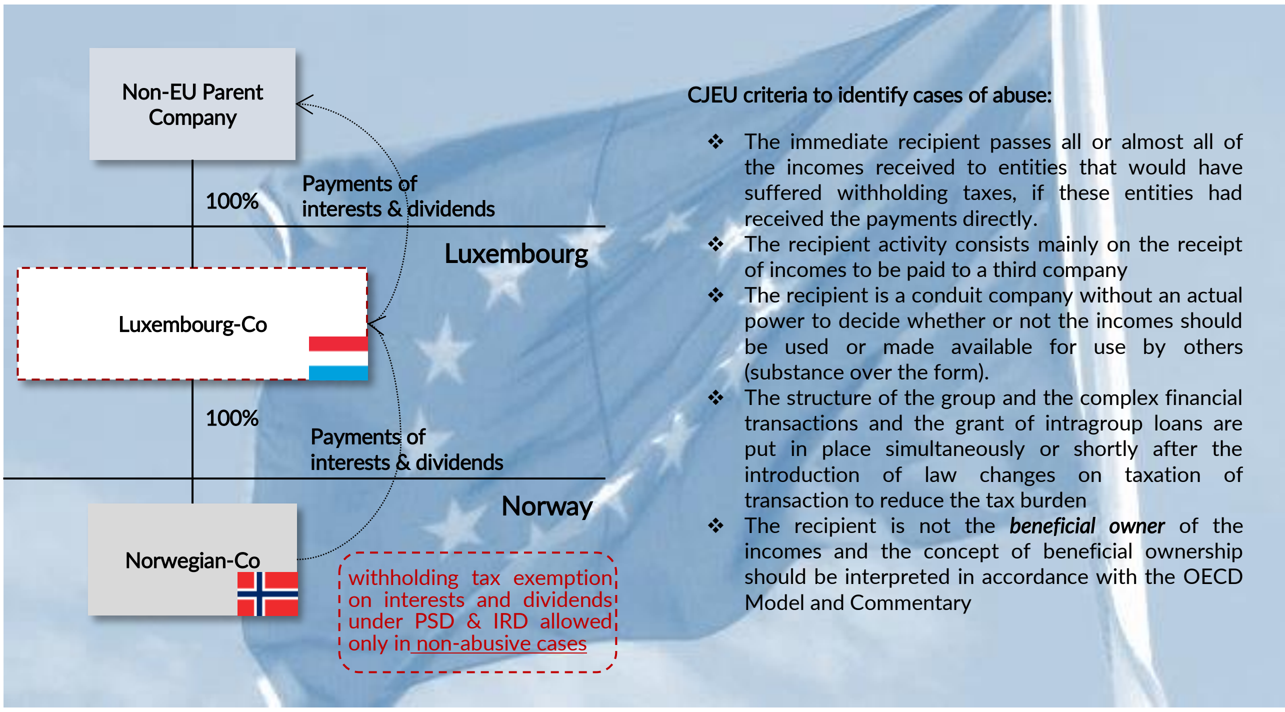
International tax planning and structuring – issues to be considered to avoid risks

EU Court of Justice clarifies the cases where the legal constructions are abusive of EU Directives



Important interpretation of the EU Court of Justice on the artificial legal constructions to reduce the taxation of group

In a group of company and under certain conditions interests, royalties and dividends paid by an European company (EU-Co) to another EU-Co are not subject to withholding taxes, in accordance with the rules of *Parent & Subsidiary* (PSD) and *Interest & Royalties* (IRD) Directives. The benefits of these rules are legally applied in group of companies, but it is extremely important to ascertain if the transactions are eligible for the benefit, in order to avoid to trigger risks connected with abusive behaviours. International tax planning and structuring are essential components for a successful business and most of the tax strategies leverage also PSD and IRD Directives, but it is crucial to avoid to trigger risks related to the wrong interpretation of the mentioned Directives. Therefore, within the scope of these EU Directives, the concept of abuse should be very clear to avoid aggressive tax planning or unexpected risks. In this respect the interpretation principles rendered by the Court of Justice of the European Union (CJEU) on February 26th, 2019 are extremely important (see IRD [joined Cases C-115/16, C-118/16, C-119/16 and C-299/16,]() see PSD [joined Cases C-116/16 and C-117/16]()).

With these cases the CJEU identified the criteria for assessing if the flow of dividends and interests, paid by an EU company to another, is qualified to obtain withholding exemption under the mentioned Directives.

Cases background

The CJEU judgements are related to flow of interests and dividends paid to recipient company based in EU, without deducting any tax at source and paid, all or almost, to entities that would have suffered withholding taxes, if these entities had received the payments directly. The withholding exemption was claimed under the PSD & IRD.

CJEU criteria to assess whether a transaction is abusive

The Court clarified important aspects on the interpretation and application of the Directives:

- first of all the CJEU stated that Member States must, in the event of evasion, avoidance or abuse, withdraw the benefits of the directives, even in the absence of domestic anti-tax avoidance provisions, because denying the benefit represents just the application of general principles of EU law and so does not infringe the principle of legal certainty, in case of abuse;

- the proof of an abusive practice requires, first, a combination of objective circumstances in which, despite formal observance of the conditions laid down by the EU rules, the purpose of those rules has not been achieved and, second, a subjective element consisting in the intention to obtain an advantage from the EU rules by artificially creating the conditions laid down for obtaining it;
- the examination of a set of facts is therefore needed to establish whether the constituent elements of an abusive practice are present, and in particular whether economic operators have carried out purely formal or artificial transactions devoid of any economic and commercial justification, with the essential aim of benefiting from an improper advantage.

Set of constituent elements of an abusive practice

The CJEU identified the following as constituent elements of abuse:

- The immediate recipient passes all or almost all of the incomes received to entities that would have suffered withholding taxes, if these entities had received the payments directly;
- The recipient activity consists mainly on the receipt of incomes to be paid to a third company;
- The recipient is a conduit company without an actual power to decide whether or not the incomes should be used or made available for use by others (substance over the form);
- The structure of the group and the complex financial transactions and the grant of intragroup loans are put in place simultaneously or shortly after the introduction of law changes on taxation of transaction to reduce the tax burden;
- The financial transactions generate flow of income within the group with the purposes of transferring profits from a profit-making company to holding (sub-holding) companies to avoid or reduce the taxation of the group;
- The “beneficial owner” of a flow of income is not the recipient of the flow, but a conduit company
- The concept of beneficial ownership should be interpreted considering the OECD Commentary.

Next steps

Groups of companies should verify and monitor if their international structure and the related flow of income give rise to abusive practices, considering the mentioned criteria. In case of tax planning or structuring strategies, potential risks of abusive practices should be soon identified as well as all the changes in the company organization with impacts on the tax approaches. The intercompany passive incomes are more and more under the tax authority scrutiny, so an assessment of potential risks should be regularly done. We observe that most of international group structures with flow of funds from EU subsidiaries to parent companies when the ultimate parent is resident in a non-EU country ought to review their tax approaches. (*)

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