THE ADVANCED DIPLOMA IN INTERNATIONAL TAXATION

December 2021

MODULE 3.01 – EU DIRECT TAX OPTION

SUGGESTED SOLUTIONS

PART A

Question 1

Directives

The transfer of the operation is for a consideration in cash and falls outside of the scope of the Mergers Directive, Council Directive 2009/133/EC Article 2 (c) in particular.

Nor is the transfer within the scope of Article 5 (1) of Council Directive (EU) 2016/1164 (ATAD), which is concerned with cross-border transfers of assets without change of ownership. Recital 10 records the exclusion from the scope of the directive of a transfer between a parent company and its subsidiaries

However, the loan facility provided by the parent company to the subsidiary to acquire the assets will fall within the scope of Council Directive 2003/49/EC (Interest/Royalties) unless (and for so long as) that the group relationship has not existed for an uninterrupted period of up to two years if Newhomeland's national law so requires (Article 1 (10)).

Where the particular circumstances fall outside of the scope of a directive, primary Treaty law may still be applicable – Euro Park Service C-14/16 paragraph 26.

Treaty Provisions

Article 49 TFEU may be potentially engaged by the tax charge under Homeland national law on the sale of assets to the subsidiary.

The likely charge on disposal will be based on a clawback of €(10m – 6m) = €4m of tax depreciation. There will be no capital gain on disposal. If, as is often the case, Homeland's tax code provides that the tax written down value of the assets should pass to a purchaser on an intra-group transaction, the tax code could be regarded as discriminatory and an obstruction to the freedom of establishment – by analogy X and Y C-436/00 paragraph 36.

Could the restriction be justified? Whilst the transaction is not a migration of tax residence of the taxpayer, as considered in, say, N C-470/04 or National Grid Indus C-371/10, a similar issue arises in that a tax charge is triggered by an exercise of a freedom of movement that would not have been triggered had it been a domestic transaction – see also DMC C-164/12. It is clear from the case law noted that the triggering of a tax event and the denial of the relief available when the intra-group transaction is between companies tax resident in the same state can be justified by reference to Homeland's taxing powers as the assets will cease to be within its taxing jurisdiction as a result of the transaction and the tax charge results from a clawback of accelerated depreciation.

Is the charge on the sale of the assets proportionate? The Court has previously considered a tax charge accruing on unrealised capital gains and has concluded that a spreading of the charge over a period of 5 years would be proportionate unless the taxpayer chooses to settle immediately and avoid the administration cost. In this case, the taxpayer has disposed of the asset and the "gain" taxed is a clawback of tax relief previously granted.

By analogy with the situation considered in Timac Agro C-388/14, which concerned the immediate taxation related to loss relief previously granted, the immediate taxation of excessive tax depreciation of the assets might be considered proportionate: "…the reincorporation of such losses into the taxable profit of the transferring company is a measure that is proportionate to the intended aims, namely the safeguarding of a balanced allocation of the power to impose taxes, the need to ensure fiscal coherence and the prevention of tax avoidance" (paragraph 51).

Furthermore, depreciation will be granted by Newhomeland on the basis of the market value at the time of the disposal and an element of temporary double deduction would be achieved if there is no immediate taxation Homeland's clawback of excess tax depreciation.

Article 49 TFEU may also be potentially engaged if Newhomeland national law disallows for tax purposes any of the interest payable by the subsidiary to the parent or/and Homeland national law imputes income to the parent company in respect of the loan that exceeds the contractual entitlement. Following the Court's rulings in, for instance, Thin Cap GLO C-524/04, a disallowance by Newhomeland of interest paid at a rate on the inter-company loan in excess of an arm's length rate for such finance could be justified on the basis of protection of the state's powers of taxation and would be proportionate.

Homeland could similarly justify imputing interest income to the parent if the interest rate on the loan to the subsidiary was set at a rate less than an arm's length rate for such finance. By analogy Horbbach-Baumarkt C-382/16.

Question 2

Part 1

In 1974, the Court established the principle that a person could not claim the protection of Article 56 TFEU to avoid "professional rules of conduct which would be applicable to him if he were established within [the state in which he was supplying his services]" van Binsbergen case 33/74 paragraph 13 reaffirmed in Knoors case 115/78 paragraph 25. In Cadbury Schweppes C-196/04 (anti-avoidance) paragraph 35, the Court termed the potential abuse as use of the Treaty rights: "…improperly to circumvent their national legislation".

Accordingly, a taxpayer seeking to circumvent or avoid national provisions by making improper use of Treaty rights would be considered to be relying upon EU law for abusive or fraudulent ends.

In Cadbury Schweppes the question was whether the foreign subsidiary could be regarded as an establishment as opposed to being a letterbox company having no substance (see Eurofood C-341/04 paragraph 35).

In ING.AUER C-251/06 (capital duty) paragraphs 44 & 45 the Court (referring to its ruling in paragraph 69 of Halifax (VAT) C-255/02) ruled that the formation of a company having no economic purpose with the intent of avoiding tax normally payable would be such an abuse.

The Court has applied the principle also in situations where national anti-avoidance provisions apply to disallow excessive interest (Thin Cap GLO C-524/04 paragraph 75) or pricing designed to export profits (SGI C-311/08 paragraph 67).

Part 2

Art.1 provides that the directive only applies to taxpayers subject to corporate taxes and Art. 3 of the directive states that it shall not preclude Member State or international treaty anti-avoidance provisions providing higher levels of protection. The directive is proclaimed as non-exhaustive. The areas of focus of the directive are set out in the fifth recital and the objective is set out in recital 16 and the focus is on cross-border tax avoidance practices.

The Treaty freedoms and the Court's case law will apply to national law not considered to engage the directive. To the extent that the matter falls outside the scope of the harmonisation measure, primary law will apply (Jacob & Lassus C-327/16 paragraph 72).

PART B

Question 3

Part 1

The Court is referring to the cash flow advantage that can be obtained by a group of companies and, specifically, by companies in a group that surrender losses for UK corporation tax purposes under the group relief rules.

Part 2

The group relief scheme enables netting of profits and losses within the charge to corporation tax that would fall to be netted out if the entire business conducted by the UK group was conducted by a single company trading through divisions and branches. See schemes examined by the Court having a comparable objective: OY AA C-231/05 paragraph 35 (Finnish system); Papillon C-418/07 paragraph 28 (French tax integration system); X AB & Y AB C-200/98 paragraph 4 (Swedish system); X Holding C-337/08 paragraph 24 (Dutch tax integration system).

Part 3

In the context of the taxpayer claims being examined by the Court, the principal condition in the national legislation restricting the availability of relief was the requirement for the losses claimed to be surrendered to be within the scope of corporation tax. To require the Member State to provide relief for losses sustained by activities conducted outside of the taxing jurisdiction of the Member State would be to override the sovereign right of the Member States to define their respective taxing jurisdictions and allocate between themselves those powers of taxation.

The Court recognised in paragraph 43 of the case that "…in tax matters profits and losses are two sides of the same coin and must be treated symmetrically in the same tax system in order to protect a balanced allocation of the power to impose taxes between the different Member States concerned".

The Court had previously accepted in Gilly C-336/96 paragraphs 24 and 30 that the Member States had the retained powers to define and allocate their powers of taxation.

Furthermore, if a Member State was required to extend its taxing jurisdiction and provide relief for losses incurred by a company resident outside of its taxing jurisdiction, the group would benefit from the double deduction of those losses when the non-resident company became profitable because those subsequent profits would not be taxable in the UK, the Member State forced to provide relief for the earlier losses.

That would not be so, however, if the non-resident company had no prospect of using the losses in the state of residence (see paragraph 55).

Question 4

The Resiland scheme for taxing the dividend income of resident companies is discriminatory and is likely to deter outward investment. The scheme applies the same rules regardless of the size of the holding.

As the dividends derive from a company resident in a third country and as the Resiland taxing provisions apply to foreign source dividend income in the same way regardless of the size of the holding, the restriction should be examined by reference to Article 63 TFEU (Secil C-464/14 paragraphs 33 & 34).

The purpose of the abatement granted in relation to domestic source dividends is likely to be to mitigate the economic double taxation that would otherwise occur. The fact that Targetland does not levy taxation on Target's profits because of the nature of its business activity does not change the fact that Resiland's tax code offers no mitigation of economic double taxation that might be suffered on an outward investment by a Resiland resident where the state of residence of the foreign company does levy tax on the underlying profits.

To comply with the requirements of EU law, foreign source dividends may not be taxed by Resiland at a rate that is higher than that levied on domestic source dividends (FII GLO C-446/04 paragraph 49).

Accordingly, the Resiland tax code needs to be amended to grant a 90% abatement of the foreign source dividend, grossed up for the withholding tax levied by the state of residence of the distributing company. The withholding tax levied on the dividends paid by Target is Targetland tax borne by Investco on income equal to a grossing up of the net amount received.

In this case, the total withholding tax suffered will exceed the Resiland tax chargeable on the dividends from Target. However, Resiland has no requirement to reimburse to Investco the excess of the withholding tax levied by Targetland over the Resiland tax chargeable on the dividends from Target (by analogy FII GLO paragraph 52).

PART C

Question 5

The principles are expressed by the Court in relation to the upholding of EU law rights and obtaining remedy in the national courts (see, for instance, Metallgesellschaft C-397/98 paragraph 85, FII GLO3 C-362/12 paragraph 32).

Equivalence – EU Law is "integrated into the legal systems of the Member States" (Frankovich C-6/90 paragraph 31. It creates "individual rights which national courts must protect" (Costa v E.N.E.L. case 6/64 paragraph 7). Accordingly, national law procedures to obtain protection of EU law rights in national courts must "…apply without distinction…" (Aquino C-3/16 paragraph 50) from those applicable to enforcement of national law rights. (see also Rewe case 33/76 paragraph 5 and XC & Others C-234/17 paras. 25 – 48). It is for the national courts to examine national procedures for obtaining protection of rights and for obtaining remedy and to determine the procedures required in the context of EU law rights to ensure equivalence.

Effectiveness – those national court procedures must make obtaining enforcement of EU law rights or obtaining remedy for loss arising from infringements of EU law by national law "excessively difficult" (Metallgesellschaft paragraph 85 and Francovich paragraph 43).

The effectiveness of EU law would be "weakened" if individuals found difficulty in enforcing their rights under that law in the national courts (van Duyn case 41/74 paragraph 12 and Costa & Cifone C- 72 & 77 / 10 paragraph 53).

Question 6

Part 1

Art.115 TFEU, which prescribes the form of the measure as being a directive. Art. 288 TFEU prescribes that: “A directive shall be binding, as to the result to be achieved, upon each Member State to which it is addressed, but shall leave to the national authorities the choice of form and methods.” Thus, it is for the Member States to enact legislation to achieve the objectives set out in the directive and to give effect to the rights created, conditions specified and procedures outlined.

Part 2

Art.5(3) TEU. “…the Union shall act only if and in so far as the objectives of the proposed action cannot be sufficiently achieved by the Member States…but can rather, by reason of the scale or effects of the proposed action, be better achieved at Union level”.

Member States have entered into wide webs of bilateral double tax agreements and it may not be possible to satisfy the stipulated criterion “cannot be sufficiently achieved by the Member States”.

Part 3

Euro Park Service C-14/16 paragraph 19 – the harmonisation measure insofar as the matter in point falls within its scope. To the extent that the matter falls outside the scope of the harmonisation measure, primary law will apply (Jacob & Lassus C-327/16 paragraph 72).

Question 7

Part 1

Regulation (EU) 2015/1589 made pursuant to Article 109 TFEU. Article 12 provides that the Commission may on its own initiative examine any allegation of unlawful aid but is obliged to make a timely examination of any formal complaint by an interested party (Article 1(h) for the definition and Article 24(2)) in the prescribed form.

The consequences of a decision by the Commission that unlawful aid has been granted are set out in Article 16, which requires the Member State that granted the aid to recover the aid from the beneficiaries plus interest calculated on the amount of the aid for the term during which it was in the possession of the beneficiary.

However, Article 17 does provide a limitation period of 10 years commencing with the date on which action is first taken in respect of it.

Part 2

As per Italian Republic v Commission of the European Communities C-66/02 paras 78 & 80:

Special deductions from the tax base, deferral of tax liabilities, reduced rate of tax, a substitution of a fixed levy for taxation calculated on the basis of profits or an exemption from tax on favoured transactions.

Question 8

Part 1

Article 49 TFEU. A Homeland resident company that carries on business through a non-resident PE is potentially at a disadvantage to a similar company carrying on comparable business through a domestic branch where losses are incurred by the business conducted through the PE and branch.

The Homeland tax provision denying loss relief to Trader is a restriction if Trader can be regarded as being in a comparable situation to a Homelands resident company conducting its business through a domestic branch. The Court held in Lidl C-414/06 paragraph 25 (by implication) that Trader could be so regarded but, in Timac Agro C-388/14 at paragraphs 64 & 65 that it cannot be so regarded.

Part 2

Preservation of taxing powers (X Holding C-337/08 at paragraph 29) and coherence of the tax system (Bevola and Jens W Trock C-650/16 paragraph 51 – profits and losses are 2 sides of the same coin Marks & Spencer C-446/03 paragraph 43 and the profits are exempted).

Part 3

The Court has held that the restriction is disproportionate when the losses incurred in the non-resident PE cannot be relieved in the state of residence of the PE and there is certainty that the benefit of the losses will be lost (see by implication Lidl C-414/06 paragraph 51). It is then certain that double deduction for the losses cannot occur (Bevola and Jens W Trock C-650/16 paragraphs 58 & 59).

Question 9

Non-corporate shareholders, whether resident or non-resident, suffer the withholding tax to the same extent and the tax does not, therefore, give rise to a restriction.

In its application to dividends payable to corporate shareholders, the national legislation applies regardless of the level of the shareholder's interest in the distributing company.

Where a national rule (as this one) is not intended to apply only to groups (such as CFC or Thin Capitalisation provisions) but applies without regard to the level of interest held by the shareholder, unless the Parent/Subsidiary directive 2011/96/EU applies, Article 63 TFEU will have application even where the shareholder's interest gives him definite influence over the distributing company's decisions and allows him to determine its activities (see Holbock C-157/05 at 22-24), that is, where the rules and benefits of Article 49 TFEU would normally apply in priority (see Baars C-251/98 at 22).

Where Article 63 TFEU is engaged, the derogation in Article 64(1) may apply if the withholding tax rule has been continuously in force since 31.12.93 and the holding is not a portfolio investment and may be regarded as "direct investment" (made by a national of a third country).

Where the shareholder holds 10% or more of the capital of the distributing company and is considered to be a national of another Member State by the criteria set out in Article 55 TFEU, the Parent/Subsidiary directive 2011/96/EU, Article 4, will prohibit the levy of a withholding tax.

Where the directive does not apply, Article 63 TFEU is engaged and there is unequal treatment of residents and non-residents such as to create a financial disadvantage to non-residents. Both have indirectly suffered tax on the profits out of which the dividends have been distributed and both are therefore in the position of suffering economic double taxation if the withholding tax is applied. They are in comparable situations, therefore, as regards this national rule and the levy of a withholding tax from dividends paid to non-residents will be regarded as a restriction to the free movement of capital unless the Article 64(1) derogation applies.

Although the state of residence of the distributing company may have entered into a DTA with the state of residence of a shareholder under which the shareholder's state of residence is obliged to grant a tax credit for the withholding tax against tax that it will levy on that income, the financial disadvantage, and therefore the restriction, may not be considered to have been neutralised in all cases (Commission v Italy C-540/07 at 36 – 38).