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Same Same But Different. A misunderstanding of the EU tax jurisprudence with possible negative spill-over effects on the BEPS recommendations.

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*The scope of the present article will be narrow. The aim is to point out a misinterpretation of the Cadbury ruling, which might have caused a flawed theory of the compatibility of certain CFC regimes with EU law. I do not use the appellative "flawed" to sound overconfident, but because in my view, good law in general must comply with and be perfectly integrated in the previous case-law. Corporate taxation even more than taxation at large must be judged against the economic background of each case at least in a society that relies genuinely on liberal principles.*In EU tax law the most common problem is the comparability of the treatment of a cross-border *versus* a purely internal situation. However, the same treatment may be prone to affect the cross-border situation in a negative manner resulting in a restriction of free movement, while it does not imply any kind of actual financial impact on the domestic situations. Moreover, each case that is reported for a preliminary ruling before the CJEU depicts situations that may seem similar from a formal perspective, but they are different in substance. The attempts to freely derive conclusions from a previous ruling before acknowledging the particularities of each new case should be discouraged.

The broken logical link that I am talking about starts with the Case C-446/03, *Marks & Spencer*[49] passes by the Case C-196/04, *Cadbury Schweppes*[55-56] continues *via* the Case C-524/04 *Test Claimants in the Thin Cap Group Litigation*[74-75] moving to the Case C-231/05, *Oy AA*[62-63] and further to a more recent Case C-311/08, *SGI*[66]. I will prove that *Cadbury* even if apparently similar, it is in substance fully different and therefore the clarifications brought by subsequent case law do not touch the substantive rule established by *Cadbury*.

A) Tax benefits granted by Member States not available to non-residents. Defensive measures.

1. Marks & Spencer

Marks & Spencer ruling treats the case of losses incurred outside the territory of the Member State and the measure under review is a tax relief i.e. a tax benefit falling within the tax autonomy of the Member State which is matched with the obligation to be subject to tax. The balance of matching losses and profits makes perfect sense from the economic perspective and the measure has a defensive character. The UK defended its right to tax profits produced on its sovereign territory, that's to say its legitimate share of the global pie of tax revenues.

> "49. relating to the risk of tax avoidance, it must be accepted that the possibility of

> transferring the losses incurred by a non-resident company to a resident company entails the risk that within a group of companies losses will be transferred to companies established in the Member States which apply the highest rates of taxation and in which the tax value of the losses is therefore the highest."

2. Test Claimants in the Thin Cap Group Litigation

Case C-524/04, *Test Claimants in the Thin Cap Group Litigation* deals with the UK CFC rules, in this instance with the reclassification of interest as dividend. The right to deduct interest on loan finance is at stake, again, a tax benefit granted to residents only if the direct or indirect parent-creditor was tax resident in the same Member State. In this case, there is a restriction of the free establishment and the means adopted were deemed appropriate to serve the purpose of preventing practices the sole purpose of which is to avoid the tax that would normally be payable on profits generated by activities undertaken in the national territory. The proportionality test has not been passed due to the specific circumstances of the case.

> "74. It follows that, in order for a restriction on the freedom of establishment to be justified on the ground of prevention of abusive practices, the specific objective of such a restriction must be to prevent conduct involving the creation of wholly artificial arrangements which do not reflect economic reality, with a view to escaping the tax normally due on the profits generated by activities carried out on national territory."
> "75. Like the practices referred to in paragraph 49 of *Marks & Spencer*, which involve arranging transfers of losses, within a group of companies, to companies established in the Member States which apply the highest rates of taxation and in which the tax value of those losses is therefore the highest, the type of conduct described in the preceding paragraph is such as to undermine the right of the Member States to exercise their tax jurisdiction in relation to the activities carried out in their territory and thus to jeopardise a balanced allocation between Member States of the power to impose taxes".

3. Oy AA

The Finnish case *Oy AA* deals with a controversial device in Scandinavian law, the so-called group contributions, which even if allowed under tax law, meaning that the deduction may be granted for tax purposes, fact remains that the transaction may still be illegal according to company law rules construed for the protection of creditors and minority shareholders. Unless the subsidiarity is wholly-owned, the principle of equal treatment of shareholdings forbids such a transfer of value from a subsidiary to its parent.

Hence, the object of discussion is a tax benefit that even in cases where it were granted between residents, it would require further considerations in view of its legality. It is the reversed situation compared to *Cadbury*, since the parent is foreign and the subsidiary is resident and a transfer of profits to a different jurisdiction would clearly imply a lessening of the power to tax and the policy in question has a defensive character exactly as in *Marks & Spencer*.

> "62. It should be noted at the outset that the objectives of safeguarding the balanced allocation of the power to impose taxes between Member States and the prevention of tax avoidance are linked. Conduct involving the creation of wholly artificial arrangements which do not reflect economic reality, with a view to escaping the tax normally due on the profits generated by activities carried out on national territory is such as to undermine the right of the Member States to exercise their tax jurisdiction in relation to those activities and jeopardise a balanced allocation between Member States of the power to impose taxes".
> "63. Even if the legislation at issue in the main proceedings is not specifically designed to exclude from the tax advantage it confers purely artificial arrangements, devoid of economic reality, created with the aim of escaping the tax normally due on the profits generated by activities carried out on national territory, such legislation may nevertheless be regarded as proportionate to the objectives pursued, taken as a whole."

It must be clearly understood that in the *Oy AA* case there is no need to prove artificial arrangements, because the conduct concerns transfer of profits obtained in the territory, not elsewhere, an arrangement that touches upon the very core of the power to tax of a sovereign state.

4. SGI

In *SGI* the case is one of a tax benefit granted only in domestic situations, which is related directly with *Oy AA* and *Marks & Spencer* and closely comparable with *Test Claimants in the Thin Cap Group Litigation*

> "66. In that context, national legislation which is not specifically designed to exclude from the tax advantage it confers such purely artificial arrangements – devoid of economic reality, created with the aim of escaping the tax normally due on the profits generated by activities carried out on national territory – may nevertheless be regarded as justified by the objective of preventing tax avoidance, taken together with that of preserving the balanced allocation of the power to impose taxes between the Member States."

The language used in this paragraph is eloquent in its specific context, but its interpretation outside this context has generated quite a lot of confusion.

B) Making non-resident legal persons subject to tax. Combative measures.

5. Cadbury

In *Cadbury*, as opposed to all four cases mentioned above, the measure that must be analysed relates of a tax obligation imposed on activities positioned at least *prima facie* outside the territory of the relevant Member State. In order to bring these activities legitimately inside the scope of the CFC, it is absolutely necessary to prove that the only purpose of the movement was the tax avoidance, thus the movement was fictitious.

Since the notion of establishment in EU law does not cover anything else than a genuine

establishment i.e. the right "*to participate on a stable and continuous basis in the economic life of a Member State other than his own*", the lack of economic substance implies that such a situation is catapulted outside the scope of the Article 49 TFEU, thus no restriction may be deemed to exist in such a case. If there is no restriction, there is no meaning to invoke a justification. (A derivation of *Cadbury* deals with automatic presumptions of abuse that must satisfy further conditions to be compatible with EU law. For such cases I refer to *National Grid Indus* jurisprudence.)

A measure that is designed on the projection of a claim of power to tax the activities of a non-resident, which were not carried out on national territory would be "combative" in character, since it might have the potential to do more than just defending a legitimate share of the pie according to the principle of territoriality. Such measures in themselves may distract the balanced allocation of the power to impose taxes between the Member States, but in the opposite sense of grasping a bigger share than customarily agreed.

What the CJEU in *Cadbury* actually does is not to propose the use of an additional justification as wrongly understood by some analysts, but the paragraph 56 (same as paragraph 75 in Case C-524/04, cited above), which makes reference to paragraph 49 of *Marks & Spencer*, only has a descriptively comparative value. The transfer of losses from a high tax jurisdiction is comparable in regard of its effect with the transfer of profits to a low tax jurisdiction. Legally speaking the two situations are nonetheless not directly comparable. A Member State is free to derogate from its own tax rules in order to give tax benefits to all taxpayers situated in comparable situations, but it is not free to impose obligations on non-residents outside the room of the two golden principles for determining tax jurisdiction: residence and territoriality.

C) Conclusions

In her Opinion of 23 October 2014 to Commission v UK, Case C 172/13, AG Kokott pointed out that despite the various formulations, the CJEU jurisprudence relies on the distinction between resident and non-resident subsidiaries with regard to the allocation of the power to impose taxes between Member States and acknowledges that a non-resident can become subject to tax only in exceptional cases. In this sense, *Cadbury* is a ruling with a narrow scope and therefore I have also placed it in a distinct category (section B).

> "[A company's non-resident subsidiaries] are subject to tax in the State in which the parent company is established solely on the basis of their domestic activity and, if appropriate, in the context of exceptional add-back taxation with a view to combatting abuse" [26].

In the OECD/G20 *Designing Effective Controlled Foreign Company Rules*, Action 3 – 2015 Final Report, one can read a concise examination of *Cadbury* and a series of recommended solutions for the CFC design. This examination is flawed, since it evokes the rulings in *Oy AA* and *SGI* submitting that they would be directly linked to *Cadbury* with the effect of ("arguably") narrowing the stringency of *Cadbury*.

The closest one can come to *Cadbury* is maybe *Nordea Bank Danmark*, where a branch (permanent establishment in Sweden) is transformed into a subsidiary and Denmark, the country where the parent company resides for tax purposes, intended to deny the deduction of losses

incurred before the named transformation, making it conditional on the inclusion of profits obtained in subsequent years in the calculation of taxable income of – at this time – non-resident subsidiary. The profits made by that establishment before its transfer and those resulting from the gain made upon the transfer shall be matched with the losses, according to the principle of symmetry between the right to tax profits and the right to deduct losses.

> "…if a CFC rule treats domestic subsidiaries the same as cross-border subsidiaries, it arguably should not be treated as discriminatory under the case law of the ECJ, and no justification is needed."[p. 18]

Aristotle (384-322 B.C.) enlightened that justice entails treating equals equally and treating unequals unequally. A CFC rule that treats resident subsidiaries and non-resident subsidiaries equally would infer an equal treatment of unequals and the same conclusion can be read even from the jurisprudence of the CJEU.

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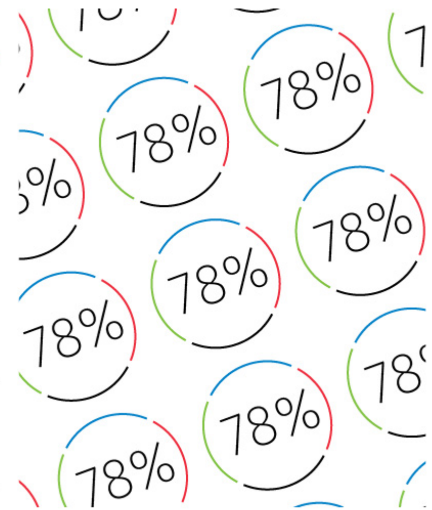

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