopping Case (Austrian Supreme Administrative Court 26 June 2014, 2011/15/0080)



Austria: PSD Shopping Case (Austrian Supreme Administrative Court 26 June 2014, 2011/15/0080)

- A Russian individual held shares in an Austrian corporation via two Cypriot holding companies. Relief from Austrian dividend withholding tax was sought under the Austrian provisions implementing the PSD.
- Pursuant to the court, abuse of law may be assumed if:
  - the interposed EU company is controlled by a person which would not be eligible for a tax exemption in case of a direct receipt of the dividends;
  - there are no economic or other relevant (non-tax) reasons for the interposition of the EU company; and
  - the EU company does not independently carry out economic activities.
- The Russian individual would not have been eligible for the tax exemption in case of a direct receipt of the dividends; the Cypriot companies were not involved in economic activities apart from the passive holding of participations and neither had own office space nor qualified personnel.
- Cyprus being an English speaking country that is culturally close to Russia was not considered a valid reason for the interposition of the Cypriot companies. Thus, the court denied the refund of withholding tax.

Spain: PSD Shopping Case (Supreme Court rulings of 4 April 2012, 21 March 2012 and 22 March 2012)



- Background
  - Spanish sub pays dividends to EU parent (tax resident in NL) with non-EU controlling shareholders.
  - NL Co's seat had been transferred from another jurisdiction (Bermuda).
  - NL Co performed an activity consisting on providing R&D support to its sub, which was engaged in a manufacturing activity.
  - NL Co had around 20 employees.

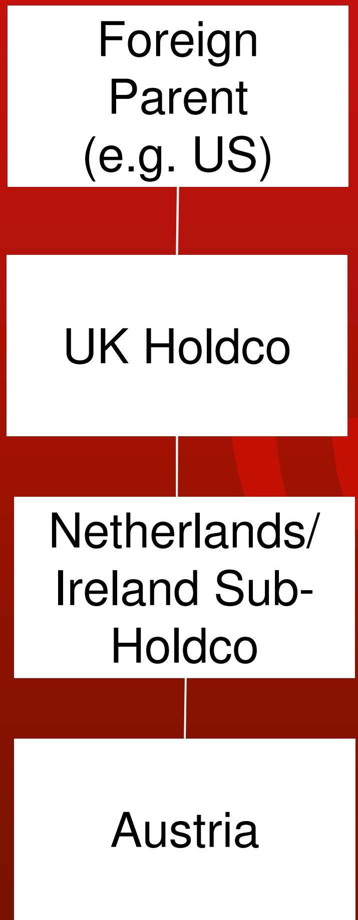
Spain: PSD Shopping Case (Supreme Court rulings of 4 April 2012, 21 March 2012 and 22 March 2012)

- Anti-abuse clause included in the Spanish rule transposing PSD:
  - Exemption denied if EU parent is controlled by non-EU residents. Unless:
    a) Parent performs an economic activity which is related with the Spanish subsidiary's activity; or
    b) Parent's activity consists in the direction and management of the subsidiary, with the corresponding human and material means; or
    c) Parent's incorporation responds to valid economic reasons different from the enjoyment of the PSD benefits.
- Court's view: none of the three exceptions was applicable.
  a) No relation between activities of parent and subsidiary.
  b) Subsidiary not managed by the Dutch parent (parent had employees but no evidence of services rendered: no management fees charge).
  c) Main purpose was enjoying the benefits of the PSD (transfer of holding's seat to the Netherlands). No analysis of commercial and business arguments posed by the taxpayer.
- Courts accept application of Spain/NL DTT (5% wht).

UK: Case Study: PSD/ATA Directive: Current pre-Brexit structure

- Pre-Brexit, there is no withholding tax as a result of the PSD.
- However, a 5% withholding tax would apply if the PSD did not apply, such as in the case of a "hard" Brexit.
- In the case of a "soft" Brexit, it is expected that the PSD would continue to apply.
- The anti-abuse provisions of the PSD must still be considered in all cases.

UK: Case Study: PSD/ATA Directive: Possible post-"hard" Brexit structure



- Here, a Netherlands or Ireland Sub-Holdco is interposed.
- In this case the PSD applies in relation to Austrian dividends to the Netherlands/Ireland Sub-Holdco and there should be no withholding tax in Austria.
- There should be no withholding tax on dividends from either (a) Netherlands Sub-Holdco (under treaty) or (b) Ireland (under domestic law).
- This is subject, again, to the application of the ATA Directive and anti-abuse provisions of the PSD.

EU Case C-6/16. Opinion of Advocate General

- French law denies wht tax exemption if ultimate owner is non-EU unless non-tax reasons are proven.
- French court refers the case to ECJ.
- AG opinion:
    - French rules are in breach of PSD: abuse cannot be presumed just because ultimate owner is non-EU.
    - French rules restrict freedom of establishment: discrimination of EU vis-à-vis domestic investors.

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