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Holding Companies, Beneficial Ownership and EU Fundamental Freedoms

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Some recent decisions of the CJEU (*Eqiom*, C-6/16 of 7 September 2017, and *Deister Holding* and *Juhler Holding*, joint cases C-504/16 and C-613/16 of 20 December 2017) and the conclusions of AG Kokott[1] delivered on 1 March 2018 in the six Danish "Beneficial Ownership Cases" (cases C-115/16, C-116/16, C-117/16, C-118/16, C-119/16 and C-299/16) shed a new light on the possibility for EU holding companies to claim the protection of EU tax Directives and fundamental freedoms.

The principles stated by the Court and by AG Kokott go well beyond the (per se quite crucial) tax regime of intra-EU dividends or interest covered, respectively, by the Parent-Subsidiary Directive (the "PSD") and the Interest-Royalties Directive (the "IRD"). As a matter of fact, those decisions and conclusions offer some crucial guidance in relation to the application of the "beneficial ownership" test and the much debated "abuse of law" concept.

In particular, with reference to the PSD, in *Eqiom* and in *Deister* the CJEU held that:

- Art. 1, para. 2, of the PSD (applicable *ratione temporis* which stated that the PSD "shall not preclude the application of domestic or agreement-based provisions required for the prevention of fraud or abuse") must be interpreted *strictly*, as it constitutes a derogation from the rules established by the directive, and therefore it solely allows the application of provisions that are actually '*required*' for the purpose of preventing tax frauds or abuse;
- EU holding companies cannot be denied the application of the tax exemptions provided for by the Directive as a mere effect of *legal presumptions*;
- The *nature and tax status of the shareholders* of EU holding companies is irrelevant for the purpose of benefiting from the Directive or EU fundamental freedoms (indeed, no "LOB" clause is included in the Directive). In particular, the fact that the shareholders of the holding are non-EU entities, who would not be entitled to benefit from the PSD, does not in itself indicate that the entity is an artificial arrangement; and
- The *mere holding activity* cannot per se indicate the existence of a wholly artificial arrangement, which may lead to denying the protection of the Directive and the fundamental freedoms to the holding company. The fact that such activity is not considered to constitute an *economic activity for VAT purposes* is irrelevant for income tax purposes.

In other words, a *passive holding company* (which does not carry on an economic activity for VAT purposes) *is not per se a wholly artificial arrangement*. On the contrary, such company has in

principle the right to fully enjoy the Directive and the EU fundamental freedoms.[2]

Further guidance can be drawn by the conclusions of AG Kokott on the Beneficial Ownership Cases. Four of those cases addressed the IRD, while the remaining two dealt with the PSD. In all cases, dividends or interest where paid by a Danish subsidiary to a Luxembourg or Cypriot holding company, ultimately controlled by a private equity fund or a non-EU company.

Interestingly enough, in all the cases related to the IRD, AG Kokott started her analysis by pointing out that "the angry political mood concerning the tax practices of certain multinational groups" makes it difficult to *draw a dividing line between the taxpayers freedom* to arrange their affairs in a tax efficient manner and the *need to prevent abuse of law*, as "not every action by an individual to reduce their tax should be open to a verdict of abuse".

AG Kokott first of all examined to what extent the exemption regulated by the PSD and the IRD can be denied to a holding company on the grounds that it cannot be qualified as the beneficial owner of payments.

In relation to the PSD, the conclusions of AG Kokott are quite unambiguous: *the "beneficial ownership" test is simply not applicable to the PSD*, in which the expression "beneficial owner" is never mentioned. Indeed, for the purpose of preventing economic and legal double taxation on profit distributions, "it is irrelevant whether the dividends recipient is also the 'beneficial owner' of the dividends".

The analysis is more articulated for the IRD, which specifically includes a beneficial ownership test. In this respect, AG Kokott concludes that:

- the concept of beneficial owner must be *interpreted under EU law* autonomously and independently of the definitions offered in the OECD treaty models and commentaries;
- the beneficial owner of interest payments is, as a rule, the recipient, i.e. *the person entitled under civil law to demand payment of the interest*;
- however, by way of *exception* to the above rule, the recipient is not the beneficial owner for the purpose of the IRD if it has set up an *open or hidden trust* for the benefit of the actual beneficial owner; and
- a mere *back-to-back arrangement* (through which the recipient refinances its exposure) is not sufficient to assume that a trust relationship exists. However, a hidden trust can be deemed to exist if, due to the back-to-back arrangement, the recipient does not make any minimal *margin* and it is not exposed to any *default risk* (which is entirely borne by a third party).

Therefore, the IRD regime can be denied to a holding company, due to lack of the beneficial ownership element, only under very specific and limited circumstances.

However, even if one were to conclude that, in a specific case, the exemptions regulated by the PSD and the IRD cannot be denied to a holding company by reason of a breach of the beneficial ownership test (due to the fact that such test simply does not apply to the PSD, or because the holding satisfies the relevant requisites), the principle of prohibition of *abuse of law* should still be considered. In fact, the CJEU has always made it clear that the application of a rule of EU law cannot be extended to cover abusive practices by economic operators.

In her conclusions, AG Kokott dwells into the concept of abuse in EU law, analysing the definition

offered by the ATAD1 Directive and the case law of the CJEU. In a nutshell, AG Kokott identifies two "mutually contingent elements": (a) fully artificial arrangements, and (b) the circumvention of tax laws through non-genuine arrangements.

In the opinion of AG Kokott, a *fully artificial arrangement* can be assumed only if the company is merely "a *fictitious* establishment in the form of a 'letterbox' company". Indeed, in case C-115/16 AG Kokott concluded that a holding company with very limited running costs (less than EUR 200,000 per year, mostly for lawyers and accountants) and an almost in-existent structure could not be defined a merely artificial arrangement. The same AG Kokott, in her conclusions in *Eqiom*, stated that a *mere holding company* is not a merely artificial arrangement if: (a) its bodies have the actual *authority to make decisions*, (b) it is sufficiently endowed with *financial means*, and (c) it bears some *commercial risk*.

However, in AG Kokott's view, an arrangement which is not "purely artificial" *can still represent an abuse of EU law*, if it is put in place with the *essential aim* of obtaining a tax advantage.

In this respect, AG Kokott specifies that:

- the fact that either the registered office or real head office of a company was established in accordance with the legislation of a Member State for the *purpose of enjoying the benefit of more favorable legislation* does not, in itself, constitute abuse. Apart from in the case of a wholly artificial arrangement that does not reflect economic reality, Union citizens cannot be deprived of the possibility of relying on the provisions of the Treaty because they have sought to profit from tax advantages in force in a Member State other than their State of residence; and
- a withholding tax is a *tax levied on the recipient* of the interest and it is simply a particular taxation technique, rather than a type of tax, intended essentially to secure (minimum) taxation of the interest recipient. Therefore, a transaction is abusive if it allows to avoid the taxation of the interest in the *State of the recipient*.

In light of the foregoing, AG Kokott concluded that *no abuse of law could be envisaged in the interposition of the Luxembourg or Cypriot entities*, either in relation to the circumstance that the interest was actually subject in Luxembourg to a minimal taxation (as the deductibility of the interest on the back-to-back arrangement was recognized),[3] or that Cyprus does not apply any withholding tax on dividends distributed to non-EU shareholders.

Rather, a risk of abuse could derive if the entity controlling the Luxembourg holding company were located in a country not granting an adequate *exchange of information* with the State of residence of the ultimate interest recipient. What matters, in AG Kokott's view, is that the transaction does not jeopardize the possibility of a correct taxation of the income in the State of the recipient.[4]

The decisions of the CJEU on the six Danish "beneficial ownership cases" are expected to be published in the next few weeks. If the CJEU were to confirm AG Kokott's analysis, those decisions would not only provide an essential guidance on the application of the "beneficial ownership" test in EU law, but they would also offer fundamental indications, in addition to the decisions in *Eqiom* and in *Deister/Juhler*, in order to distinguish when an "intermediate" holding company is a legitimate tool and when, on the contrary, the interposition of a holding represents an abusive arrangement.

In particular, extremely important, in consideration of the principles of legal certainty and legitimate expectation, are the clarifications given to the concept of “fully artificial arrangement”, whose interpretation has always been quite debated between taxpayers and tax administrations,[5] as well as to the relevance of an actual exchange of tax information among tax administrations (and, specifically, with the State of the recipient), in order to ascertain the possible abusive nature of a transaction.

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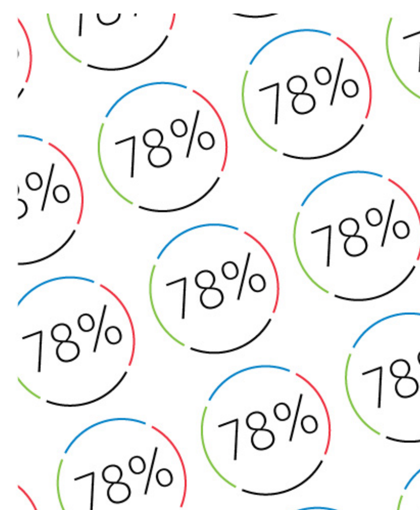

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References[+]

Specifically, the Court held that a lack of substance (in terms of premises and personnel) is normal

for holding companies, as they do not require such elements to carry out their business purpose. Rather, the Supreme Court considered other elements as decisive, such as the fact that: (i) the company is potentially entitled to retain and use the income received, and (ii) the key management decisions necessary for the conduct of its business are made in the contracting state in which it is established. **?3** Opinion of AG Kokott delivered on 1 March 2018 in case C-115/16, CJEU, para. 84: "Any such actual minimal taxation or non-taxation is a consequence of the tax autonomy of each State. If fiscal competition between Member States is admissible under EU law due to the lack of harmonisation of income taxes, a taxable person cannot be blamed for availing himself in reality (i.e. not just on paper) of the tax advantages offered by certain Member States". **?4** Opinion of AG Kokott delivered on 1 March 2018 in case C-115/16, CJEU, para. 89: "Any such complaint of abuse might, in turn, be invalidated if the capital funds provide the relevant tax information to the investors' States of residence or if the information in question is available to the State of residence of the capital funds and they forward the information to the relevant States". **?5** Such concept, frequently mentioned by the CJEU since *Cadbury Schweppes*, has also been introduced in some domestic tax provisions (e.g. Art. 167, para. 8-ter, of the Italian income tax code), whose interpretation should also be compliant with the interpretative principles set forth by the CJEU.

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