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The Prohibition of Abuse of Rights after the ECJ Danish cases

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Analysis of the ECJ judgments, reading by national courts, and impact on tax treaty practice

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Since they were delivered in 2019, the judgments of the ECJ in the *Danish cases* have been widely discussed by commentators. Yet, the authors feel that the topic now deserves further scholarly attention for the following main reasons. First of all, national courts of Member States (in particular Belgium, France, Italy, the Netherlands, and Spain) have recently referred to the indicators of abuse provided by the ECJ in alleged cases of directive shopping. Moreover, the Federal Supreme Court of a third country, Switzerland, has also relied on the findings of the ECJ in a case involving the Swiss-EU Agreement partially providing equivalent benefits to those of the parent-subsidiary and interest royalty directives. Secondly, the question of the possible ramifications of the *Danish cases* in tax treaty practice (like for example recent Spanish decisions have shown) is obvious from both the perspective of the principal purpose test (PPT) and the beneficial ownership limitation applying to dividends, interest, and royalties. It is therefore an appropriate time to consider the practical and possible long-term impact of the Danish cases on international tax practice. Last but not least, on 3 May 2021, the High Court of Eastern Denmark delivered its judgments on the "dividend cases" which had been referred for a preliminary ruling to the ECJ (C-116/17 and C-117/17).

Building on a seminar organized in September 2020 by the Tax Policy Center of the University of Lausanne (Switzerland), this forthcoming *Intertax* article explores the foregoing issues. A comparative approach is adopted whereby the Danish cases are contrasted not only with EU law and past judgments of the ECJ but also with tax treaty law and practice, including the customary rules of interpretation of the Vienna Convention on the Law of Treaties (VCLT).

The first part of the article is devoted to a comparison of the origins and effects of the prohibition of abuse of rights under EU and tax treaty law. The authors submit that there is a fundamental difference between the EU principle of abuse of rights (insofar as it forms part of EU primary law) and what is described as the inherent prohibition of abuse under tax treaty law. That latter principle is indeed merely an interpretative tool which remains subject to the limitations imposed by the VCLT. That distinction is particularly relevant with respect to ongoing disputes involving tax treaties not containing a general anti-avoidance rule such as the PPT. For tax treaties incorporating

a PPT (in particular post-BEPS tax treaties), on the other hand, the convergence of the indicators of abuse provided by the ECJ with the 2017 OECD commentaries dealing with conduit situations is obvious.

The second part of the article engages in a comparative and critical analysis of the so-called two-pronged abuse test under EU and tax treaty law. The authors contrast, in particular, the evolution of the ECJ's case law with its findings in the Danish cases as well with the OECD commentaries and tax treaty practice. The authors submit that the findings of the ECJ in the Danish cases remain clearly rooted in the *Emsland-Stärke* two-pronged test. Therefore, even if the EU principle of abuse rights sits on top of secondary legislation, such a principle cannot override a directive provision (including a specific anti-avoidance rule) when it is established that the object and purpose of such a provision is not defeated. For this reason, the authors insist on the fact the subjective and objective elements of the abuse of rights test must always be considered separately and cannot be merged into one. The authors submit that the Danish cases have not affected the settled case law of the ECJ on this point. Stated differently, it is one thing to establish that the principal purpose (or one of the principal purposes) of a corporate structure is to obtain a tax benefit. It must however additionally always be established that such a structure defeats the object and purpose of the provisions of a directive. That conclusion also applies for tax treaty purposes, in particular under the so-called *"guiding principle"* and the PTT. The compatibility of domestic anti-avoidance rules with tax treaties is thus subject to this two-pronged test. The *Alta Energy* case currently pending before the Supreme Court of Canada is also illustrative of the need to maintain that distinction.[7] Next, a more concrete perspective is taken, and the impact of the indicators of abuse provided by the ECJ in practice is considered. In this respect, a distinction is drawn between wholly artificial /sham arrangements, on the one hand, and real arrangements with tax motives, on the other hand. Finally, it is quite clear that the finding of an abusive practice implies that the transaction at stake must be redefined so that benefits that would have been applicable in the absence of abuse remain available. The ECJ did not deal with this latter issue in the *Danish cases*. However, this conclusion that was affirmed by the ECJ on numerous occasions and flows from the EU principle of proportionality remains applicable in the framework of direct tax directives. Similarly, nothing prevents a state from proceeding accordingly under a tax treaty even in the absence of a provision comparable to Article 7(4) MLI.

The third part of the paper deals *inter alia* with the relevance of the beneficial ownership limitation in the PSD (i.e. whether it can be regarded as an implicit requirement), the interpretation of this requirement following the additions made in the 2014 OECD Commentary, and its relationship with the prohibition of abuse of rights. It remains unclear whether the findings of the ECJ in the PSD cases should be read to mean that beneficial ownership represents an implicit requirement that would apply separately from the abuse of rights principle. The French Supreme Administrative Court has read the findings of the ECJ in such a way while, on the other hand, the Swiss Federal Supreme Court has left the question open. An equally important question is the level of convergence between the meaning of beneficial ownership favoured by the ECJ in the IRD cases and that under the 2014 OECD Commentary. Here we consider recent court decisions which have dealt with the 2014 commentaries (in particular in Switzerland) and, on the basis of these decisions, find that an analysis of beneficial ownership taking into account the existence of a legal or contractual obligation to pass on the income received derived from the facts will, in most instances, not be so far apart from an economic interpretation of beneficial ownership as favored by the ECJ in the IRD cases. Whether that reading is fully in line with the interpretation conveyed by the 2014 OECD commentaries will need to be clarified. This question is also important as regards the delineation between beneficial ownership and the prohibition of abuse.

The authors conclude that the *Danish cases* undoubtedly represent an important milestone with respect to the prohibition of abuse of rights not only in EU but also in international tax practice. In light of the increased convergence between the EU principle of abuse of rights and OECD standards (in particular, the PPT), there is little doubt that the indicators of abuse provided by the ECJ in conduit situations involving dividends, interest, and royalties will also have ramifications in post-BEPS tax treaty practice.

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