THE ADVANCED DIPLOMA IN INTERNATIONAL TAXATION

June 2023

MODULE 3.01 – EU DIRECT TAX OPTION

SUGGESTED SOLUTIONS

PART A

Question 1

Report submitted to the Government of Member State A

From: ADIT Candidate
Subject: Compatibility with Eu law of the different methods for calculating income from real property

Summary of the facts and relevant issues

The proposed legislation provides for two methods for the calculation of the taxable income in member State, depending on the availability of information. For the immovable property that is situated in Member State A, it is proposed to use as basis for the calculation of the taxable income the administrative value of the real property, reduced by 40% for maintenance and repair costs. This method is proposed to be used for all real property situated in Member State A, whether it is rented or not.

For the immovable property that is located in other member states, a different approach is proposed. If the immovable property is rented, then the actual rental income is to be taken into account, reduced by 40% for maintenance and repair costs, as well as by the relevant taxes paid in the member state where the property is located. If the immovable property is not rented, then a notional income equal to the rental value of the property is taken into account, reduced by 40% for maintenance and repair costs, as well as by the relevant taxes paid in the member state where the property is located.

It is observed that there is a different way of calculating the taxable income from real property, depending on whether the property is located in Member State A or in other member states. It must therefore be assessed whether such a different method for the calculation of the taxable income leads to the income from immovable property located in other member states being treated disadvantageously in comparison with income relating to immovable property located in member State A. The CJEU examined a similar situation in the case C-110/17, Commission v Belgium.

Which freedom applies?

First of all it must be determined which freedom applies in this situation. Since the legislation under examination does not refer specifically to the carrying out of business but applies without distinction to all income from real property, the case must be examined under the light if the free movement of capital and laid down by Article 63 TFEU and Article 40 of the EEA Agreement (C-110/17, Commission v Belgium, §37).

The existence of a restriction

According to the case law of the Court, the measures prohibited by Article 63(1) TFEU as restrictions on the movement of capital include all those which are likely to discourage residents of one Member State from making investments in immovable property in other Member States (C 489/13, Verest and Gerards, § 21 and the case-law cited).

The issue here is that the taxable income is proposed to be determined on a flat-rate basis for property situated in Member State A and on the basis of the actual rental value or the actual rent for that situated in another member State. It is common ground that administrative values (such as the cadastral value) of immovable property are in general lower than the actual rent of that property or its actual rental value. Moreover, they are usually not updated as frequently, as to reflect the actual market value or rental value of the properties. Accordingly, if the administrative values in Member State A are significantly lower than the rental value of the property in Member State A, the income subject to tax will be lower than the income from immovable property in other member states, for which the actual rental income is taken into account.

Therefore, investment in real property in other member states is potentially taxed in a more burdensome way compared to investment in real property in Member State A. This results in a difference in treatment that is liable to discourage residents of Member State A from making investments in immovable property in Member States of the European Union or the EEA other than Member State A. Consequently, the proposed legislation potentially constitutes a restriction of the free movement of capital, which is prohibited in principle by Article 63 TFEU (C-110/17, Commission v Belgium, §54).

<u>Possible justifications</u>

Next, it must be examined whether there is a possible justification that could justify this different treatment. According to settled case-law, a distinction must be made between the differences in treatment authorised by Article 65(1)(a) TFEU and discrimination prohibited by Article 65(3) TFEU. National tax legislation can be regarded as compatible with the provisions of the FEU Treaty on the free movement of capital, if the difference in treatment concerns situations which are not objectively comparable or if it can be justified by an overriding reason in the public interest (see, to that effect, C 127/12, Commission v Spain, §73; C 489/13, Verest and Gerards, §28; C 10/14, C 14/14 and C 17/14, Miljoen and Others,§64).

In order to assess comparability, we need to examine the objective of the proposed legislation (C-110/17, Commission v Belgium, §61). The objective of the proposed legislation is to tax income relating to immovable property owned by residents in Member State A. this legislation is equally applicable to income from immovable property situated in Member State A or in another State. In both cases, such income is included in the taxable base for the purposes of taxing income. Therefore, the situation of taxpayers who have acquired immovable property in Member State A is comparable to that of taxpayers who have acquired such property in another Member State of the European Union or the EEA (Verest and Gerards, C 489/13, § 32; and C-110/17, Commission v Belgium, §60).

As to whether the difference in treatment of taxpayers according to whether they own immovable property (in Member State A or in another Member State or in the EEA (may be justified by an overriding reason in the public interest, it must be pointed out that few justifications have been accepted by the Court in that regard. In the present case it does not seem that the proposed difference in treatment aims at combating tax avoidance, and therefore this justification cannot be put forward. Similarly, the proposed legislation does not seem to be linked with the balanced allocation of taxing powers between member states, and therefore neither this justification could be put forward.

<u>Conclusion</u>

The proposed legislation is in breach of the free movement of capital for which no valid justification can be proposed.

Yours faithfully,
ADIT Candidate

Question 2

Part 1

Candidates should ideally refer to both Art. 5 of the ATAD (that makes exit taxes compulsory) and the case law of the CJEU. In their analysis, they are supposed to follow the 'traditional' steps followed by the Court in its analysis.

Exit taxes impose a restriction when the taxpayer decides to move cross-border, but are justified on the basis of securing the balanced allocation of taxing rights between Member States, linked with the territoriality principle and a temporal component (= residence). However, the exit taxes cannot infringe the principle of proportionality. In the present scenario, the possibility of deferral for up to 5 years is fine (compatible both with the CJEU case law and Art. 5 of the ATAD), however the requirement for bank guarantee can only be allowed ad hoc, after an assessment whether there is a risk of non-recovery (based on the assets of the corporation) (National Grid Indus and DMC cases).

Part 2

Based on the CJEU case law, subsequent decreases in value do no have to be taken into account by the host state even if they are not taken into account by the home (exiting) state. Candidates should ideally differentiate the natural persons' case law from the legal persons' case law.

The Court decided in the NGI case that 'since the profits of a company which transfers its place of effective management are, after the transfer, taxed exclusively in the host Member State, in accordance with the principle of fiscal territoriality linked to a temporal component, it is also for that Member State, in view of the above-mentioned connection between a company's assets and its taxable profits, and hence for reasons relating to the symmetry between the right to tax profits and the possibility of deducting losses, to take account in its tax system of fluctuations in the value of the assets of that company which occur after the date on which the Member State of origin loses all fiscal connection with the company.' [par. 58] (≠ N. judgment) = Post-emigration decreases in value are to be taken into account by the host state.

Also: Art. 5 (5) ATAD, establishes an obligation for the 'new' state to grant a step up for tax purposes to the market value used by the MS of origin to calculate the exit tax, that allows for decreases in value in future disposals to be taken into account. However, two conditions have to be fulfilled a) the possibility to use any losses arising after the transfer and b) the agreement of both states' on the assets' valuation.

Part 3

The last part of the question aimed to discuss the Court's AURES case and the applicability of the 'final losses' doctrine in exit tax cases. The Court there explained that the final loss doctrine applies to situations that are 'characterised by the fact that, during the same year, the company and the loss -incurring entity are situated in two different Member States' (para. 48).

According to the Court in AURES, the Member State to which a company transfers its place of effective management cannot be required to take into account a loss incurred before that transfer which relates to tax years in respect of which that company did not fall within the tax jurisdiction of that Member State. However, the Court does not exclude the possibility that a company may invoke the final loss doctrine following a move to another Member State if that Member State already exercised its tax jurisdiction over the company in some way at the time when the loss was incurred.

PART B

Question 3

Directive 2011/16 (DAC) has established a system of cooperation between the national tax authorities of the Member States and lays down the rules and procedures to be applied when exchanging information for tax purposes. Directive 2011/16 has been amended on several occasions, in particular by Directive 2018/822 (DAC 6). That directive introduced an obligation to report any potentially aggressive tax-planning cross-border tax arrangements to the competent authorities. Among its provisions, DAC 6 provides for the relationship between the reporting obligation and the legal professional privilege by which certain intermediaries are bound, such as lawyers. In particular, when an intermediary is bound by legal professional privilege, he or she is required to notify any other intermediary or intermediaries in writing, giving reasons, that he or she is unable to comply with the reporting obligation, as a result of which that reporting obligation automatically rests with the other intermediary or intermediaries. In the absence of any other intermediary, he is required to notify the relevant taxpayer or taxpayers of their reporting obligation, in writing, giving reasons. The waiver from the reporting obligation shall take effect only when an intermediary has fulfilled this obligation.

This obligation was challenged before the CJEU under the light of the EU Charter of Fundamental Rights, and in particular under the light of the right to a fair trial (article 47 of the Charter) and the right to privacy (article 7 of the Charter). The Court dealt with these issues in its decision C-694/20, Orde van Vlaamse Balies.

Indeed, lawyers may, in the performance of their activities, be 'intermediaries' within the meaning of Article 3(21) of amended Directive 2011/16, by reason of the fact that they may themselves perform activities relating to designing, marketing, organising, making available for implementation or managing the implementation of reportable cross-border arrangements or, failing that, because they may provide aid, assistance or advice in relation to such activities.

Lawyers carrying out such activities are thus, in principle, subject to the reporting obligation laid down in Article 8ab(1) of that directive. According to the directive, lawyer-intermediaries, are given a waiver from filing information on a reportable cross-border arrangement where the reporting obligation would breach the legal professional privilege under the law of that Member State. In such circumstances, each Member State is to take the necessary measures to require intermediaries to notify, without delay, any other intermediary or, if there is no such intermediary, the relevant taxpayer of their reporting obligations That paragraph provides that, in such a case, the reporting obligation lies with the other notified intermediary or, if there is no such intermediary, with the relevant taxpayer.

However, lawyer-intermediaries may only be entitled to a waiver under the first subparagraph thereof to the extent that they operate within the limits of the relevant national laws that define their profession, which it is, where relevant, for the national court to ascertain when applying that legislation. Therefore, it is only in relation to lawyer-intermediaries who actually operate within such limits that Articles 7 and 47 of the Charter can apply.

Article 7 of the Charter recognises that everyone has the right to respect for his or her private and family life, home and communications. It protects the confidentiality of all correspondence between individuals and affords strengthened protection to exchanges between lawyers and their clients. Article 7 of the Charter necessarily guarantees the secrecy of that legal consultation, both with regard to its content and to its existence. Individuals who consult a lawyer can reasonably expect that their communication is private and confidential and thereforethose persons must have a legitimate expectation that their lawyer will not disclose to anyone, without their consent, that they are consulting him or her.

The obligation laid down by DAC 6 for a lawyer-intermediary where he or she is, on account of the legal professional privilege by which he or she is bound by national law, exempt from the reporting obligation laid down in DAC 6 to notify without delay other intermediaries who are not his or her clients of their reporting obligations under that directive, necessarily entails the consequence that those other intermediaries become aware of the identity of the notifying lawyer-intermediary, of his or her assessment that the arrangement at issue is reportable and of his or her having been consulted in connection with the arrangement.

In those circumstances there is an interference with the right to respect for communications between lawyers and their clients, guaranteed in Article 7 of the Charter. Moreover, the obligation to notify leads, indirectly, to another interference with that right, resulting from the disclosure, by the third-party intermediaries thus notified, to the tax authorities of the identity of the lawyer-intermediary and of his or her client.

The reporting and notification obligations established by Article 8ab of amended Directive 2011/16 are intended to contribute to the prevention of the risk of tax avoidance and evasion. Combating aggressive tax planning and preventing the risk of tax avoidance and evasion constitute objectives of general interest recognised by the European Union for the purposes of Article 52(1) of the Charter, capable of enabling a limitation to be placed on the exercise of the rights guaranteed by Article 7 of the Charter (see, to that effect, judgment of 6 October 2020, État luxembourgeois (Right to bring an action against a request for information in tax matters), C 245/19 and C 246/19, §87).

However, in this case the Court in the case Orde van Vlaamse Balies,held that DAC 6 infringes the right to respect for communications between a lawyer and his or her client, guaranteed in Article 7 of the Charter, in so far as it provides, in essence, that a lawyer-intermediary, who is subject to legal professional privilege, is required to notify any other intermediary who is not his or her client of that other intermediary's reporting obligations.

On the other hand the Court held that Article 47 of the Charter and the right to a fair trial do not apply in this case, since the requirements implied by the right to a fair trial presuppose, by definition, a link with judicial proceedings (Ordre des barreaux francophones et germanophones and Others, C 305/05, §35).

Question 4

Part 1

Candidates are expected to follow the Court's 'traditional' way of approaching a fundamental freedoms case.

- Cross- border element, which freedom is applicable: here not enough information about the shareholding so either establishment or capital would work.
- Is there a restriction? Member States Z taxes shareholders / parent companies more heavily than domestic shareholders/parent corporation and this amounts to a restriction on the relevant freedom.
- Candidates could also consider here whether the Parent Subsidiary Directive applies and if all conditions are met, then the WHT would be contrary to the PSD. However, reliance on the PSD only does not suffice.
- Continuing from the restriction step, one has to consider whether the two 'parents' shareholders are comparable. By imposing a WHT the source state effectively extends its jurisdiction to the 'foreign' parent/shareholder, who then becomes comparable to the domestic one. Thus, same treatment should apply.
- No justification in this case would appear to justify this difference treatment.

Part 2

The second part of the question has two subparts.

First, whether the DTC can neutralize this restrictive treatment. According to the Amurta case, for instance, where the Court ruled that although a Member State may not rely on a tax benefit granted unilaterally by another Member State to justify a violation of EU law, it may, however, achieve conformity with EU law through treaty provisions, subject to the scrutiny of national Courts.

The second subpart relates to the credit itself and whether this indeed ensures same treatment with the domestic situation. As the Court ruled in Denkavit, although the DTC between the countries of the subsidiary and the parent companies provided for a tax credit in the parent company's country for the WHT paid at source, the restriction was not eliminated as the dividend was tax-exempt domestically. The question here would be a question of rates at source/residence and whether the credit could actually achieve the results of the exemption. If so, then the violation would indeed be neutralized via the DTC.

PART C

Question 5

On 26 February 2019, the Grand Chamber of the CJEU delivered two landmark judgments, commonly referred to as the Danish Cases, dealing with the problem of directive shopping under the Parent-Subsidiary Directive (Council Directive (EU) 2015/121 of 27 Jan. 2015 amending Directive 2011/96/EU on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States) and the Interest and Royalty directive (Council Directive 2003/49/EC of 3 June 2003 on a common system of taxation applicable to interest and royalty payments made between associated companies of different Member States).

In relation to the Interest-Royalty Directive, the referring courts seeked to ascertain whether, in order to combat an abuse of rights in the context of applying Directive 2003/49, a Member State must have adopted a specific domestic provision transposing that directive or whether it may refer to domestic or agreement-based anti-abuse principles or provisions (C-115/16 at §95 and C-116/16, at §68).

It is settled case-law that there is, in EU law, a general legal principle that EU law cannot be relied on for abusive or fraudulent ends (Centros, C 212/97, paragraph 24 and the case-law cited; Halifax and Others, C 255/02,paragraph 68; Cadbury Schweppes and Cadbury Schweppes Overseas, C 196/04, paragraph 35; Cussens and Others, C 251/16, paragraph 27; Commission v Belgium, C 356/15paragraph 99).

That general principle of law must be complied with by individuals. Indeed, the application of EU legislation cannot be extended to cover transactions carried out for the purpose of fraudulently or wrongfully obtaining advantages provided for by EU law (Kofoed, C 321/05, paragraph 38; Cussens and Others, C 251/16, paragraph 27; Commission v Belgium, C 356/15, paragraph 99).

It follows from that principle that a Member State must refuse to grant the benefit of the provisions of EU law where they are relied upon not with a view to achieving the objectives of those provisions but with the aim of benefiting from an advantage in EU law although the conditions for benefiting from that advantage are fulfilled only formally (C-115/16, §98). It follows that the general principle that abusive practices are prohibited must be relied on against a person where that person invokes certain rules of EU law providing for an advantage in a manner which is not consistent with the objectives of those rules.

The Court has thus held that that principle may be relied on against a taxable person in order to refuse him, inter alia, the right to exemption from VAT, even in the absence of provisions of national law providing for such refusal (Schoenimport ‘Italmoda’ Mariano Previti and Others, C 131/13, C 163/13 and C 164/13, paragraph 62, and Cussens and Others, C 251/16, paragraph 33). Accordingly, the national authorities and courts can refuse to grant entitlement to rights provided for by Directive 2003/49 where they are invoked for fraudulent or abusive ends. The court provided useful guidance on several indicators of abuse that can be used to this purpose.

The judgments of the CJEU in the Danish cases represent an important milestone with respect to the prohibition of abuse of rights.

Question 6

Directive 2011/16/EU on administrative cooperation in the field of taxation. Before its amendment by DAC 7, the Directive specified that Member States could only undertake exchange of information procedures to share information foreseeably relevant for the tax administrations. According to Recital 9 of the Directive "the standard of 'foreseeable relevance' is intended to provide for exchange of information in tax matters to the widest possible extent and, at the same time, to clarify that Member States are not at liberty to engage in 'fishing expeditions' or to request information that is unlikely to be relevant to the tax affairs of a given taxpayer."

The CJEU examined the question of whether certain information requested complied with the standard of foreseeable relevance in Case C 682/15, Berlioz. The Court in its decision followed DAC's wording and set out general hallmarks for tax administrations to apply on a case-by-case basis. In Cases C-245/19, B v État Luxembourgeois and C-246/19 État Luxembourgeois v B, C, D and FC, the Court went beyond the wording of the Directive and gave an extensive interpretation regarding third parties. The CJEU considers that such information meets the foreseeable relevance criteria only if it is related to the investigated taxpayer and the period on which the investigation is focused.

Last but not least, in the case C-437/19, État du Grand-duché de Luxembourg v L, the Court focused on the foreseeable relevance of data belonging to groups of taxpayers. The Court adopted several criteria that such requests of information concerning a group of taxpayers should present, in order to avoid being classified as "fishing expeditions".

By directive 2021/514 (DAC 7) a new article 5a was inserted in DAC, containing a definition of the concept of foreseeable relevance.

According to that provision the requested information is foreseeably relevant where, at the time the request is made, the requesting authority considers that, in accordance with its national law, there is a reasonable possibility that the requested information will be relevant to the tax affairs of one or several taxpayers, whether identified by name or otherwise, and be justified for the purposes of the investigation.

Moreover, it is provided that with the aim to demonstrate the foreseeable relevance of the requested information, the requesting authority shall provide at least the following information to the requested authority: the tax purpose for which the information is sought and a specification of the information required for the administration or enforcement of its national law.

The Directive also provides for "group requests". In cases a request relates to a group of taxpayers who cannot be identified individually the requesting authority shall provide at least the following information to the requested authority: a detailed description of the group; an explanation of the applicable law and of the facts based on which there is reason to believe that the taxpayers in the group have not complied with the applicable law an explanation how the requested information would assist in determining compliance by the taxpayers in the group; and where relevant facts and circumstances related to the involvement of a third party that actively contributed to the potential non-compliance of the taxpayers in the group with the applicable law.

Question 7

Candidates are supposed to discuss the fundamental freedoms as a tool to combat double taxation in the EU. They should ideally start with noting that direct taxation is not an EU competence and there are no EU rules allocating taxing rights – this is for the DTCs.

That said, the Court has often eliminated economic double taxation through its case law, when the 'problematic' state at issue engages in discriminatory treatment and treats domestic residents/investments more favourably than cross-border ones. In these cases, the Court has found a discriminatory restriction which could only be justified if specific justifications were found successful by the Court.

In contrast, the Court has not managed to resolve juridical double taxation in many cases, which remains for the DTCs to resolve. The important element here is the distinction between discriminatory treatment (caught by the fundamental freedoms) and disparity (not caught by the freedoms). Candidates are particularly encouraged to use examples from case law on how economic and juridical double taxation have been treated by the Court through the lens of the fundamental freedoms. They should also highlight how the perspective of the state at issue (residence/source) plays an important role in this assessment.

Question 8

Candidates are expected to discuss Articles 7 and 8 of the ATAD in conjunction with the case law of the CJEU. In principle the Cadbury judgment is reflected in Art. 7 2(a) of the ATAD's carve-out ('substantive economic activity supported by staff…' vs. 'wholly artificial arrangement'). What is not reflected in the ATAD is the X-GmbH judgment where the Court applied its Cadbury jurisprudence also to the free movement of capital in relation to third countries, allowing, effectively the shareholder to show that their shareholding is not the result of an artificial scheme – this remains to be integrated in Art. 7 2 (a) ATAD.