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CJEU Danish cases on beneficial ownership and treaty abuse

BY PATRICK SCHRIEVERS, YORAN NOIJ AND ANNEKE FRANCISSEN

On 26 February 2019, the Court of Justice of the European Union (CJEU) issued landmark judgements in six cases which deal with the application of the EC Parent-Subsidiary Directive and the EC Interest and Royalty Directive. The majority of the cases involved Luxembourg or Cyprus holding and financing companies. Effectively, the Luxembourg and Cyprus holding companies formed part of a pooled investment group collecting funds from generally non-European Union (EU) investors.

The cases revolve around Danish operational companies owned by a parent company in another EU Member State, namely Luxembourg, Cyprus and Sweden. Subsequently, these EU parent companies were all owned by companies outside the EU. In respect of the dividend and interest payments, the Danish companies claimed exemptions of withholding tax based on the EC Parent-Subsidiary Directive or the EC Interest and Royalty Directive.

The claim was challenged or the request was denied by the Danish Tax Authorities (DTA), stating that the recipients in the EU were not the beneficial owners of the interest or dividend payments. The case ended up in the Danish High Court, which then referred questions to the CJEU. The CJEU ultimately agreed with the DTA. The CJEU clarified that it was not its duty to assess the facts in the main proceedings. However, when giving a preliminary ruling, the CJEU may, if appropriate, specify *indicia* in order to guide the national court in the assessment of the cases that it has to decide.

This part of the CJEU decisions is noteworthy as a number of indications are presented that could lead to the conclusion that there is an abuse of law. Both CJEU decisions provide the opportunity to perform a 'sanity check' and identify potential red flags. We also expect that tax authorities, as a corollary to the Danish cases, will pay closer attention to the intention to obtain a tax advantage in (close) cooperation with an arrangement or a set of arrangements involving companies with limited economic substance. The

CJEU decisions may ultimately serve as a benchmark to determine abuse of law.

Indicia presented by the CJEU

The CJEU is able to provide *indicia* in order to guide the national court in the assessment of the cases that it has to decide. Hence, the *indicia* that have been presented by the CJEU that could lead the referring court to establish abuse of law in case of intermediary holding companies are mainly of a general nature. Among others, the following *indicia* were provided.

For the CJEU, the assessment of actual economic activity must be inferred from an analysis of all relevant factors relating, in particular, to the management of the company, to its balance sheet, to the structure of its costs and to the expenditure actually incurred, to the staff that it employs and to the premises and equipment that are available.

An arrangement may be considered to be artificial when the company receiving the interest or dividends passes all, or almost all, of such income soon after its receipt to entities that do not satisfy the conditions for the application of the EC Parent-Subsidiary Directive and the EC Interest and Royalty Directive.

Indications of an artificial arrangement may also be founded by the various contracts existing between the companies involved in the financial transactions at issue giving rise to intragroup flows of funds, by the way in which transactions are financed, by the valuation of the intermediary company's equity and by the inability to have the economic use of the dividends or interest received.

Does substance matter?

It should be noted that typically substance requirements, such as personnel expenses or the availability of office space, have not been emphasised in both court cases. As a general remark we note that it makes sense, and with regard to the conclusions of the advocate-general, that the EC Parent-Subsidiary Directive does not contain any substantive criteria. The EC Parent-Subsidiary Directive is 'only' related to the distribution of profits by a subsidiary to its parent company, which must have a certain minimum holding.

Unlike interest payments, dividends do not, as a rule, represent operating expenditure which may be set against profit. In light of the fact that holding companies may engage in little activity, the requirements for satisfying any substance criteria are, or should be, relatively minor. If the company has been validly incorporated, can actually be reached at its registered office and has tangible and human resources at its disposal on site to achieve its objective, it typically cannot be seen as an arrangement that does not reflect economic reality. In addition, dividend rights ultimately follow from the company's status as parent company under company law, which can only be enjoyed in its own name.

To a certain extent this reasoning also applies to financing income. In one of the six cases reference was made to the somewhat strange distribution of costs, including low rents, low staff costs and high consultancy fees, which may be due to the fact that small office space and few employees are required to manage a single loan. The fact that the activity consists only of the management of assets, and the income results only from such management, does not mean that a wholly artificial arrangement exists which does not reflect economic reality. We expect that it may ultimately be difficult for tax authorities to argue, based on actual substance, that a business exists only on paper.

We expect that it would be difficult to argue that a wholly artificial arrangement does not exist if, for example, the considerable expenses of a conduit company were not to be met out of the interest income and the interest had to be passed on alone and in full. It might also be difficult if the refinancing interest rate and the interest rate received were identical, or the interpolated company incurred no costs of its own to be paid out of its interest income.

In conclusion, we expect that the various aspects that relate to the CJEU cases will be used by tax authorities in close connection with the applicable substance in the six private equity holding and financing structures that were scrutinised by the Danish tax authorities. Tax authorities could look at the applicable substance and governance model of the underlying Danish cases, which serve as a benchmark, and argue that abuse of law applies. In this context we also note that, in general, no circumstance on its own was decisive in the cases, but all relevant circumstances combined lead to the conclusion of abuse of treaty or abuse of EC Directive entitlements. ■