Latest case law from EU member states on beneficial ownership and abuse of law

Recent case law across Europe shows that domestic courts are being inspired by the CJEU case law on abuse. In this newsletter we have summarised recent case law in Switzerland, France, Spain, the Netherlands and Italy. Despite the Italian Supreme Court's positive ruling, a trend seems to be set: taxpayers claiming benefits under EU or treaty law should more than ever be ready to demonstrate the economic rationale of their structures.

RULING BY THE SWISS FEDERAL SUPREME COURT ON THE APPLICATION OF ABUSE OF RIGHTS ON CROSS-BORDER DIVIDEND DISTRIBUTIONS

In a recent ruling of 20 April 2020, the Swiss Federal Supreme Court (Schweizerisches Bundesgericht) had to decide whether dividends paid by a Swiss company to its Irish parent company could be considered as abuse of rights and therefore be excluded from withholding tax privileges.

The case dealt with a situation in which a Swiss subsidiary was sold by its Dutch parent company to an Irish group company. However, the Irish group company was only able to buy the Swiss subsidiary with a loan granted from its Irish parent company (the grandparent company of the Swiss subsidiary), who in turn received the necessary funds via a loan from the Swiss subsidiary. The Irish group company claimed a refund of withholding tax on the post-acquisition dividends that it had received from the Swiss subsidiary and relied on the Agreement between the European Community and the Swiss Confederation providing for measures equivalent to those laid down in Council Directive 2003/48/EC on taxation of savings income in the form of interest payments.

Even though the Swiss Federal Supreme Court's ruling was made in 2020, and thus after the Protocol of Amendment had entered into force, it was based on the old regulations.

The Court upheld the existence of abuse due to the specific structure of the transaction and refused the withholding tax privileges.

In its ruling, the Court highlighted the following aspects:

- **Right of use:** In accordance with the CJEU cases C-116/16 and C-117-16 T Danmark and Y Denmark Aps of February 26, 2019 (the so-called "Danish cases"), the Court stated that the refund must be refused if the parent company, (i.e. the Irish group company), not only lacks the right of use of the income, but also if the whole structure constitutes fraud or abuse. In its ruling, the Court argued that, to the extent that the offence of the misuse of rights is fulfilled, the right of use does not need to be examined.
- **Abuse of rights:** The Court concluded that all elements required to prove tax avoidance in Switzerland were met. In particular, the legal structure chosen by the companies involved would have resulted in considerable tax savings for the companies belonging to the group, since substantial old reserves (i.e. reserves that, under the previous own-

ership structure, only qualified partly for a refund of the Swiss withholding tax) would come within the scope of the withholding tax privileges. Under this approach, the Swiss Federal Tax Administration generally refuses refund claims of Swiss withholding tax if Swiss investments are transferred from one country to another country that has more advantageous refund conditions under the applicable double taxation agreement. In this case, the old reserves were generated in a period where the Double Taxation Agreement with the Netherlands applied, which had a specific anti-abuse provision and 15% of the Swiss withholding tax was non-refundable; whereas, under the new ownership structure, only 10% was non-refundable.

→ **Consequences of abuse of rights:** Since this dispute involved an unjustified claim to an advantage under the CH-EU Agreement, the Swiss Federal Supreme Court decided to apply the CJEU case law in the "Danish cases". According to the CJEU, Member States are obliged to deny the benefits of the Parent-Subsidiary Directive of 23 July 1990, even if they do not have anti-abuse rules in their national law and agreements. Consequently, no refund of withholding tax was granted to the Irish group company.

ACCORDING TO THE FRENCH ADMINISTRATIVE SUPREME COURT, BENEFICIAL OWNER STATUS IS A CONDITION FOR BENEFITING FROM THE PARENT-SUBSIDIARY DIRECTIVE'S DIVIDEND WITHHOLDING TAX EXEMPTION

Under French domestic law, the distribution of dividends by a French company to its EU parent company is exempt from withholding tax, provided that the latter can demonstrate that it is the beneficial owner of the dividends.

In its ruling of 5 June 2020 n° 423809, Eqiom and Enka, the French Administrative Supreme Court ruled that this condition is compatible with the Parent-Subsidiary Directive, which is to be interpreted in line with the Danish cases.

In this particular case, dividends were paid by a French company to its sole shareholder, a Luxembourg company whose shares were held by a company resident in Cyprus, which in its turn was wholly controlled by a company established in Switzerland.

The French tax authorities refused the application of the withholding tax exemption considering that the Luxembourg parent company was not the beneficial owner of the distributed dividend, since it was able to establish that it was indeed the holder of the Swiss bank account into which the dividends were paid by the French company.

It was therefore not a question of a transit of the dividends through the intermediary of the Luxembourg company before their transfer to a beneficiary established in a third country (Switzerland), but about the reality of the collection of the dividends by the Luxembourg company.

The French and Luxembourg companies challenged this refusal, arguing before the Court that the French law provisions were incompatible with the Parent-Subsidiary Directive's objectives, which do not contain a beneficial owner clause (unlike the Interest-Royalty Directive).

In its ruling, the Court expressly quoted point 113 of the Danish cases, which states that: *"[...]The mechanisms of the Parent Subsidiary Directive, in particular Article 5 providing for a withholding tax exemption are not, on the other hand, intended to apply when the beneficial owner of the dividends is a company resident for tax purposes outside the European Union since, in such a case,*

exemption of those dividends from withholding tax in the Member State from which they are paid could well result in them not actually being taxed in the European Union."

The Court then ruled on these grounds that *"the status of beneficial owner of dividends must be regarded as a condition to benefit from the withholding tax provided by Article 5 of the Directive."*

It follows from this ruling, and the reasoning of the Advocate General's Opinion, that the condition of beneficial owner may constitute an autonomous basis for refusing to apply the withholding tax exemption, without invoking an abuse of rights, but only to the extent that the beneficial owner is not him/herself established in the European Union.

THE SPANISH CENTRAL ADMINISTRATIVE COURT REFERS TO THE DANISH CASES IN INTERPRETING THE SPANISH ANTI-ABUSE CLAUSE ON DIVIDENDS PAID TO EU HOLDINGS

The Danish cases doctrine has been interpreted by the Spanish courts in two decisions from the Spanish Central Administrative Court from October 2019. One of the resolutions, which we analysed in Newsflash #4, concerned the payment of interest by a Spanish subsidiary to a Dutch holding company, which was held by a structure of conduit companies, and ultimately by a non-EU entity. The Court rejected the application of the exemption on interest paid to an EU tax resident recipient because the Dutch holding entity was not the beneficial owner of the interest paid by the Spanish entity.

In the other resolution, which is the subject of this summary, the Court referred to the Danish cases doctrine to interpret the Spanish domestic anti-abuse provision regarding the obligation to withhold dividends and shareholder bonuses paid by a Spanish company to its Luxembourg parent, which in turn was fully-owned by a Qatar investment fund.

The Court confirmed that shareholder's bonuses for attending should be treated as dividends for tax purposes. In addition, the Court concluded that the dividends paid by the Spanish entity could benefit neither from the EU Parent-Subsidiary Directive exemption, nor from the Luxembourg - Spain Double Tax Agreement, to the extent that the Luxembourg holding entity was not the beneficial owner of the dividends, as the actual beneficial owner was a non EU-resident. During the periods under consideration the Double Tax Agreement between Qatar and Spain was not yet in force, so the domestic withholding rules of Spanish Non-Resident Income Tax applied.

The Court ruled that the Spanish domestic anti-abuse provision on dividends is in accordance with EU Law. In particular, the Court held that, on the one hand, the Spanish tax authorities had proved that the Luxembourg holding company was held by a non-EU shareholder and funds were passed on to the non-EU shareholder.

On the other hand, according to the Court the taxpayer had not proved the fulfillment of the requirements for the exception to the application of the anti-abuse provision. This exception requires (i) that the EU recipient company carries out economic activity directly related to the subsidiary and (ii) that the EU company has not been set up solely to benefit from the exemption.

To the extent that the compliance with these requirements was not proved, the Court accepted as evidence of abuse the following facts: the lack of employees at the level of the Luxembourg parent company, the fact that dividends paid by the Spanish company were finally repaid by the Luxembourg holding company to its sole non-EU shareholder via a loan repayment and interest payments, and the fact that the directors of the Luxembourg holding company were also directors of its non-EU shareholder.

It can be inferred from these rulings that both the Court and the Spanish tax authorities are referring to the beneficial ownership and the applicable anti-avoidance provisions when challenging the withholding tax exemption on dividend and interest payments. Although the Court's rulings are binding on other administrative courts, they can be appealed to the Spanish Courts of Justice, who may take a different approach.

DUTCH CASES: ONE STEP FURTHER ...

Following the Court of Justice of the European Union's ruling in the Danish conduit cases, courts across Europe seem to be increasingly faced with cases in which the application of withholding tax exemptions on cross-border dividend and interest payments is being scrutinised.

Just as in Italy, France and Switzerland, the Dutch lower court of Haarlem has recently made two rulings in which reference is made to the principles set out in the Danish conduit cases.

Both rulings involved structures with a Belgian BVBA (a limited liability company, which today is called BV) ultimately held by individuals resident in Belgium. So, in contrast to all the other cases, these cases only involved two jurisdictions.

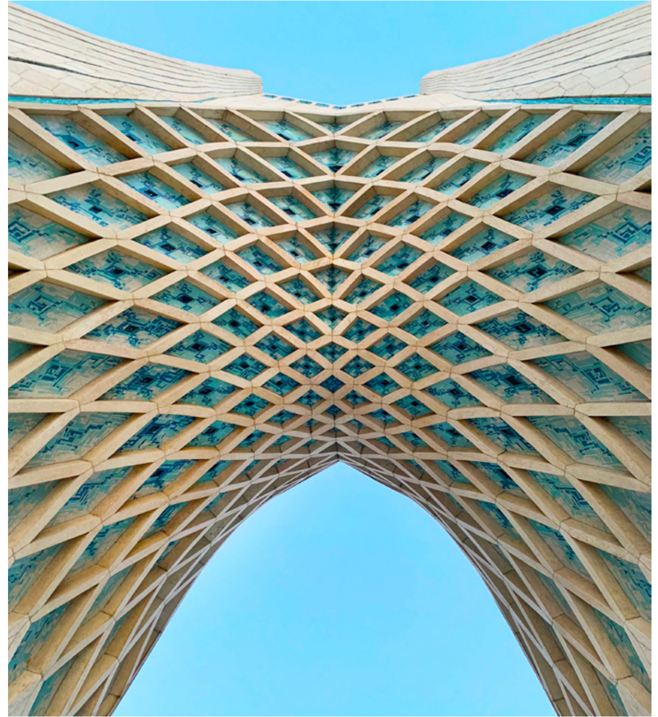
The Belgian BVBAs in both cases held a minority interest (i.e. 38.71% and 24.39%) in a Dutch BV, which had been set up for its shareholders to hold an investment in a Dutch private equity fund.

In the first case, the BVBA did not hold any other assets than the shares in the Dutch BV and two 'old timer' classic cars. Further, it did not have any employees or office space at its disposal.

In the second case, the BVBA owned shares in more than ten other companies, including operational companies, and performed management activities for certain of these companies. The BVBA in this case used office space and paid significant fees (around EUR 650,000 per year) for management services performed by its director and legal and administrative services performed by the director's wife. Furthermore, the BVBA´s director was actively engaged with searching for potential investments for the BVBA in the high-tech sector.

At some point the Dutch BV distributed dividends to its shareholders. Both Belgian BVBAs claimed an exemption from Dutch dividend withholding tax based on Article 4, paragraph 2, of the Dutch 1965 Dividend Withholding Tax Act ("DWT"), which is an implementation of the Parent-Subsidiary Directive. The exemption was denied by the Dutch tax authorities in both cases based on the anti-abuse provision included in the DWT. More specifically, the Dutch tax authorities took the position that both BVBAs were interposed between the Dutch BV and the Belgian individual shareholders to make use of the dividend withholding tax exemption and that the structures should be considered as artificial.

The Court indeed acknowledged that if the individual shareholders had held the interest in the Dutch BV directly without the interposition of the BVBAs, then they would not have been entitled to the exemption from Dutch dividend withholding tax. As such, it considered that one of the main purposes for interposing the BVBAs in the structure was to avoid Dutch dividend withholding tax and that the structure was presumed to be artificial unless it could be demonstrated that the structure was not wholly artificial with no economic purpose.



The Court held that the BVBA in the first case had not succeeded in demonstrating the structure's economic purpose, considering that it did not have many other assets than the shares in the Dutch BV, lacked office space and personnel.

In contrast to the BVBA in the first case, the Court held that the BVBA in the second case had successfully demonstrated that the structure was not wholly artificial and did have an economic purpose, considering the other investments (actively) held by the BVBA, the services performed by the director and his wife and the availability of office space.

Appeals have been raised in both cases. It is in any event clear that taxpayers claiming benefits under the Parent-Subsidiary Directive should more than ever be ready to demonstrate the economic purpose of their structure in order to tackle challenges from the tax authorities across Europe.

BENEFICIAL OWNERSHIP AND SUBSTANCE OF HOLDING COMPANIES (ITALIAN SUPREME COURT, 10 JULY 2020, NO. 14756)

The Italian Supreme Court has recently delivered a remarkable ruling on the beneficial ownership requirement in the context of an acquisition funding scheme. The Italian acquisition vehicle had paid interest to the Luxembourg parent company, which in its turn had

been financed by a bank loan through several layers of Luxembourg holding companies.

The Supreme Court concluded that the Luxembourg parent company qualified as the beneficial owner of the interest received on the basis of arguments that are rather different from those usually deployed in similar cases. Indeed, according to this ruling:

→ the notion of beneficial owner must be assessed in the light of the 'availability test', as recommended by the OECD Commentary. In this particular case, the recipient (despite the matching terms of its own funding) was considered to have full ownership and availability of the proceeds it had received from group companies and had no legal obligation to return them to third parties;

→ the Luxembourg company, which received income from subsidiaries was acting as an international financial centre for the entire group and managing all treasury and financing needs. It received financial income from all group companies and not only from the Italian subsidiary. Therefore, its role was to harmonise investments and to manage all financial flows and its income statement showed operating profits coming precisely from the performance of these activities;

→ the income of the Luxembourg company was taxable and taxed in Luxembourg;

→ the circumstances that the recipient company held, on top of the facilities, only controlling shareholdings and that it was wholly-owned by another company ("cascade" control) did not prove, by themselves, that the sub-holding was only an artificial or instrumental entity without organisational and managerial autonomy;

→ the only regulatory element relevant for the purposes of the notion of beneficial owner was the parent company's mastery and autonomy in decisions concerning the shareholdings held and the destination of the financial income perceived;

→ when assessing the status of a holding company, reference cannot be made to the typical features of operating companies. Instead of focusing on the premises, assets and employees, focus should be upon the company's organisational and managerial autonomy;

→ furthermore, the loan from the Luxembourg company to the Italian subsidiary was part of a broader portfolio of facilities drawn in order to complete the complex leveraged buyout operation. Therefore, the loan (and the interest flow) could not be taken alone, for the purposes of the assessment of the beneficial owner requirement, which was insensitive to the general contractual framework in which it was inserted, and typical of the dynamics of corporate groups.

The ruling indicates that the Supreme Court is prepared to take into account the role and the management autonomy of the interest recipient, rather than merely looking at the objective features of any individual facility.

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