

EU: Holding companies and access to EU directives and tax treaty benefits post-BEPS in light of recent court decisions

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Executive summary

A substantive economic connection between entities claiming benefits has become increasingly important as a threshold to secure tax treaty and European Union (EU) directive benefits.

This Alert summarizes a recent Italian Supreme Court decision and its potential impact on access to EU directives and tax treaty benefits in the post-Base Erosion and Profit Shifting (BEPS) environment.

Detailed discussion

Italian Supreme Court judgment¹

There is considerable interest and discussion related to a recent decision (*Macquarie*) by the Italian Supreme Court (SC). The case considers the circumstances required for an EU holding company to benefit from the EU Parent Subsidiary Directive (EU PSD or PSD) when receiving dividends from an Italian subsidiary.

In particular, most of the discussion relates to the SC's apparent support of the Italian tax authorities' (ITA) denial of the potential benefit - reduction to nil of the domestic 26% withholding tax (WHT) - when the receiving parent is not subject

to tax in its own country by virtue of legislation such as what is commonly known as the "participation exemption." This decision appears to be in line with another previous decision of the SC last year (no. 32555 of 13/12/2018, CDC) regarding the same issue. The decision was heavily criticized by prevailing commentary at the time, without any impact.

The decision also seems consistent with the findings of the Court of Justice of the European Union (CJEU) regarding the entitlement to benefits of a Dutch Fiscal Investment Institution incorporated in a taxable form (NV) but subject to Dutch corporation tax at a zero rate when it pays all its profits to its shareholders (C-448/15 Wereldhave). Similarly, in Case C-118/16 addressing the important Danish cases the CJEU held that a Luxembourg SCA authorized as a SICAR cannot benefit from the Interest and Royalties Directive if the interest it receives is exempt from corporate income tax in Luxembourg.

This Alert summarizes the critical conclusions that can be drawn from the Italian decision(s) taking into consideration the overlapping cases at the CJEU level. As Italy is a civil law country, no precedent arises from the SC's rulings. Rather the ruling comprises an authoritative opinion on the specific case that could conflict with other comparable cases.

In *Macquarie*, the SC has confirmed the tax court decisions of the first instance and the appellate level, which agreed with the ITA that neither the PSD nor treaty benefits were available to the Luxembourg holding company (Holdco or Malsa) belonging to the Macquarie group. The ITA argued that Malsa had been incorporated in Luxembourg for the sole purpose of benefitting from the Italy/Luxembourg double tax treaty and the EU PSD, without being either the dividends' beneficial owner (this being a Bermudan and an Australian group company) or having its place of effective management (POEM) in Luxembourg.

Malsa appealed against the appellate tax court decision claiming the following:

- a) It is sufficient for a parent to be resident in an EU/treaty country to benefit from the PSD/Treaty, without the need of having its POEM therein.
- b) The tax residence certificate issued by the foreign (Luxembourg) tax authorities is sufficient to prove that Holdco's POEM is located in the country, especially when a second (subsequent) tax authorities' certificate expressly states that not only the Lux residence but also the POEM's requisites were verified.

- c) The appellate decision was in conflict with Italian tax law and the EU principles of Freedom of Establishment (FoE) and Free Movement of Capital (FMC) where it considered Holdco's incorporation in Lux as an abusive practice simply because its shareholders were Australian and Bermudan, without taking into account that the group was present in Luxembourg via other group companies and that such country is also attractive because of its company and financial laws.
- d) The appellate decision was incorrect inasmuch that it denied the status of beneficial owner to Holdco simply because those dividends were tax exempt via the domestic law participation exemption.

The SC rejected all the above claims stating that:

- a) The Italian provision implementing the EU PSD at that time (subsequently modified) granted the 0% WHT to EU parents owned by shareholders resident in third countries only if such parents demonstrated that they were not holding the Italian participation with the sole or principal purpose of obtaining the benefit. In addition, it is inherent in the system that abusive practices are to be disallowed not only for PSD purposes but also with respect to treaty benefits. Hence, it is not sufficient to be resident in an EU/treaty country to obtain the related benefits.
- b) The certificates issued by Lux tax authorities were not sufficient to prove that Holdco's POEM was located therein. POEM is rather a question of substantive fact. The appellate decision concluded that Malsa did not demonstrate that the Board of Directors ever met in Luxembourg, nor did they produce minutes of the meetings, where decisions regarding the company had been taken, nor did they claim the existence of an office in Lux, wherefore expenses could be found in the financial statements. Hence the appellate decision was justified.
- c) Even if it is acknowledged that a holding company does not operate as a manufacturing or commercial company, nonetheless it needs to have a proper nexus with the country where it is apparently resident, which is its POEM; at least to exclude its alleged nature of conduit that is claimed by the ITA, that they support by reference to the Macquarie Airports website that declares Malsa as an SPV, i.e., a "vehicle" with the "special purpose" of transferring dividends to the beneficial owners. Hence, in view of the reasons whereby at the previous remark, Malsa is to be qualified as a wholly artificial arrangement

and, as such, not able to invoke the FoE or the FMC in the case of anti-avoidance provisions (mentioning C-135/17, C-116/16 and C-117/16 “the Danish Decisions”, and C-212/97, Centros).

- d) It has been ascertained that Holdco has not paid any Luxemburg tax on the dividends and the PSD requires the parent to be subject to one of the listed taxes “without the possibility of an option or of being exempt.” Indeed, the SC has already clarified in the past that bilateral treaties and the PSD produce a complementary and multi-level discipline aimed at avoiding, through the treaty, the juridical double taxation and, through the PSD, the economic double taxation of companies; however, it remains necessary that the avoidance of double taxation does not result in the opposite effect of double non-taxation. As per the treaty benefit, it was demonstrated (see above) that Holdco was not the beneficial owner of the dividends.

The decision is not inherently contradictory to the *Eqiom* decision (C-6/16), where the CJEU stated that the fact that an EU company is owned by shareholders resident in third countries does not imply per se a wholly artificial arrangement. Nonetheless, what the SC failed to acknowledge is that in the same decision the CJEU considered disproportionate a measure that – to fight tax avoidance – grants the PSD benefit only if the taxpayer first demonstrates that the principal purpose of the chain of interest is not to take advantage of the benefit, as it was in the Italian provision at that time (which has been changed as of 1 January 2016).

In addition, what really calls attention is that the SC continues to raise the position that treaties and directives’ provisions limiting double taxation may not be meant to end up with double non-taxation. It is important to consider that non-taxation could be evidence of an abusive purpose [indeed this is made explicit in double tax treaties post-BEPS Action 6 implementation of the MLI] but non-taxation alone should not be sufficient to deny directive/treaty benefits in circumstances where there is a substantive economic nexus between the counterparties (under a double taxation agreement) or where there are genuine economic arrangements (under an EU directive).

Indeed, in cases like *Macquarie* or *CDC*, there is no double non-taxation when neither the subsidiary nor the parent applies taxes on the dividend, and that is because the subsidiary has already paid local taxes on the profits originating the dividend itself. This can be clearly induced by the PSD itself, which requires to refrain from taxing the dividend both at the

source (under the form of WHT) and in the home country. This same point is recognized explicitly or implicitly in double taxation agreements albeit the precise position differs by reference to individual tax treaties.

The purpose of the PSD is to reduce obstacles – such as economic double taxation of dividends – that hinder the grouping together of companies of different Member States (first whereas of Dir 90/435/EEC) and for that reason requires that its provisions apply (only) to “companies.” And “companies” must take certain legal forms, be resident in a Member State and subject “without the possibility of an option or of being exempt” to certain corporate taxes. In *Wereldhave*, the Dutch FII was subject to tax at a zero rate when distributing all its profits to its shareholders, even if non-EU: this seems to clearly be one of the cases that the PSD was not meant for and, indeed, the requisites have not been considered met by the CJEU.

Unfortunately, the Italian SC’s argument is following up – without apparent reason – a series of decisions taken in the past (e.g., no. 27111 of 2016, *Elantas*) with respect to the simultaneous application of both the EU PSD and the underlying tax credit refund granted by certain Italian treaties. In particular certain taxpayers requested not only the refund of the tax (credit) underlying dividends (i.e., the tax paid by the subsidiary on its profits) that the treaty with France and the United Kingdom allowed, but also that such tax credit was exempted from WHT by virtue of the PSD: there the SC was right in denying the contemporary application of both measures by invoking the double non-taxation. However, this cannot be said where (only) the PSD WHT exemption is invoked by an EU parent that benefits from a participation exemption in its home country.

Relevance for taxpayers

The following conclusions can be drawn from the Italian case discussed above as well as the Danish cases decided by the CJEU.

1. It is increasingly clear that the threshold for treaty access in a post-BEPS environment is a higher threshold than may have been assumed in countries where treaties did not include a comprehensive limitation on benefits provision.
2. Treaty or directive limitation on benefits will arise consequential to holistic reviews of the purpose, effect and substance of arrangements.
3. Arrangements may be attacked under POEM, beneficial ownership and/or abusive purpose principles.

4. An exemption from tax on income should not be sufficient to deny tax treaty benefits. The analysis should depend on the language of each individual treaty. However non-taxation of income may commonly be seen as evidence of abusive purpose and may preclude access to EU directives.
5. In cases where treaty benefits are economically material a strong defense against POEM, beneficial ownership and/or abusive purpose principles whether under EU law or under double taxation agreements will be a substantial economic nexus that underpins the legal relationships between entities in a corporate structure. At the very least this implies a "business substance" led approach to selection of holding and financing locations and entities.
6. Holding companies take a very wide degree of forms in practice from mere legal intermediaries to substantial global or regional headquarter enterprises with material economic integration with their subsidiaries. It is likely to be the nature and extent of the economic connection between the holding company and the participation that supports entitlement to benefits rather than some abstract notion of holding company substance.
7. Certain businesses might require material operational change to secure treaty benefits. Two common examples where this might be the case are:
 - (i) Multinational groups where management control is centralized in the global headquarters but where "third country" holding companies seek to claim tax treaty benefits
 - (ii) Non-CIV funds where management control is vested in an asset management organization but where "third country" holding companies seek to claim tax treaty benefits without sufficient non-tax business purpose and nexus in the "third country."

EY's experience to support taxpayers

1. Entitlement to treaty and directive benefits is an area of significant change in the reliability of long-held analyses, approaches and structures. EY has significant experience with the Organisation for Economic Co-operation and Development and the European Commission and major countries to provide risk assessment and resolution options.
2. We have undertaken many treaty/directive access risk assessment projects for which we have a standardized approach.
3. We have undertaken a range of treaty/directive access remediation projects which typically include any or all of the following:
 - (i) Changes to documentation and operational guidelines
 - (ii) Relocation of functions
 - (iii) Wider reorganizations of group holding, financing and/or intellectual property holding structures

Endnote

1. No. 25490 of 10/10/2019, "Macquarie."

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