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NEW EU ANTI - TAX ABUSE CLAUSES

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1.Introduction

1.1 New EU provisions discussed at this seminar

(1) the new GAAR clause of the Parent Subsidiary Directive ("**PSD**" and "**PSD GAAR**")[1]

(2) the proposed new 'general' GAAR clause of the proposed ATA Directive ("**ATA Directive**" and "**ATA GAAR**")[2]

References
1. Article 1(2) of the Directive 2011/96/EU on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States as amended by Council Directive (EU) Doc 2015/121 of 27 January 2015
2. Article 7 of the Proposal of 28 January 2016 for a Council Directive laying down rules against tax avoidance practices that directly affect the functioning of the internal market . This is not a final text yet. Subsequent unofficial negotiation versions have been taken into account . Latest version used is the adapted proposal from the Dutch Presidency to the Council of 24 May 2016.

1.1 New EU provisions discussed at this seminar

- Other related (new/existing) EU anti-abuse provisions (not discussed here):

(3) the existing GAAR clause of article 15 (1) (a) of the Merger Directive

(4) the proposed introduction of a new anti-abuse clause (similar to the PSD GAAR) in the Interest & Royalty Directive[3]

(5) the EU Commission's recommendation for Member States to introduce a principal purpose test provision ("**PPT**") in their tax treaties (both intra EU and with third countries)[4]

References
3. Communication from the EU Commission of 28 January 2016 on the Anti-Tax Avoidance Package: Next steps towards delivering effective taxation and greater tax transparency in the EU (Com(2016) 23 final), p. 5
4. Commission Recommendation of 28 January 2016 on the implementation of measures against tax treaty abuse (C(2016) 271 final)

1.1 New EU provisions discussed at this seminar

NEW PSD GAAR (Article 1 (2 - 4) PSD)

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

An arrangement may comprise more than one step or part.

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

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

PROPOSED ATA GAAR (Article 7 (1 – 3) draft ATA Directive)[1]

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. ~~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 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.

3. Where arrangements or a series thereof are ignored in accordance with paragraph 1, the tax liability shall be calculated [~~by reference to economic substance~~] in accordance with national law.

1. Marks in red and deletions show changes of the negotiation version of 24 May 2016 compared to the initial proposal of 28 January 2016

1.2 Objectives

'top down' shift
imposed on EU Member States through new directive provisions

from

'GAAR-authorization'
maximum anti-abuse prevention
allowed to Member States

to

GAAR-uniformization
minimum uniform anti-abuse prevention
imposed on Member States

1.2 Objectives

- Stated objectives for introducing uniform minimum anti-abuse prevention:
  - close loopholes for abuse by doing away with the absence of accurate abuse prevention in certain member States
  - more efficient protection of national corporate tax bases (>< subsidiarity principle?)
  - more legal certainty for businesses (sic!)

1.3 Consequences of the legal form of directive provisions

(1) Questionable whether transposition by Member States will achieve aimed uniformization

(2) Questionable whether compatible with EU subsidiarity and proportionality principles

(3) No “reverse” vertical direct effect (from national tax authorities against taxpayers)

2. Analysis at EU level

2.1 Scope of application

2.1.1 Definition of abuse

- New directive provisions follow the classical composition of definition of abuse as developed by ECJ case law:

(1) ‘arrangement or series of arrangements’
(2) subjective purpose test: ‘main or one of the main purposes’
(3) objective purpose list: defeating the object or purpose of the tax provisions concerned
(4) safeguarding for ‘genuine arrangements’, i.e. arrangements put in place for valid commercial reasons which reflect economic reality

- Some particularities of the terminology used are shown on following slides

2.1.1 Definition of abuse (I)

- 'an arrangement or series of arrangements'
  - not defined
  - "transaction, scheme, action, operation, agreement, understanding, promise, or undertaking"
- 'having been put into place'
  - not necessarily put into place by the taxpayers concerned themselves → open-ended personal scope
  - quid position of e.g. minority shareholders?
- 'for the main purpose or one of the main purposes' (subjective test)
  - if taken literally: very extensive test
  - in practice: similar wording as in Merger Directive ("*principal objective or one of its principal objectives*") and arguably to be interpreted in accordance with ECJ case law on Merger Directive anti-abuse clause (Kofoed C-321/05: sole purpose; Foggia C-126/10: tax considerations predominant)
  - so probably real criterion = "sole or predominant purpose" (in combination with safeguarding for 'genuine arrangements')

2.1.1 Definition of abuse (II)

- 'of obtaining a tax advantage that defeats the object or purpose of the [PSD/ applicable tax law]' (objective test)
  - cfr. Halifax C-255/02, para. 74
  - with regard to PSD GAAR: tax purposes other than PSD benefits allowed (cfr. ECJ in Zwijnenburg C-352/08)
  - with regard to ATA GAAR: tax purposes other than corporate tax allowed?
- 'are not genuine having regard to all relevant facts and circumstances'
  - comes in addition to subjective and objective test
  - "genuine": new concept -> "put into place for valid commercial reasons which reflect economic reality"
  - "valid commercial reasons" -> elaboration on subjective test (cfr. Merger Directive)
  - "reflect economic reality" -> link to "wholly artificial(ity)" test? Cfr. Itelcar C-282/12: "wholly artificial arrangements which do not reflect economic reality"

2.1.2 Tax domains covered

- PSD GAAR: participation exemption & dividend withholding tax
- ATA GAAR: national corporate tax at large

→ does corporate tax also cover withholding taxes on dividends/ interest/ royalties?

- unclear…
- GAAR – Version 4 May 2015 – Presidency comment: "As currently drafted, the GAAR does not apply to withholding taxes since the text refers to the calculation of corporate tax liability"
- GAAR – Version 10 May 2015 – Presidency comment: "Withholding taxes have been included in the scope of the GAAR (…) [but] "the scope of this extension has been limited to situations involving entities in third countries in order not to overlap with the PSD anti-abuse clause (and possible equivalent clauses in other directives in the future)"
- GAAR – Version 13 May 2015 – reference to applicability of the GAAR to withholding taxes deleted (Recital (12))

2.1.3 Scope of arrangements covered

- only cross border arrangements into the EU?
  - in principle, yes
- or also arrangements with third countries?
  - probably no, unless GAAR extended in tax treaty
  - but: potential (future) impact of the EU Commission's recommendation for Member States to introduce a principal purpose test provision ("PPT") in their tax treaties
- also domestic arrangements?
  - cfr. Leur-Bloem C-28/95: when Member States (unilaterally) decide to extend the GAAR to purely internal situations, these provisions will need to be interpreted consistently with the PSD/ATA GAAR and will be subject to the ECJ's jurisdiction

2.2 Mandatory anti-abuse prevention rules

2.2.1 Mandatory minimum anti-abuse test (minimum level of severity)

- Minimum rule (no 'under implementation' allowed)
  - obligation for Member States to provide for, **and to (effectively) apply**, the minimum anti-abuse prevention imposed by the new EU anti abuse clauses (through either new legislation or Directive-conform interpretation of existing legislation)
- Effective implementation of the minimum standard rule will be difficult to measure in practice
  - unclear scope of the provision due to broad and undefined concepts
  - risk of non-uniform/non-consistent implementation across the EU
  - No action required if existing domestic GAARs are already compliant
  - It will take time before the ECJ ensures uniform interpretation
- Minimum standard policy does not impose full alignment and may allow for diversity of approach
  - stricter anti abuse rules permitted (e.g. lower thresholds for considering an operation as abusive), subject to limitations set by ECJ case law on anti-abuse
  - no obligation to remove existing domestic anti-avoidance provisions

2.2.2 Consequences in case of abuse

- If a given arrangement, or series of arrangements, is (found to be) in breach of a GAAR clause, then the Member State(s) concerned should
- under the PSD GAAR, not grant the directive benefits :
  - However similar benefits could be granted under a tax treaty (eg. DWT exemption), subject to other GAARs provided for in the treaty or domestic law
  - Are Member States obliged to apply per se 'full taxation' or are they free to provide for an alternative more lenient intermediate level of taxation (e.g. DWT at lower rate)?
  - under the ATA GAAR:
  - 'a Member State shall ignore' the abusive arrangements
    &
  - 'the tax liability shall be calculated in accordance with national law'
  - Preparatory documents state that Member States are allowed to apply penalties as well

2.3 'Policing' of transposition by EU Commission (1)

Implementation deadlines of the directives:

- Transposition of PSD GAAR in national law was due by 31 December 2015
- Deadline for transposition of the ATA GAAR still to be determined (possible by 31 December 2017 according to the most recent draft published by the Commission)

According to article 288 TFEU, a directive is "binding as to the result to be achieved, upon each Member State to which it is addressed, but shall leave to the national authorities the choice of form and methods"

Member States may implement the Directives in different ways:

- Enacting new statutory provisions
- No further legislative action is necessary – the purpose of the directive is already achieved by existing domestic statutory provisions

2.3 'Policing' of transposition by EU Commission (2)

- National tax authorities cannot invoke a directive provision, insofar as it is not implemented (or not timely implemented) - no top down vertical direct effect of directives
- Courts may in principle make a "directive compliant" interpretation, but the ECJ case law shows that such interpretation cannot be used against a legal subject in the absence of domestic transposition of a directive (ECJ, 16 July 1998, case C-355/96, Silhouette International Schmied, par. 32-37)
- As a consequence, Member States tax authorities cannot ask courts to "directive compliant" interpretation against a taxpayer if the Member State has chosen a more lenient implementation

2.3 'Policing' of transposition by EU Commission (3)

- Commissions weapons to force "unwilling" Member States to full implementation of the PSD GAAR and TAP GAAR:
  - Infringement procedures may be launched by the Commission against such Member States (article 258 TFEU), nevertheless such procedures take for a rather long time
  - The launching of infringement procedures is often enough to persuade the Member States to bring in line its legislation with the directive
    - According to available data, more than 85% of all infringement procedures are settled before the litigation procedure
  - Risk of possible retroactive effect:
  - Certain Member States implemented the PSD GAAR with retroactive effect (i.e. Spain, Italy)
  - Commission investigations: state-aid type retroactive recovery – only in line with the respect of the EU fundamental freedoms, therefore there should be no risk of retroactive application for operations carried out before effective transposition by the Member State concerned (unless if qualification as state aid)

2.3 'Policing' of transposition by EU Commission (4)

- Monitoring by the EU Commission:
  - PSD GAAR: Member States have to communicate to the Commission the implementation provisions adapted in the framework of the PSDGAAR as well as the main provisions of the national law which covers the field of the PSD
  - ATA GAAR: According to the most recent draft, the directive makes explicitly reference (article 11 draft ATA GAAR) to the evaluation of the implementation by the Member States three years after its entry into force.
    - The Commission is allowed to make proposals to legislative changes for the Member States
    - Member States have the obligation to communicate any necessary information to the Commission in order to this later may properly evaluate the implementation
    - Furthermore, Member States have to communicate the main domestic provisions existing in the field of the ATA GAAR

3. Status of transposition in Belgium, France & Luxembourg

3.1 Transposition in Belgium

3.2 Transposition in France

3.3 Transposition in Luxembourg

3.1 Transposition in Belgium

- Current general anti-tax abuse provision (Article 344, § 1, BITC) not suitable/sufficient
  - only "legal acts" (<-> "arrangements")
  - only "legal acts" realized "by the taxpayer" (<-> open-ended personal scope PSD/ATA GAAR)
  - no (explicit) reference to "non-genuineness" or "artificiality" in text of the statute
- Re PSD GAAR: ad hoc draft implementation legislation under discussion at Government level, but not (yet) publicly available

3.2 Transposition in France

- LFR 2015 of Dec 29, 2015, art. 29 & 36 : full transposition of the PSD GAAR
  - « Le 1 ne s'applique pas aux dividendes distribués dans le cadre d'un montage ou d'une série de montages qui, ayant été mis en place pour obtenir, à titre d'objectif principal ou au titre d'un des objectifs principaux, un avantage fiscal allant à l'encontre de l'objet ou de la finalité de ce même 1, n'est pas authentique compte tenu de l'ensemble des faits et circonstances pertinents. »

    « Un montage peut comprendre plusieurs étapes ou parties. »

    « Pour l'application du présent 3, un montage ou une série de montages est considéré comme non authentique dans la mesure où ce montage ou cette série de montages n'est pas mis en place pour des motifs commerciaux valables qui reflètent la réalité économique. »
- The GAAR applies to all distributions subject to the PS regime
  - whether inbound or outbound distributions
  - whether EU or non-EU related distributions
  - Distributions from domestic sources are also covered
  - In all cases, the provisions apply to distributions with respect to tax years opened as of Jan 1st, 2016

3.2 Transposition in France

- High uncertainty as to how the new PS GAAR should be applied in certain circumstances
  - Poor translation of an English wording
  - New concepts with no legal meaning : « montage non authentique »
  - Improper use of legal terminology : motifs « commerciaux » instead of « économiques »
  - Is the non genuine test specific and separate from the main purpose test ?
- High level of concern with respect to possible adverse treatment of pure holding companies
  - A report before the Parliament (Rapp. N° 3347, Dec. 14 2015) states :
    - « the provisions aims at tackling artificial arrangements. This is the case for arrangements involving a holding companies which sole and exclusive purpose is to hold shares »
  - Under an – unduly ? – extensive reading of the GAAR, pure holding companies do not meet the purpose and substance tests
  - Administrative guidelines not available yet

3.2 Transposition in France

- Need for a similar transposition of the ATA GAAR ?
- The French system does include an impressive amount of anti-abuse provisions already
  - **Abuse of tax law (L64 LPF)**: typical GAAR model / sanctioned by 80% penalty
  - **Tax fraud** (art. 1741 GTC) : criminal offence / sanctioned by fine (0,5/2,5 MEuros) and imprisonment (5 years)
  - **Multiple SAARs**
- Abuse of tax law is traditionnally based on an **exclusive purpose** test
  - A proposed reform to replace the exclusive purpose test by a principal purpose test has been turned down by the Constitutional Council in 2013
  - The principle purpose test was held to be too vague in light of a provision which is severely sanctioned
  - However, the Constitutional Council validated the transposition of the PSD GAAR, although it also includes a principal purpose test, because unlike the abuse of tax law, the new provision does not attract a 80% penalty
- In this context, it is likely that the ATA GAAR will be transposed
  - The tax authorities should follow the PSD GAAR precedent
  - A transposition will allow for the implementation of a principal purpose test, which was denied by the Constitutional Council as part of the existing GAAR

3.3.1 Transposition of the PSD GAAR in Luxembourg (1)

- Luxembourg implemented the PSD GAAR by enacting the law dated 18 December 2015 (the "**Law**")
- The new Law modified the major existing tax laws in Luxembourg, in order to be in line with the PSD GAAR, such as:
  - Income Tax Law (*loi concernant l'impôt sur le revenu*)
  - Municipal Business Tax Law (*loi concernant l'impôt commercial*)
  - General Tax Code (*Abgabeordnung*)

3.3.1 Transposition of the PSD GAAR in Luxembourg (2)

- Classical concept of abuse under national tax law is defined in article 6 of the Luxembourg Tax Adaptation Law (*Steueranpassungsgesetz*) in the following manner:
  - The tax liability cannot be avoided or reduced on an abusive manner by using forms and opportunities provided by civil law ("*Durch Missbrauch von Formen und Gestaltungsmöglichkeiten des bürgerlichen Rechts kann die Steuerpflicht nicht umgangen oder gemindert werden*")

- The notion of abuse in the PSD GAAR goes effectively beyond the domestic general anti abuse provision. Since the PSD GAAR has been implemented directly in the specific articles concerning the participation exemption regime, they supersede the general anti abuse provision in the specific participation exemption context ("Lex specialis derogat legi generali")

3.3.1 Transposition of the PSD GAAR in Luxembourg (3)

- Luxembourg implemented the PSD GAAR by modifying the pre-existing tax laws dealing with the participation exemption regime.

- According to the tradition of Luxembourg legislators, the PSD GAAR was copied into the relevant Luxembourg law provisions

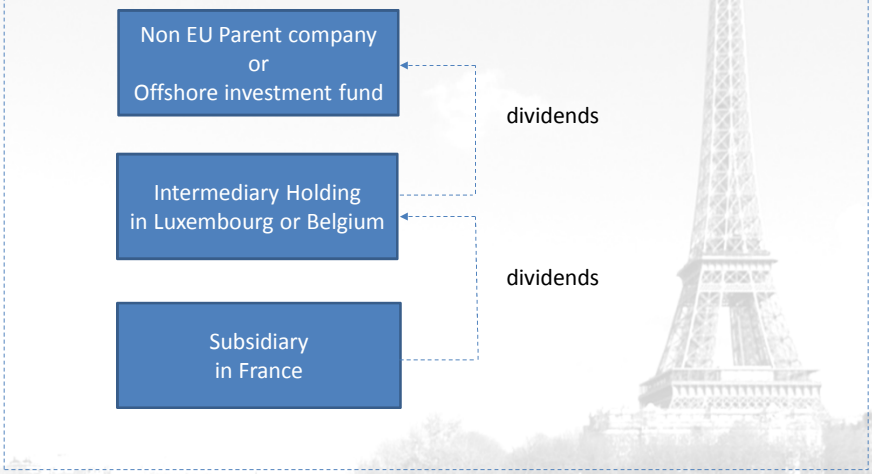
- As a consequence, Luxembourg has implemented the PSD GAAR in line with the directive.

3.3.1 Transposition of the PSD GAAR in Luxembourg (4)

- The tax consequence of an arrangement constituting an abuse depends on the position of the Luxembourg company involved:
  - Dividend distributed by a Luxembourg company to a company resident in another Member State: the withholding tax exemption provided by the participation exemption regime is denied – potential withholding tax of 15% applies, subject to applicable double tax treaty provisions
  - Dividend received by a Luxembourg company from a company resident in another Member State: the tax exemption provided by the participation exemption regime is denied – dividends will be subject to tax at the statutory corporate income tax rate, subject to applicable double tax treaty provisions
  - Capital gains exemption is out of scope of the PSD GAAR

4. Case studies

4.1 Intermediary EU holding company used for expatriating dividends without DWT to outside the EU



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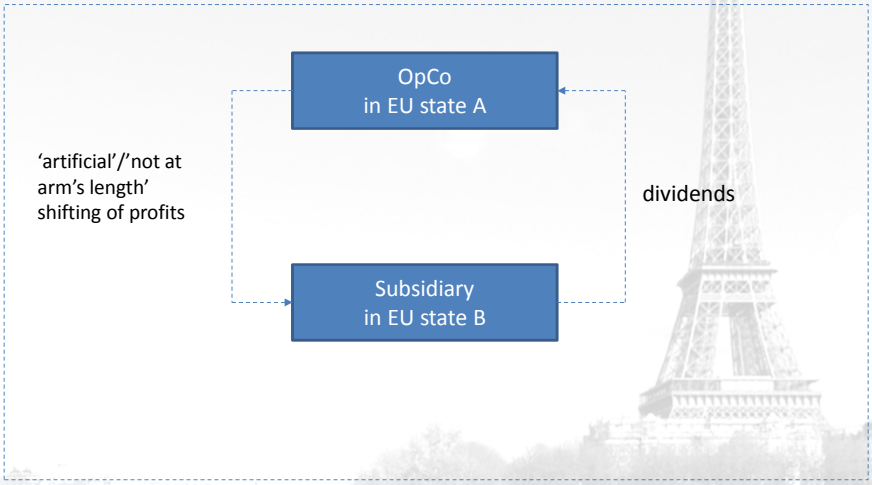
4.2 Dividends originating from profits artificially shifted to an EU subsidiary



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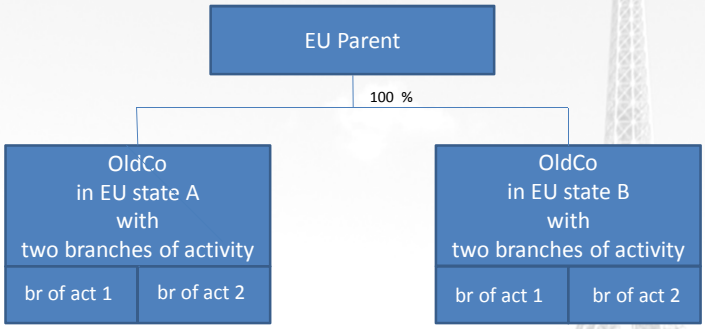
4.3 Disposal of branch of activity through partial demerger followed by transfer of shareholding (1)

Existing situation

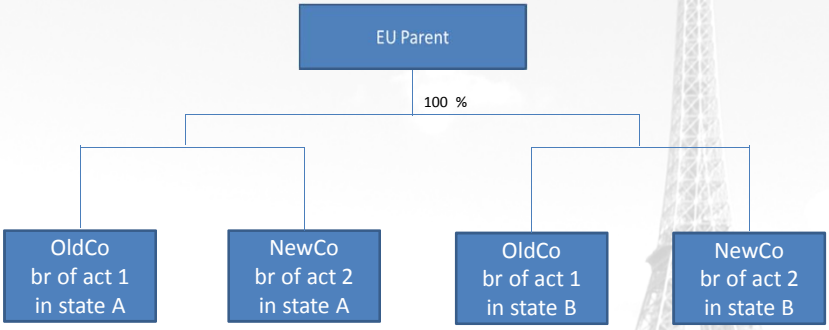


Other investor interested to acquire a JV-shareholding in br of act 2 in lieu of "taxable" sales of br of act 2 (asset deals)

⟹ 1) partial demerger of each of the OldCo's
2) sale by EU Parent of shareholdings in NewCo's

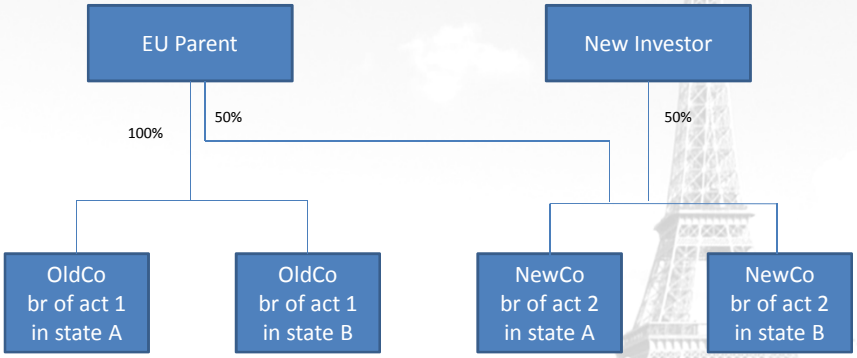
4.3 Disposal of branch of activity through partial demerger followed by transfer of shareholding (2)

First step: partial demergers



4.3 Disposal of branch of activity through partial demerger followed by transfer of shareholding (3)

Second step: transfer of 50% of shares in NewCo's



Questions