

THE ADVANCED DIPLOMA IN INTERNATIONAL TAXATION

June 2024

MODULE 3.01 – EU DIRECT TAX OPTION

ADVANCED INTERNATIONAL TAXATION (THEMATIC)

TIME ALLOWED – 3¼ HOURS

This exam paper has **three** parts: **Part A**, **Part B** and **Part C**.

You need to answer **five** questions in total. You will **not** receive marks for any additional answers.

You must answer:

- **Both** questions in **Part A** (25 marks each)
- **One** question from **Part B** (20 marks)
- **Two** questions from **Part C** (15 marks each)

Further instructions

- All workings should be made in appropriate monetary currency, unless otherwise stated. Any monetary calculations should be made to the nearest whole unit of currency. Any necessary time apportionments in your calculations should be made to the nearest whole month.
- You must provide appropriate line breaks between each question, and clearly indicate the start of each new question using the formatting tools available.
- Marks may be allocated for clarity of presentation of your answers.
- The time you spend answering questions should correspond broadly to the number of marks available for that question. You should therefore aim to spend approximately half of your time answering Part A, and the other half answering questions in Parts B and C.
- There is no separate reading time, so you can start typing your answers as soon as the exam begins. However, we recommend that you set aside some time to thoroughly read each question and plan each of your answers.

PART A

You are required to answer BOTH questions from this Part.

1. On 1 December 2020 Company A, resident in Member State A, paid the following:

- a) A bonus for its services to Person B, who was one of the managing directors. Person B is resident in a state outside the EU, with which Member State A has no double tax agreement.

When Company A sought to deduct this bonus from their taxable base, the tax authority of Member State A rejected this request, citing the law of Member State A which states that “bonuses and other gratuitous advantages may not be deducted when paid to non-resident beneficiaries, if they are deemed disproportionate and unrelated to the economic benefit of the services”.

Person A complains that the law of Member State A is incompatible with EU law.

- b) Dividends to individual shareholders who are residents in Member States X and Z. Member State A has applied a 5% withholding tax to those dividends. Member State X has provided a credit for the withholding tax imposed by Member State A, whereas Member State Z has not relieved the double taxation arising.

The shareholder in Member State Z complains that the withholding tax imposed by Member State A is contrary to EU law.

- c) Interest to parent company LOL, resident in Member State F, for a loan which LOL had provided to Company A. The tax authority of Member State A does not allow for the deduction of the interest, on the basis that LOL is not the beneficial owner of the interest and will likely pass on the income to another company in a third state.

1) You are required to explain whether the domestic rules at issue in (a) and (b) are compatible with EU law. (17)

2) Can Member State A refuse to deduct the interest in (c)? If so, on what basis? (8)

Total (25)

2. Company X, resident in Member State A, is part of a multinational group of companies established in a third country. The European regional head of the group, Company Z, is established in Member State B and indirectly owns the entirety of Company X, as well as Company Y, established in a European Economic Area (EEA) country.

In 2022 Company X had transferred certain intellectual property rights relating to its products to Company Y. In 2023, Company X transferred to its parent, Company Z, its shares in a subsidiary established in a third country.

Under Member State A’s domestic legislation, group transfers are tax neutral when they take place between companies established in Member State A, but corporate tax on the capital gain is immediately due when the transferees are established outside Member State A. No option for deferral or payment in instalments is provided.

The chief financial officer of Company Z believes this contradicts EU law and seeks your advice.

You are required to prepare a report, including your assessment of whether the group transfer rules in Member State A are compatible with EU law. In particular you are required to discuss the scope of the fundamental freedoms, the correct comparator in establishing discrimination, and the proportionality of discriminatory taxation of capital gains. (25)

PART B

You are required to answer ONE question from this Part.

3. Member State A has enacted the “interest barrier” under Article 4 of the Anti-Tax Avoidance Directive (ATAD) by choosing, per ATAD Article 4(1), a fixed ratio rule of 30% of a taxpayer’s earnings before interest, taxes, depreciation and amortisation (EBITDA). In addition, Member State A has exercised the option of a group ratio rule (i.e. the group EBITDA escape clause under ATAD Article 4(5)(b)).

Company A is resident in Member State A and a member of a consolidated group that also includes companies B and C, both resident in other EU member states. Those three companies have the following EBITDAs and exceeding interest expenses, all of which are borrowing costs vis-à-vis third parties:

	<u>Company A</u>	<u>Company B</u>	<u>Company C</u>
EBITDA	100	200	100
Net Interest Expense	40	80	40

You are required to answer the following questions:

- 1) **How much interest will be deductible by Company A, if calculated only under the fixed-ratio rule?** (5)
- 2) **How much interest will be deductible by company A, if calculated under the group-ratio rule?** (5)
- 3) **What is the economic rationale for the group-ratio rule, in light of the OECD BEPS Project?** (5)
- 4) **Could Member State A enact a stricter interest limitation rule than the one provided by the ATAD? If so, what might such a rule consist of?** (5)

Total (20)

4. Mrs X has recently retired, having worked for 35 years as a public sector employee in Member State A where she paid social security contributions. Upon her retirement she receives a pension from the public sector pension fund in Member State A, which remains her state of residence. The pension is her only income.

Mrs X is considering moving permanently to Member State B, where she already owns a house that she purchased before her retirement. She does not plan to take up any work in Member State B, as her pension from Member State A is sufficient to provide her with a comfortable standard of living.

According to the double tax agreement between Member State A and Member State B, pensions for previous work in the public sector are taxable only in Member State A.

Furthermore, the law in Member State A provides for progressive taxation for pensioners who are residents of Member State A and are subject to tax on their worldwide income; the applicable rate for Mrs X’s pension income is 25%. For non-residents receiving pensions from previous employment in the public sector in Member State A, the law provides for a special regime according to which pension income is taxed at a flat final withholding rate of 35%.

Mrs X is concerned that, upon moving to Member State B, her tax obligation in Member State A may increase. She approaches you to find out whether she can rely on the EU fundamental freedoms and move to Member State B without becoming subject to a more burdensome level of taxation.

You are required to prepare a report explaining whether Mrs X can rely on EU law in order to be taxed in the same way as tax residents of Member State A, in the event that she moves her tax residence to Member State B. (20)

PART C

You are required to answer TWO questions from this Part.

5. **What are the three types of exchange of information available to EU member states in the Directive on Administrative Cooperation (Directive 2011/16/EU)? What does ‘foreseeable relevance’ mean in the context of Article 1(1) of the same Directive, and is it a condition for all exchanges of information?** (15)

6. **You are required to examine whether Article 107(1) of the Treaty on the Functioning of the European Union (the state aid provision) includes an EU arm’s length principle that must be applied by all member states.** (15)

7. **You are required to describe the role of the European Commission and of the Court of Justice of the European Union in the development of EU direct tax law.** (15)

8. **You are required to describe the main features of the 2017 EU Dispute Resolution Directive (DRD), compare it with the dispute resolution mechanism contained within the Arbitration Convention, and make an assessment of the DRD’s effectiveness in its initial years of implementation.** (15)