Advocate General Kokott opines in the Danish "beneficial ownership"-cases

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Kromann Reumert's tax group represents several international groups and private equity funds in lead cases concerning interest and dividend withholding tax (WHT), currently pending before the Court of Justice of the EU (CJEU) for preliminary rulings. On 1 March 2018 Advocate General Kokott issued her opinions in the cases.

The matters and the preliminary questions

The cases are commonly referred to as "beneficial ownership-cases". The interest cases are covered by the EU Interest and Royalties Directive (2003/49/EC). This Directive is designed to eliminate withholding taxes on cross-border interest payments within a group by abolishing withholding taxes on interest payments arising in an EU member source state. It is a condition under the Directive that the "beneficial owner" of the payment is a company or permanent establishment in another member state. One of the central questions the CJEU is asked to rule on is therefore the definition of “beneficial owner” in the Directive.

The dividend cases are covered by the EU Parent Subsidiary Directive (90/435/EEC). The objective of this Directive is to exempt dividends and other profit distributions paid by subsidiaries to their parents from withholding taxes, etc. There
is no beneficial ownership requirement in the Parent Subsidiary Directive.

In the preliminary cases, the Danish Ministry of Taxation argues that parent companies in other EU member states receiving dividend and interest cannot benefit from the directives because the companies are allegedly conduit companies, even though they have civil law claims to the payments.

Both directives offer member states the option of applying domestic or agreement-based provisions for the prevention of fraud or abuse. Denmark had not implemented any such measures in the relevant income years, nor did general Danish anti-abuse regimes (the Danish principles concerning “substance over form” and concerning the rightful recipient) offer basis for disregarding the dividend and interest payments. The referring Danish High Court specifically confirms this in the referral decisions to the Court of Justice.

Interest WHT cases

The notion of beneficial ownership

Advocate General Kokott maintains that a company resident in another member state than Denmark is, in principle, the beneficial owner within the meaning of the Directive, if the company owns the interest-bearing claim and fulfils the other criteria under the Directive. The situation would be different only if it was acting not in its own name and on its own account, but for and on the account of a third party. The Advocate General thus emphasizes that the civil law claim to interest is decisive.

According to the Advocate General, the concept of beneficial owner must be interpreted under EU law autonomously and independently of the commentaries on Article 11 of the 1977 OECD Model Tax Convention or subsequent versions. The OECD member countries would otherwise be able to decide on the interpretation of an EU Directive.
In relation to the EU Interest and Royalties Directive where there is a beneficial ownership requirement, the Advocate General’s conclusions are laudable and necessary, in terms of legal certainty. In particular, the OECD Model Tax Convention and the commentaries published after the adoption of the Directive have undergone a very dynamic interpretation, giving the concept a different scope from the one assumed at the time when the Directive was adopted.

Member states are obliged to identify the beneficial owner

The Advocate General also derives from the Interest and Royalties Directive that member states that do not wish to recognise a company resident in a different member state as the beneficial owner must state whom it considers to be the beneficial owner in order to assume that abuse exists.

This finding should be seen in the light of another important conclusion by the Advocate General, namely that in order for abuse of possible legal arrangements to exist, a legal arrangement must be chosen that differs from the arrangement normally chosen and that gives a more favourable result than the ‘normal’ arrangement.

Consequently, abuse can only arise if interest disbursed directly would have been taxed accordingly in Denmark, but not if, e.g., the ultimate beneficial owner can invoke a double taxation agreement and thus be exempt from withholding taxes.

Read the preliminary questions and opinions

The opinions in the interest WHT cases can be accessed here: C-115/16, C-118/16 and C-119/16.

The full sets of questions can be read here: C-115/16, C-118/16 and C-119/16.
The Danish Ministry of taxation acts as applicant in the dividend cases before the Danish Eastern High Court, having lost already before the Danish National Tax Tribunal and subsequently appealed to the Danish courts. Notably, the Tax Tribunal found that the involved parent companies were entitled to invoke the Parent Subsidiary Directive already because they fulfil the objective criteria under the Directive. In this regard, the Tribunal pointed out that the Directive does not contain a beneficial ownership requirement and consequently, no beneficial owner assessment is required.

The Advocate General concurs with the Danish Tax Tribunal in this regard, stating that the Parent Subsidiary Directive follows a different approach than the Interest and Royalties Directive. The Parent Subsidiary Directive abstains from using the notion beneficial owner and this is a conscious choice. Consequently, a parent company domiciled in another member state receiving dividends from its Danish subsidiary must be considered as the dividend recipient covered by the Parent Subsidiary Directive.

If the CJEU were to back the Danish tax authorities' interpretation, it could potentially be very damaging for funds operating out of Luxembourg, including the many funds establishment there for reasons not related to tax. It could also create uncertainty more generally within the internal market, concerning source taxation.

**Read the opinions**

The opinions in the dividend WHT cases can be accessed here: C-116/16 and C-117/16.

The full sets of questions can be read here: C-116/16 and C-117/16.

**Joint questions**

Facultative anti-abuse rules in directives cannot have
direct effect

Both Directives offer member states the option of applying domestic or agreement-based provisions for the prevention of fraud or abuse. Denmark had not implemented any such measures in the relevant income years, nor did general Danish anti-abuse regimes (the Danish principles concerning “substance over form” and concerning the rightful recipient) offer basis for disregarding the dividend and interest payments. As mentioned, the referring Danish High Court specifically confirms this in the referral decisions to the Court of Justice.

According to the Advocate General, Denmark cannot rely on the right for member states to voluntarily implement anti-abuse provisions, if it has not transposed any such provisions. This in line with already established case-law on direct effect. A rule in a double taxation agreement corresponding to Articles 10 and 11 of the OECD Model Tax Convention also cannot be treated as sufficient transposition. These OECD provisions contain beneficial ownership requirements concerning dividend and interest payments.

The concept of abuse in EU law

According to the Advocate General, the concept of beneficial owner is not addressed primarily at anti-abuse. In particular, the Advocate General points out, the involvement of a trustee is not necessarily abusive.

Concerning the definition of the concept of abuse under EU law, the Advocate General refers to the Directive laying down rules against tax avoidance practices (ATAD/Directive 2016/1164), which was not yet in force in the years at issue. The criterion there is whether a non-genuine arrangement has been put into place for the main purpose or one of the main purposes of obtaining a tax advantage that defeats the object or purpose of the applicable tax law. According to Article 6(2), an arrangement is regarded as non-genuine to the extent that it was not put into place for valid commercial reasons which reflect economic reality.
According to the Advocate General, two requirements must be fulfilled for an arrangement to qualify as abusive. First, in the case of direct disbursement, tax must be chargeable in Denmark. Second, there must be a risk that the income will not be caught in the actual state of receipt and thus will not be taxed. If, therefore, one reason for choosing a particular business structure is to pay interest to investors via a third country in order to prevent their states of residence from obtaining information on their income, then that overall arrangement should, in the Advocate General's opinion, qualify as abuse of law. However, the Advocate General also notes, any such complaint of abuse might, in turn, be invalidated.

Comments and next step

Advocate General Kokott offers an analysis in line with already established case-law, coupled with the following introductory remarks:

"In light of the angry political mood concerning the tax practices of certain multinational groups, drawing that dividing line is no easy task for the Court of Justice and not every action by an individual to reduce their tax should be open to a verdict of abuse."

This must be read as a word of caution from the Advocate General to the CJEU not to just give in to the prevailing political sentiment, but to stick to the basic European internal market rights and a proper construction of the EU Directives.

The preliminary judgments will likely be delivered sometime later this year, upon which the Danish court proceedings will resume.