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Covid-19 Aids: Difficult Time for Tax-haven Companies?

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In a moment of crisis like the one provoked by the Coronavirus, the problems of tax avoidance and tax evasion become particularly relevant, even more when they are blamed for cutting national resources to ride out the crisis and save millions of lives. Experts and activists in many countries are appealing to governments to go after offshore companies, excluding them from the benefit of national Covid-19 tax measures.

In this spirit, some countries like Belgium, France, Denmark and Poland have clearly excluded from Covid-19 tax benefits companies having a link with or registered in tax havens.

But what is the definition of tax haven they are referring to? And to what extent is the defensive measure mentioned above in line with the EU freedom of capital? The last question will be answered also in the view of the recent recommendation of the European Commission on the matter (C(2020) 4885 final).

The answer to the first question lies in the blacklisting criteria that each country has adopted nationally or at the EU level (via the EU tax haven blacklist). By reading the text of the measure, it is not always clear whether the term "tax haven" is based on the national or the EU blacklist. Therefore, it is not evident whether companies located in Member States publicly blamed for their aggressive tax policy ("EU tax havens") are also exempted from the benefit. On the one hand, in the case of a negative answer, it becomes difficult to justify the mindset of different treatment between companies located in an "EU tax haven" and companies located in a non-EU tax haven. On the other hand, in the case of equal treatment, it should be wondered whether a policy of listing and shaming, rather than harmonization and supra-national coherence, is really the most accurate within our Union.

Let's answer the second question. Focusing on Belgium, it has implemented the one-off tax losses carryback and the recovery reserve tax benefits in order to prop up companies' liquidity in the country. Companies making annual payments exceeding EUR 100,000 to tax havens without business purpose, and companies holding interest in entities located in tax havens are excluded from the two favorable measures. Such a political decision is questionable under legal scrutiny. The most relevant point lies in the absence for companies holding an interest in an entity located in a listed tax jurisdiction to prove the economic reasons justifying such an interest. This is not only nationally discriminatory compared with companies making payments to tax havens (for which the mentioned possibility is allowed), but it may also violate the EU freedom of capital[1].

Quoting the ECJ, "the exclusion of a cash-flow advantage in a cross-border situation when it is

granted in an equivalent situation on national territory constitutes a restriction on the free movement of capital" (*Danish* cases, *Sofina* case). At the same time, it is undoubted that such a freedom is not absolute and that exceptions can be justified. And considering the risk of tax evasion, tax avoidance and lack of exchange of information that tax havens may imply, a measure denying tax benefits to companies holding an interest in an entity in a tax haven could be justified. Particularly relevant could be the justifications for protection of national law and for effective fiscal supervision.

However, justifications must be tested against suitability and proportionality. According to ECJ case law (for example, the *SIAT* case), when a defensive measures against a taxpayer linked to a blacklisted country is suitable, it can be also considered proportionate if it makes reference to the artificiality of the arrangements put in place. This implies that the tax authority must "prove prima facie evidence of tax evasion or avoidance", while the taxpayer must have the possibility to prove the contrary.

With regard to the need for effective fiscal supervision, a check on the actual need for information and on the actual denial of the same by the blacklisted country is needed (*Haribo Lakritzen* case). Considering that not all jurisdictions are listed on the basis of refusal to exchange relevant information (indeed, others are also the criteria for being blacklisted, e.g. ring-fenced preferential tax regimes), it could be the case that a country is blacklisted even though it has signed and enforced agreements on exchange of information with the EU or with (some of) its Member States.

Being aware of the relevance of Covid-19 tax aid measures not only from a justice perspective, but also from a financial one, EU Member States should find solutions in order to pursue their legislative goals in line with the EU legal principles they committed to. Countries could make their new tax measures in line with EU law simply by: i) implementing a substance test in the national provision; or ii) stating conditions such as to include only situations where the participation has definitive influence (for example, specifically referring to relatively high ownership percentage – e.g. 40% – or effective control of the holder) (*Intelcar* case, *Kronos* case, *Eqiom* case, *Glaxo Wellcome* Case, *KBC Bank* and *BRB Nv* case; *Burda* case). In this way, the EU freedom of capital would not be applicable anymore and the measure would be safe from EU infringement

Similar conclusions seem to be reported by the European Commission in its recent recommendation.. Through all the points addressed, it seems that the Commission agrees on and supports the intention of Member States to make any Covid-19 financial supports conditional on the absence of links to non-cooperative jurisdictions.

However, the Commission carefully highlights some crucial elements. First, when referring to companies not entitled to the benefit, it uses the term "control". Therefore, it seems that the Commission stresses the relevance of control through the holding, implying exclusion of participation by which no definitive influence is exercised by the holder. This is coherent with the point highlighted before, according to which only participation with effective control can be excluded without breaching the EU freedom of capital.

Second, the Commission stresses the necessity that "Member States protect genuine economic activities in listed non-cooperative jurisdictions and guarantee that those economic activities are not inadvertently affected". This means that "Member States should include appropriate exceptions in their laws, in order to ensure that financial support not be prevented where there is real economic activity". Economic substance should be tested by means of specific criteria, such as

"staff, equipment, assets and premises, as evidenced by relevant facts and circumstances". Although the Commission added that the carve-out should not apply when the Member State is not in the position to verify the accuracy of the information (for example, because the other jurisdiction refuses to exchange information), it should be assumed that this could not, in any way, be a detrimental limitation to the right of the taxpayer to prove genuine features of its economic activity, as in line with ECJ case law. This will ensure proportionality in a well-done measure.

Attention to proportionality seems to be shown by the Commission when it suggests Member States to disregard the existence of links to the listed non-cooperative jurisdictions, when the undertaking provides evidence that one of the following circumstances is met: i) the undertaking makes legally binding commitments to remove its ties to EU listed non-cooperative jurisdictions within a short timeframe, subject to appropriate follow-up and sanctions in case of non-compliance; ii) the level of the tax liability in the Member State granting the support over a given period of time is considered adequate when compared to the overall turnover or level of activities of the undertaking receiving the support, at domestic and group level, over the same period. This last point is particularly interesting and recalls the conclusions reached by the General Court of the European Union when recently deciding on the Apple case (Press Release no. 90/20). By annulling the decision of the Commission, the Court declared the absence of any advantage for the company. In practical terms, this means that Apple's level of tax liability in Ireland can be considered adequate and comparable to the one owned by similar companies in the country. Thus, no factors can invite chastisement on the company (or the country).

To conclude, the intention to use national resources to help only resident companies paying their fair share of taxes is reasonable. However, countries should enforce a system able to properly distinguish tax avoiders and evaders from the rest. A mistake in this distinction would force genuine companies to bankruptcy, where any claim for their rights would come too late.

[1] The reference to the freedom of capital is based on the assumption that the blacklisted countries referred to by the Covid-19 tax measures are third countries (to which the EU freedom of capital is the only applicable). If also Member States accused for their aggressive tax policy are included in the exception, then the EU freedom of establishment might be applied as well. However, this would not change the final conclusions on the proportionality test here provided, particularly due to the lack of a substance test. Some additional ECJ jurisprudence would be relevant in this case, for example the *Test Claimants* case (C-524/04) ¶82 and the *Danish* cases (C?115/16, C?118/16, C?119/16 and C?299/16).

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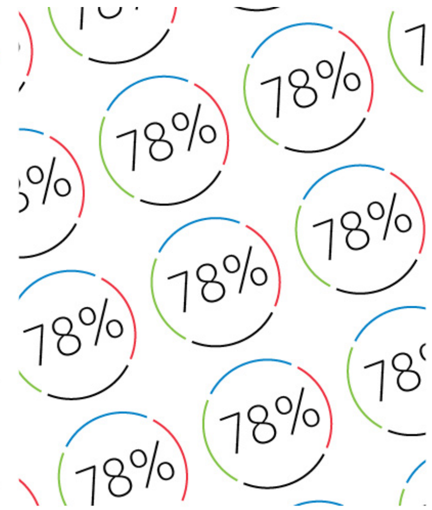

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