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INTERNATIONAL BAR ASSOCIATION

RECENT DEVELOPMENTS IN INTERNATIONAL TAXATION

MAY 2019

DENMARK

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1. Introduction

On the 26 February 2019, the European court of Justice ("ECJ") ruled in six so-called "beneficial ownership"-cases. Two rulings concerns tax on dividends and four concerns tax on intra-group interest. The rulings have major influence as it sheds some light on the definition of the concept "beneficial owner" (in relation to the EU Interest-Royalty Directive) and how this concept is to be applied both under Danish law and in relation to EU law, just as they rulings focus on abuse. The cases are now to be interpreted by the Danish eastern and western high court. The courts are to make concrete decisions as to whether the individual companies should be denied protection under the directives, i.e. whether the companies have abused the directives.

2. The Danish beneficial ownership-cases

2.1 Since 2009, the Danish Ministry of Taxation has filed a number of lawsuits against companies being tax resident in Denmark which have distributed profits or paid interest on controlled debts owed to recipients residing in other EU member states which have claimed protection under EU law or a double taxation treaty.

The Danish companies claim exemption from withholding tax requirements in relation to the payments under the EU Parent-Subsidiary directive, the EU Interest-Royalty directive or a double tax treaty. The question before the ECJ was whether the Danish companies were exempt from withholding tax on payments made to entities not deemed to be "beneficial owners".

The Danish Ministry of Taxation holds the view that a recipient acting solely as conduit entity cannot be beneficial owner of amounts received and that beneficial ownership is condition for protection under EU law and/or a double tax treaty to be available. The Danish company paying interests or distributing dividends is only exempt from withholding tax if the foreign recipient qualifies for protection under EU law and/or a double tax treaty.

Accordingly, the Danish Ministry of Taxation states that the Danish companies were liable for withholding tax on the interest or dividends paid.

Generally, there has been considerable uncertainty concerning:

i) Whether a Member State's reliance on anti-abuse-considerations presuppose the adoption of specific national anti-abuse provision, or whether the member State can rely on a general anti-abuse principle inherent in EU law;

ii) Whether the absence of "beneficial ownership" to funds received constitute an attempt to abuse EU-law;

iii) How the concept "beneficial ownership" is to be interpreted and if the concept of "beneficial ownership" mentioned in EU law is the same as the concept of "beneficial ownership" mentioned in double tax treaties based on the OECD Model Tax Treaty.

3. The Danish beneficial ownership-cases

3.1 In its rulings, the ECJ particular provides guidance on the interpretation of the EU Parent-Subsidiary Directive and the EU Interest-Royalty Directive.

In relation to the beneficial ownership concept the ECJ stated that the concept within the meaning of the EU Interest-Royalty Directive (the EU Parent-Subsidiary Directive does not contain such requirement) must be "*interpreted as designating an entity which actually benefits from the interest that is paid to it*". Accordingly, the ECJ says, the beneficial owner is the entity which has the power to freely determine how the interest received shall be used. The ECJ also states that member states can rely on the OECD model tax convention and its commentaries when they interpret the beneficial ownership concept. This includes successive amendments.

Remarkably the ECJ also states that the mere fact that a company receiving interest payments is no to be considered the beneficial owner does not necessarily mean that the exemption in the EU Interest-Royalty Directive does not apply. Actually, according to the ECJ, it is conceivable that interest paid from a company in a member state will be exempt from withholding tax that state if the receiving company (not qualifying as beneficial owner) transfers the amount to a beneficial owner within the EU and satisfies all the other conditions set out in the directive for the application of the exemption.

In addition, the ECJ states that an EU member state must not grant benefits under EU law (including the EU Parent-Subsidiary Directive and the EU Interest-Royalty Directive) if the grant of those benefits is contrary to the objectives of EU law.

According to the ECJ, denial of benefits is based on a general legal principle stating that EU law cannot be relied on for abusive or fraudulent ends. This principle may be relied on by the member states even if there are no domestic or agreement-based anti-abuse provisions.

The ECJ further states that a refusal of benefits is applicable where the transaction at hand or a group structure is established/designed to circumvent the application of the legislation for the member state concerned.

4. Assessment of abuse

4.1 The ECJ states that proof of an abusive practice as a main rule is present if a *"… purely formal or artificial transactions devoid of any economic and commercial justification, with the essential aim of benefiting from an improper advantage…"* is proven [emphasis added].

Proof of abusive practice is present where – despite formal observance of conditions laid down by EU law – the purpose of EU law has been achieved or whether an intention to obtain an advantage from the EU rules by artificially creating the conditions laid down for obtaining it.

The ECJ further states that certain facts may demonstrate abuse of rights granted under EU law.

Such facts may include, in particular:

- That a group structure is set up for reasons not reflecting economic reality, but purely as a matter of form with the principal objective to obtain a tax advantage. Specifically, in the case of interposing a conduit entity in the group between the company paying interest or dividends and the beneficial owner, payment of tax on interest or dividend is sought to be avoided in an abusive way.

- That the passing on of all (or almost all) of interest or dividend received very soon after receipt by the first recipient should be seen as an indication that the recipient is a conduit entity. The ECJ states that a company may be considered as a mere conduit if interests or dividends are in fact passed on even though there is no legally binding obligation to do so, if the first recipient does not in fact have the right to use and enjoy those sums.

- That the sole activity of the receiving company is to act as recipient of interest and/or dividend.

- That complex financial transactions and the grant of intra-group loans are carried out in close connection with the implementation of new tax laws in relevant member states.

The ECJ also states that when examining the structure of the group it is immaterial that some of the beneficial owners of the interest or the dividend paid by the conduit company are resident for

tax purposes in a third state which has concluded a double taxation convention with the source member state. The existence of a double taxation convention does not in itself rule out abuse. However, according to the ECJ the taxpayer can prove that the aim of a certain structure was not abuse if the interest would have been tax exempt under the convention had the interest been paid directly to a company residing in the third state.

In addition, the ECJ states that a national authority refusing to grant the first recipient of income protection as being beneficial owner of the income is not required to identify the entity or entities which should be considered beneficial owners. It will be sufficient for the tax authorities to establish proof that the first recipient is a conduit entity.

The final ruling of the cases at hand – and the application of the guidelines specified by the ECJ – is now up to the Danish Western High Court and the Danish Eastern High Court where the six cases are pending.