

ATOZ TAX ALERT



CJEU decides in Danish cases relating to beneficial ownership

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On 26 February 2019, the Court of Justice of the European Union (“CJEU”) issued its decisions in six cases which deal with the interpretation of the Parent-Subsidiary Directive (“PSD”) and the Interest & Royalties Directive (“IRD”, together the “Directives”).

For the purposes of the judgments, the cases T Danmark (C-116/16) and Y Denmark Aps (C-117/16) regarding the interpretation of the PSD, and the cases N Luxembourg 1 (C-115/16), X Denmark A/S (C-118/16), C Danmark I (C-119/16) and Z Denmark ApS (C-299/16) regarding the interpretation of the IRD, have been joined.

Background

In the cases, the Danish companies were all owned by a parent company resident in another EU Member State (i.e. Luxembourg, Cyprus or Sweden). The EU parent companies were all directly or indirectly owned by companies resident in third countries or by private equity funds with unknown residency of the investors.

The Danish companies paid out either dividends or interest to their EU parent companies and claimed that such payments of dividend or interest should be exempt from withholding tax in accordance with the PSD or the IRD. Here, the Danish tax authorities claimed that the withholding tax exemptions following from the PSD and IRD should not be granted since the recipients (i.e. the EU parent companies) were not the beneficial owners of the payments. The cases were appealed to the Danish High Court which referred questions to the CJEU.

The referred questions in the dividend and interest cases are generally the same. The question on beneficial ownership was only asked in the interest cases, as it is a requirement in the IRD that the recipient of interest payments is the beneficial owner thereof, whereas this is not a requirement in the PSD.

Questions referred to the CJEU

The questions referred by the Danish Court to the CJEU mainly concern three topics:

- (i) The first topic relates to the existence of a legal basis enabling a Member State to refuse to grant withholding tax exemptions on dividend and interest payments made to EU parent companies as provided in the PSD and the IRD. The question of the Danish Court further relates to the “beneficial ownership” concept in the IRD.
- (ii) In so far as such legal basis exists, the second topic addressed by the questions of the Danish Court concerns the constituent elements of any abuse of rights and the conditions for proving it.
- (iii) The third topic of the questions, likewise in the event that it is possible for a Member State to deny the benefits of the PSD and the IRD to an EU parent company, concerns the interpretation of the provisions of the Treaty on the Functioning of the European Union (“FEU Treaty”) relating to the freedom of establishment and the free movement of capital, in order to enable the referring court to establish whether the Danish legislation infringes those freedoms.

Is there a need for domestic or agreement-based anti-abuse provisions?

Until the adoption of Law No. 540 of 29 April 2015, Danish tax law did not provide for any anti-abuse legislation. Therefore, the question has been raised by the Danish Court whether, absent a specific domestic or agreement-based anti-abuse provision, it was possible to deny the withholding tax exemptions provided in the PSD and IRD.

In this regard, the CJEU states the general principle of EU Law that a taxpayer cannot enjoy a right or advantage arising from EU Law where the transaction at issue is purely artificial economically and is designed to circumvent the application of the legislation of the Member State concerned.

Thus, where there is a fraudulent or abusive practice, the national authorities and courts should refuse a taxpayer the withholding tax exemptions provided under the PSD and the IRD even if there are no domestic or agreement-based provisions provided for such a refusal. In addition, the withholding tax exemption on interest payments provided in the IRD is restricted to the beneficial owners of such interest.

The answer to this question is important to the Danish cases that go back as far as 2005 when the Danish tax law did not provide for any general anti-abuse rule. It is not surprising that the CJEU held that EU Law cannot be relied on for abusive or fraudulent ends and benefits may be denied absent specific anti-abuse provisions.

However, this clarification has only a very limited impact for other cases since as of today all EU Member States have implemented a general anti-abuse rule, at the latest since 1 January 2019 when the Anti-Tax Avoidance Directive (“ATAD”) had to be implemented.

How to prove the existence of an abusive practice?

With regard to the question as to how to prove an abusive practice, the CJEU states two requirements:

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

According to the CJEU, the examination of a set of facts is needed to establish whether the constituent elements of an abusive practice are present and, in particular, whether economic operators have carried out purely formal or artificial transactions devoid of any economic or commercial justification, with the essential aim of benefiting from an improper advantage.

A group of companies may be regarded as being an artificial arrangement where it is not set up for reasons that reflect economic reality, its structure is purely one of form and its principal objective or one of its principal objectives is to obtain a tax advantage running counter to the aim or purpose of applicable tax law.

The presence of a certain number of indications may demonstrate that there is an abuse of rights, in so far as those indications are objective and consistent. Such indications can include, in particular, the existence of conduit companies which are without economic justification and the purely formal nature of the structure of the group of companies, the financial arrangements and the loans.

Can a SICAR benefit from the IRD?

In its decision, the CJEU also clarified that a SICAR established in corporate form (S.A., S.C.A., S.à r.l.) may not benefit from the withholding tax exemption on interest provided under the IRD since a SICAR benefits from a tax exemption on all its income (including interest) from investments in risk capital.

Do the fundamental freedoms protect fraud or abuse?

The CJEU further states the obvious that when a withholding tax exemption provided under the PSD or IRD is not applicable because there is found to be fraud or abuse, the application of the freedoms enshrined in the FEU Treaty (freedom of establishment, free movement of capital) cannot be relied on in order to call into question the legislation of the Member State governing the taxation of the dividend or interest payments.

Conclusion

In the present judgements, the CJEU had to answer to questions raised by the Danish Court in relation to six cases where the Danish tax authorities refused to apply the withholding tax exemption as provided in the PSD and IRD.

While it was not for the CJEU to assess the facts in the cases, the Court specified indicia of abusive or fraudulent acts and when an EU parent company may not be the beneficial owner of interest income with a view to guide the national court in the assessment of the cases. In contrast, the advocate general Kokott analysed in her opinion rather in which cases anti-abuse legislation should not apply and when EU parent companies should be considered as beneficial owner. The approach taken by the CJEU in its decisions, describing situations where abuse might be present rather than detailing when the benefits of the PSD and the IRD should be granted, somehow creates the perception of a broad interpretation of abuse and fraudulent acts. In addition, some of the criteria mentioned by the CJEU seem to lower the threshold of abuse when compared to previous decisions (e.g. dividends are very soon after their receipt passed on by the EU parent company to entities which do not fulfil the conditions of the PSD) which is not helpful when it comes to legal certainty.

However, it can be assumed that the CJEU examined the very same elements in previous cases when analysing the existence of abusive or fraudulent acts and the compatibility of anti-abuse legislation in an EU context. In several judgements in 2017 and 2018, the CJEU reiterated its “wholly artificial arrangement” doctrine that the court systematically followed since the Cadbury Schweppes case in 2006 (see the cases Eqiom SAS (C-6/16), Deister Holding AG (Case C-504/16), Juhler Holding A/S (Case C-613/16), GS v. Bundeszentralamt für Steuern (Case C-440/17)). Thus, national anti-abuse legislation must be targeted to prevent conduct involving the creation of “wholly artificial arrangements” which do not reflect economic reality and the purpose of which is to unduly obtain a tax advantage.

It is now for the Danish courts to finally decide the cases in accordance with the guidance provided by the CJEU and the court’s previous case law. It might still take years until these cases will be finally solved given that appeals might be filed with the Danish Supreme Court. Unfortunately, the present case law of the CJEU did not contribute much to legal certainty in times that are characterized by chronic legal uncertainty.

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