THE ADVANCED DIPLOMA IN INTERNATIONAL TAXATION

June 2024

MODULE 3.01 – EU DIRECT TAX OPTION

SUGGESTED SOLUTIONS

PART A

Question 1

Part 1

Bonus for services to Person B

The first part of the question resembles the SGI and the SIAT cases. Identification of applicable freedom: Comparison between free movement of services vs. free movement of capital. Identification that the applicable freedom is free movement of services. In this case, the analysis stops here. If identification that the free movement of capital applies (acceptable), then analysis in the line of the cases – no general presumption of tax avoidance can be accepted. However, stricter interpretation because no exchange of information in place (lack of DTC).

Dividends to individual shareholders who are residents in Member States X and Z

Identification of arising juridical double taxation due to the imposition of WHT by State A. Identification that by imposing a WHT, State A extends its jurisdiction to other taxpayers (of states Z and X) and thus, comparability is established (see e.g. cases Denkavit, Amurta, etc.). Hypothesize what state A does domestically – if it relieves WHT domestically, then it must do so also for the outgoing dividends. If same treatment domestically, then no such obligation for State A. Bonus, if identification that MS Z is under no EU-law obligation to provide a relief for the double taxation.

Part 2

Question resembles the 'Danish beneficial ownership' cases. Identification that possibly the IRD applies (bonus: if identification of the relevant assumptions). If so, explanation that the beneficial ownership clause is enshrined in the Directive and thus, the refusal of deduction effectively, falls within the scope and the rules of the directive. Alternatively (if no identification that the IRD applies or assumption that the conditions for the IRD do not apply in this case), see anti-abuse clause and the Danish beneficial ownership case. Accordingly, there is the possibility to refuse the deduction on the basis of the anti-abuse doctrine. Identification that this would be the case if candidate (and Member State in the case at issue) shows that LOL is an artificial arrangement, not set up for reasons that reflect economic reality, its structure is purely one of form and its principal objective or one of its principal objectives is to obtain a tax advantage running counter to the aim or purpose of the applicable tax law (for example, it is simply an interposing conduit company).

Question 2

From: ADIT Student
To: the Chief Financial Officer of Company Z, in Member State B
Subject: Report on the compatibility with EU law of the group transfer rules in Member State A.

Introduction: facts of the case and issues

The facts of the case resemble the Gallaher case (C-707/20). Company X is a resident in Member State A. It belongs to a multinational group of companies that is established in a third country. The European regional head of the group is Company Z which is established in another RU member state, Member State B. The European head, Company Z, owns indirectly two other companies: the entirety of Company X (in Member State A), as well as Company Y, which is established in a European Economic Area (EEA) country.

There are two group transfers described. First, in 2022 Company X had transferred certain intellectual property rights relating to its products to Company Y, an EEA country. Second, in 2023, Company X transferred to its parent, Company Z, its shares in a subsidiary established in a third country.

Since Company X is established in Member State A, the legislation of Member State A applies on those transfers. Under Member State A's domestic legislation, group transfers are tax neutral only when they take place between companies established in Member State A. In cross-border cases, i.e. when the transferees are established outside Member State A, corporate tax on the capital gain is immediately due. No option for deferral or payment in instalments is provided.

You asked me to examine the compatibility of this legislation of Member State A with EU Law.

Scope of Fundamental Freedoms

The group transfers described here can in principle fall under both the free movement of capital and the freedom of establishment.

It is clear from settled case-law of the Court that, in order to determine whether national legislation comes within the scope of one or other of the fundamental freedoms guaranteed by the FEU Treaty, the purpose of the legislation concerned must be taken into consideration. Moreover, the Court has held that national legislation intended to apply only to those shareholdings which enable the holder to exert a definite influence on a company's decisions and to determine its activities falls within the scope of Article 49 TFEU and the freedom of establishment. On the other hand, national provisions which apply to shareholdings acquired solely with the intention of making a financial investment without any intention to influence the management and control of the undertaking must be examined exclusively in light of the free movement of capital (see C-35/11, Test Claimants in the FII Group Litigation, paragraphs 91 and 92 and the case-law cited).

Where a national measure relates to the freedom of establishment and the free movement of capital at the same time, in accordance with its settled case-law, the Court will in principle examine the measure in dispute in relation to only one of those two freedoms if it appears, in the circumstances of the case in the main proceedings, that one of them is entirely secondary in relation to the other and may be considered together with it (see, C 182/08, Glaxo Wellcome, paragraph 37 and the case-law cited). Furthermore, it is apparent from the Court's case-law that, in so far as any given national rules concern only relationships within a group of companies, they primarily affect the freedom of establishment (see Burda, C 284/06, paragraph 68 and the case-law cited). In such a situation, should the said rules have restrictive effects on the free movement of capital, those effects would be the unavoidable consequence of such an obstacle to freedom of establishment as there might be, and do not therefore justify an independent examination of those rules from the point of view of Article 63 TFEU (see, Oy AA, C 231/05, paragraph 24 and the case-law cited).

Since the legislation in the case applies only to group transfers, the case must be examined under the freedom of establishment only.

The correct comparator in establishing discrimination

Freedom of establishment aims to ensure that nationals of other Member States and the companies referred to in Article 54 TFEU receive the same treatment as nationals of the host Member State, by prohibiting any discrimination based on the place in which companies have their seat.

In order to establish the potential different treatment we need to compare similar situations. In this case the applicable domestic legislation of Member State A concerning the group transfer rules, does not entail any difference in treatment according to the place of tax residence of the parent company. Company X which is a subsidiary of

Company Z, established in another Member State, is treated in the same way as a tax-resident subsidiary of a parent company having its seat in Member State A. Company X would have received the same tax treatment if the parent company – Company Z, in Member State B – had had its tax residence in Member State A.

Such national legislation does not treat a subsidiary of a company resident for tax purposes in another Member State less favourably than a comparable subsidiary of a company resident for tax purposes in Member State A. Accordingly, such legislation does not entail any restriction on the freedom of establishment of the parent company.

The facts of the case cannot be compared to the National Grid Indus case, as National Grid Indus covers situations which are different from what we discuss here. National Grid Indus covers situations where a company seeking to exercise its freedom of establishment in another Member State suffers a disadvantage by comparison with a similar company which does not exercise that freedom. In the present case, the group transfer rules impose an immediate tax liability on the disposal of assets by a company in member state, irrespective of the place of establishment of its parent (whether in the same Member Stare or in another Member State or in a third country).

Proportionality

First of all we have to establish that there is a restriction. Indeed, when Company X transferred its assets to other companies that are not established in Member State A, the group transfer rules gave rise to different tax treatment. If the transferees were in the same Member State A, no tax would have been charged to Company X. The group transfer rules do not provide for such an advantage when the disposal is to a group company chargeable to tax in another EU or EEA Member State. It follows that such rules constitute a restriction on freedom of establishment in so far as they lead to less favourable tax treatment of companies chargeable to tax in Member State A which carry out disposals of intra-group assets to companies which are not chargeable to tax in Member State A compared to companies chargeable to tax in Member State A which carry out disposals of intra-group assets to companies chargeable to tax in the same Member State A.

Such a restriction may be justified by overriding reasons in the public interest, namely the need to maintain the balanced allocation of the power to impose taxes between the Member States. Indeed, the maintenance of a balanced allocation of taxing powers between the Member States can, in principle, justify a difference in treatment between cross-border transactions and transactions carried out within the same tax jurisdiction. However, the Court has repeatedly held that the justification based on the need to maintain the balanced allocation of the power to impose taxes between the Member States can be accepted where the system in question is designed to prevent situations which are liable to jeopardise the right of a Member State to exercise its power to tax in relation to activities carried out in its territory (see, Lexel, C 484/19, paragraph 59 and the case-law cited).

According to the case-law of the Court, a Member State may impose a tax charge in respect of the unrealised capital gains in order to ensure that the assets transferred are taxed (see, Verder LabTec, C 657/13, paragraph 45). However, legislation of a Member State which requires the immediate recovery of the tax due in respect of the unrealised capital gains generated in the context of its fiscal jurisdiction, at the time of the transfer of the place of effective management of a company to a place outside its territory has been held to be disproportionate by reason of the fact that measures existed which were less restrictive of the freedom of establishment than the immediate recovery of that tax. In that regard, the Court has held that it was appropriate to give the taxable person the choice between, on the one hand, immediate payment of that tax, and, on the other hand, deferred payment of that tax, together with, if appropriate, interest in accordance with the applicable national legislation (see Commission v Germany, C 591/13, paragraph 67).

However we must distiguish the case of realised capital gains from the case of unrealised capital gains. First, all cases of exit taxes are characterised by the liquidity problem faced by a taxpayer who must pay a tax on a capital gain which he or she has not yet realised; second, the tax authorities must ensure the tax on the capital gains realised during the period the assets were within their tax jurisdiction is paid (see, National Grid Indus, C 371/10, paragraph 52) and that the risk the tax will not be paid may increase with the passage of time (see, National Grid Indus, paragraph 74, and Verder LabTec, paragraph 50).

The Court points out that in the case of a capital gain realised as a result of a disposal of assets, the taxpayer does not, in principle, face a liquidity problem and can pay the capital gains tax with the proceeds of that disposal of assets. In a similar case (Gallaher, C-707/20, paragraph 93) the Court held that where, first, capital gains were realised at the time of the taxable event, second, the tax authorities must ensure the tax on the capital gains realised during the period the assets are within their tax jurisdiction is paid and, last, the risk the tax will not be paid may increase with the passage of time, an immediately recoverable tax charge appears proportionate to the objective of maintaining a balanced allocation of the power to impose taxes between the Member States, without the possibility of deferring payment having to be granted to the taxpayer.

Conclusion

In the light of this analysis and the case law of the Court, it is concluded that a restriction of the right to freedom of establishment resulting from the difference in treatment between national and cross-border disposals of assets for consideration within a group of companies under national legislation may, in principle, be justified by the need to maintain a balanced allocation of the power to impose taxes between the Member States, without it being necessary to provide for the possibility of deferring payment of the charge in order to guarantee the proportionality of that restriction, where the taxpayer concerned has obtained, by way of consideration for the disposal of the assets, an amount equal to the full market value of those assets

I remain at your disposal for any additional clarifications

ADIT Student

PART B

Question 3

Part 1

Reference to fixed ratio rule (30% taxpayer's EBITDA, Art. 4(1) ATAD) □ 30% * 100 (company A's EBITDA) = 30. Only 30 out of the total 40 interest expenses will be deductible.

Part 2

Reference to group ratio rule (Art. 4(5) (b) ATAD) □ deduction of exceeding borrowing costs as per the rule, Group's exceeding borrowing costs vis−à−vis third parties/Group's EBITDA ∗Taxpayer's EBITDA (= Company A) = 160/400 *100 = 40.

Part 3

The introduction of a group ratio rule is based on the inefficiency of a fixed ratio rule for groups of companies. A fixed ratio rule does not take into account the fact that groups in different sectors may be leveraged differently and, even without a sector bias, some groups are simply more highly leveraged. → Therefore, if a fixed ratio rule is introduced in isolation, groups which have a net third party interest/EBITDA ratio above the benchmark fixed ratio would be unable to deduct all of their net third party interest expense.

Part 4

Yes, a MS could introduce stricter rules as the ATAD is a 'minimum harmonisation' directive. Such a stricter rule could consist of a lower % of EBITDA as permissible deductible expense.

Question 4

From: ADIT Student
To: Mrs X, pensioner, Member State A
Subject: Report on the tax implications of moving your residence to another EU Member State and the protection you may enjoy under EU law

Dear Mrs X,

The Facts

I understand that you have recently retired, after having worked for 35 years as a public sector employee in Member State A, where you have also paid social security contributions. Upon your retirement you remain a tax resident of member State A and you receive a pension from the public sector pension fund in Member State A. This pension is your only income.

At this moment you are considering moving permanently to Member State B, where you already own a house that you had purchased before reaching retirement. You do not plan to take up any work in Member State B, as the pension from Member State A is sufficient to provide you with a comfortable standard of living.

The law on the taxation of pensions in Member State A

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 your pension income is 25%. However, 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%.

The issue

You are concerned that, upon moving to Member State B, your tax obligation in Member State A may increase from 25% to 35%. The question is whether you can rely on the EU fundamental freedoms and be able to move to Member State B without becoming subject to a more burdensome level of taxation in Member State A.

Analysis

Acording to article 21 TFEU, every citizen of the Union shall have the right to move and reside freely within the territory of the Member States. Article 21 TFEU, which sets out generally the right of every citizen of the Union to move and reside freely within the territory of the Member States, finds specific expression in Article 45 TFEU in relation to freedom of movement for workers.

The provisions of the Treaty relating to freedom of movement for persons are intended to facilitate the pursuit by Community nationals of occupational activities of all kinds throughout the Community, and preclude measures which might place Community nationals at a disadvantage when they wish to pursue an economic activity in the territory of another Member State. National provisions which preclude or deter a national of a Member State from leaving his country of origin in order to exercise his right to freedom of movement therefore constitute an obstacle to that freedom even if they apply without regard to the nationality of the workers concerned. However, persons who have carried out all their occupational activity in the Member State of which they are nationals and who have exercised the right to reside in another Member State only after their retirement, without any intention of working in that State, cannot rely on the freedom of movement guaranteed by Article 45 TFEU.

According to settled case-law, the status of citizen of the Union is destined to be the fundamental status of nationals of the Member States, enabling those among such nationals who find themselves in the same situation to enjoy the same treatment in law irrespective of their nationality, subject to such exceptions as are expressly provided for in that regard. Situations falling within the scope of Community law include those involving the exercise of the fundamental freedoms guaranteed by the Treaty, in particular those involving the freedom to move and reside within the territory of the Member States, as conferred by Article 21 TFEU.

Accordingly, a citizen of the Union must be granted in all Member States the same treatment in law as that accorded to nationals of those Member States who find themselves in the same situation, it would be incompatible with the right to freedom of movement were a citizen to receive in the Member State of which he is a national treatment less favourable than he would enjoy if he had not availed himself of the opportunities offered by the Treaty in relation to freedom of movement. Those opportunities could not be fully effective if a national of a Member State could be deterred from availing himself of them by obstacles placed in the way of his stay in the host Member State by legislation in his State of origin penalising the fact that he has used them.

According to the settled case law of the Court, national legislation which places some of its nationals at a disadvantage simply because they have exercised their freedom to move and to reside in another Member State would give rise to inequality of treatment, contrary to the principles which underpin the status of citizen of the Union, that is, the guarantee of the same treatment in law in the exercise of the citizen's freedom to move.

Accordingly, in case you decide to exercise your rights to freedom of movement and residence conferred by Article 21(1) TFEU, you may rely on that provision as against your State of origin, i.e. your current state of residence.

Moreover, the Court has also accepted that a non-resident taxpayer, whether employed or self-employed, who receives all or almost all of his income in the State where he works is objectively in the same situation so far as concerns income tax as a resident of that State who does the same work there. Both are taxed in that State alone and their taxable income is the same. That reasoning applies mutatis mutandis in a situation where a retirement pension constitutes the taxable income (see Turpeinen, C-520/04, para. 29). Consequently, in so far as your retirement pension constitutes all or almost all of your income, as a non-resident retired person you would be in the same situation as regards income tax as retired persons resident in Member State A who receive the same retirement pension.

The difference of treatment resulting from the existing rules in member State A could be justified only if they were based on objective considerations proportionate to the legitimate aim of the national provisions Iundeed, objectives such as the simplification and transparency of the tax system for non-resident taxpayers could be achieved by measures less restrictive of the freedom of movement of citizens of the Union than a tax which could, in certain cases, prove to be higher than that applicable to resident taxpayers who receive the same income. Similarly, as far as alleged difficulties as regards collection of the definitive tax from non-resident taxpayers,are concerned, the tax regime at issue in the main proceedings goes beyond what is necessary in order to guarantee effective tax collection.

<u>Conclusion</u>

Under Article 21 TFEU, national legislation according to which the income tax on a retirement pension paid by an institution of Member State A to a person who has exercised his / her Treaty freedom and has moved his/her residence to another Member State is higher than the tax which would be payable if that person had never left Member State A, where that pension constitutes all or nearly all of that person's income, is prohibited. Accordingly, when you decide to move your residence to Member State B, the tax imposed in Member State A cannot be different than the tax that you would be subject to if you had remained a tax resident of Member State A.

Sincerely
ADIT Student

PART C

Question 5

Reference to the three different types of exchange of information established by 'DAC 1'. Exchange of information (EoI) on request, spontaneous and automatic. Explanation that the EoI on request (EOIR) is limited by the required standard of 'foreseeable relevance' of the information, which means that the request must be relevant to the investigation and justified by the purpose pursued by the requesting tax authorities, no fishing expeditions are allowed.

As a bonus, any reference to the OECD 'standard' of foreseeable relevance and the similarity to the DAC1 standard, although the DAC standard is arguably broader than the OECD one. In relation to Spontaneous EoI, this can take place under five categories of circumstances, as those are established under DAC1. In relation to Automatic EoI, DAC1 provides five categories of income that can be covered, under this category, that defines also the extent of the information exchange obligation.

Question 6

Identification that in recent Advance Tax Rulings and state aid decisions of the Commission (e.g. FIAT, Apple, Amazon), the Commission derived from Article 107 TFEU the existence of the 'arm's length principle' (ALP) in the analysis of whether an economic advantage existed. In the Commission's view the ALP derives from Article 107(1) TFEU irrespective of whether it is incorporated into national law or not. In the Commission's view, if transactions are not valued at an 'EU ALP', then an economic advantage is established for the benefited undertakings.

The CJEU annulled the General Courts' decisions that agreed with the Commission. The CJEU confirmed that there is no general ALP in EU law and specifically in the state aid rule. The CJEU ruled that the Commission cannot apply an arm's length principle different from that defined in national law. According to the CJEU, the tax rulings at issue must be examined after taking into account the way the ALP has actually been incorporated into that law with regard to integrated companies in particular.

Question 7

Regarding the role of the European Commission in the development of EU Direct tax law, the answer should include reference to the following:

- The competence of the Commission to table proposals for Directives on direct tax matters, such as the parent-subsidiary directive, the merger directive, the directive on administrative assistance (DAC), the mutual assistance for the recovery of taxes directive, the anti-tax avoidance directive, the dispute resolution directive. In addition, article 352 of the TFEU authorizes the Council to take any appropriate measures, if action by the Union should prove necessary, to attain one of the objectives of the European Union and the founding treaties have not provided the necessary powers.
  In such a situation, the Council may (acting unanimously) take the appropriate measure on a proposal from the Commission and after obtaining the consent of the European Parliament. Following the initiative of the Commission, a number of proposals are currently under discussion such as the FASTER initiative, the proposal for the harmonisation of TP rules in the EU, the BEFIT proposal and the HOT proposal. Last but not least the Commission also publishes soft law instruments such as recommendations that also facilitate the harmonisation of direct taxation rules in the EU.
- The competence of the Commission to initiate infringement procedures when challenging the compatibility of a national tax measure with the fundamental freedoms of the TFEU or with the provisions of a directive. Through this procedure significant steps of negative harmonisation have been established.

Regarding the role of the Court of Justice of the European Union in the development of EU direct tax law, the answer should include reference to the development of the case law of the Court in the area of direct taxation and the negative integration of EU direct taxation, which is primarily a result of the judgments of the EU Court. Negative integration includes the abolition of the domestic law tax provisions and practices that constitute discrimination or a restriction in conflict with the TFEU or which otherwise, on the basis of the EU Court judgments, conflict with EU law. Through the case law of the CJEU a significant number of obstacles have been removed, leading to greater harmonisation.

Question 8

The main features of the 2017 EU Dispute Resolution Directive (DRD)

The answer should include reference to:

- The personal scope, i.e. the persons that can have access to the DRD
- The substantive scope, i.e. the type of cross-border disputes that it covers
- The objective scope, i.e. the taxes that can be the object of the cross-border dispute covered
- The territorial scope, i.e. the European Union
- The two-tiered procedure, MAP and Arbitration
- The unilateral phase and the consultation phase
- The use of arbitration as a complement to MAP, the appointment of the panel, the rules of functioning, the modes of arbitration,
- The possibility of setting up a standing committee
- The involvement of the affected persons in the procedure
- Confidentiality of the proceedings
- The decision and the implementation of the final decision
- The relation with domestic remedies and with other cross-border dispute resolution procedures.

Comparison with the dispute resolution mechanism of the Arbitration Convention

The answer should include reference to the following:

- The DRD has a broader scope as the Arbitration Convention is only limited to transfer pricing disputes
- The DRD is an EU law instrument (directive) whereas the Arbitration Convention is a multilateral international law convention which is not part of EU law
- The CJEU has jurisdiction to deal with issues concerning the application and interpretation of the DRD whereas it has no such jurisdiction regarding the Arbitration Convention
- The Commission can monitor the implementation and application of the DRD whereas it has no such authority for the Arbitration Convention
- The two instruments follow the same two-tiered approach concerning the dispute resolution mechanism: MAP complemented by arbitration
- The DRD offers in general broader protection, providing also for the involvement of the affected taxpayers and has priority over the Arbitration Convention, where a case is submitted to both procedures.

Assessment of the DRD's effectiveness in its initial years of implementation

So far the DRD has rarely been used, and therefore there is only very limited experience with the rules of the Directive. In general it can be said that the DRD is seen as helping to resolve effectively the dispute in a binding manner within a clear and defined deadline. When it comes to the taxpayers' rights, the DRD provides taxpayer(s) with enhanced rights to enforce the setting up of resolution mechanisms.