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The Rise of Tax Litigation

Panel

- Liesl Fichardt
  - Quinn Emmanuel (UK)
- Stefano Petrecca
  - CBA (Italy)
- Christopher Slade
  - Aird & Berlis (Canada)
- Bodil Tolstrup
  - Bjørnholm Law (Denmark)
- Jonathan Schwarz (Chair)
  - Temple Tax Chambers (UK)
- Jivaan Bennett (Reporter)
  - Linklaters (UK)

Danish Tax Tribunal
Reverse hybrid – SKM2023.481.LSR

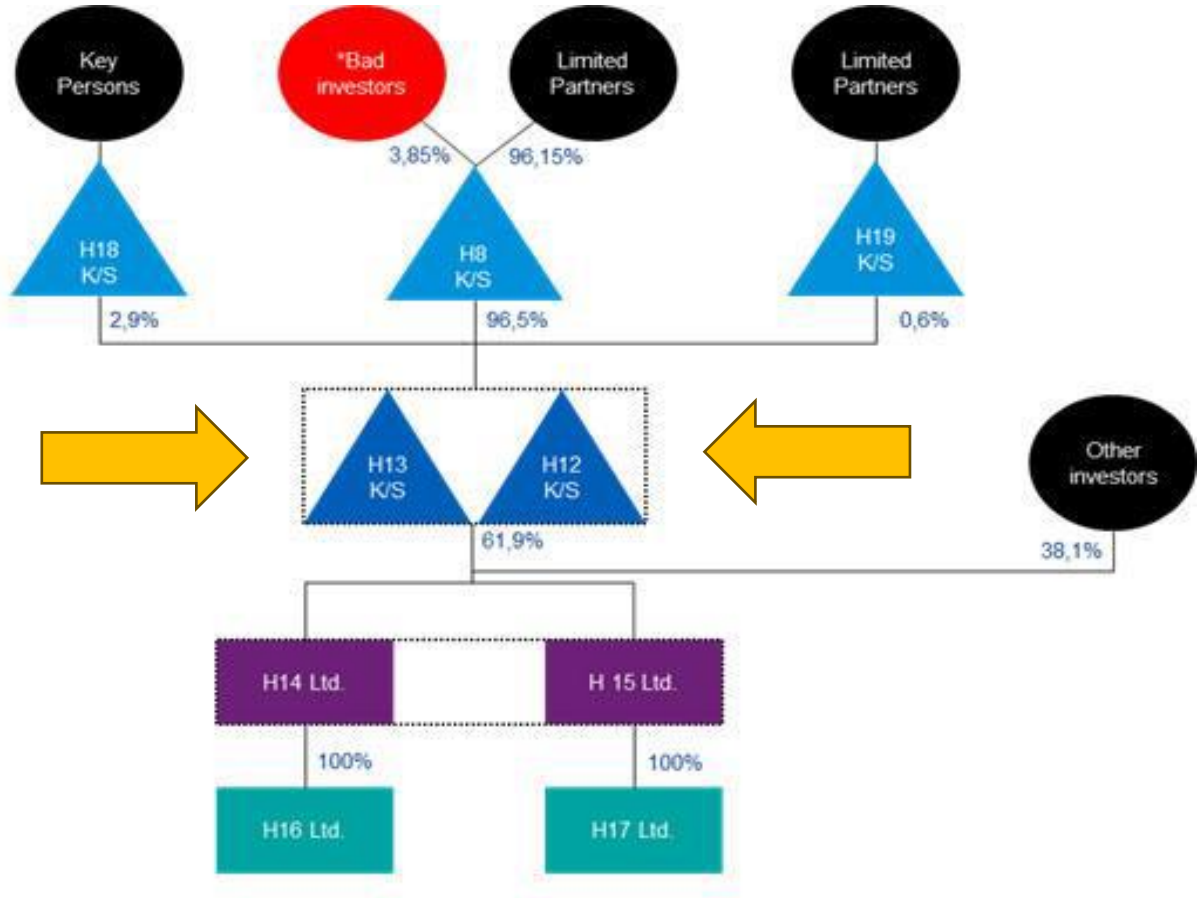
Reverse hybrid – Danish case law in reverse

- DK CITA art. 2C: hybrid mismatch provision enacted in 2008
- BEPS action 2 from 2015,
- EU ATAD II art. 9A (2017/952)
- => reverse hybrid mismatch included effective 2020 in Danish CITA art. 2A
- Conditions for application: ”bad investors”, ”associated persons”, ”direct or indirect at least 50 %”

“[…] entities that are transparent for tax purposes […] are taxed subject to the rules that apply to companies […] if one or more associated persons […], which directly or indirectly owns at least 50 % of the voting rights, capital or the right to a share of the profits, are domiciled in states [that recharacterizes or is a tax heaven = bad investor]*”*

- Consequence: Full recharacterization for all purposes, e.g. corporate taxation of entity, investors are shareholders, withholding taxes could be applied

Reverse hybrid – SKM2023.481.LSR



* Investorer fra Land A, Land B, Land C samt Land D

<u>Topic</u>

- H12 and H13 are transparent under DK law, but are they reverse hybrids because of the 3.85 % bad investors in H8?

<u>Main issues:</u>

- ”Associated persons” are those who act together towards the ‘investment’ but are they also associated to each other?
- ”Associated persons” respecetive ownership shares are considered as one common share when assessing the ”direct or indirect share of at least 50 %” => ”bad investors” taints others?

Reverse hybrid – SKM 2023.481.LSR.

Danish Tax Authority / Tax Board in binding ruling from 2021

- Investors acting together through a common vehicle (H8 K/S) are “associated persons” in respect of H12 K/S and H13 K/S.
- There is no reason to assume that the “association” only relates to the relation to investment => investors are also “associated to each other”. => “associated persons” shares must be counted as one for assessing the “at least 50 %” condition => 96.5% of H12 K/S and H13 K/S are “bad investors” and are therefore reverse hybrids subject to requalification.

Danish Tax Tribunal (administrative tax appeals body)

- Considering the purpose of the rule and in the absence of clear wording and clear preparatory comments to the opposite, “bad investors” must meet the 50 % criteria without including shares held by good investors.

Reverse hybrid – SKM 2023.481.LSR.

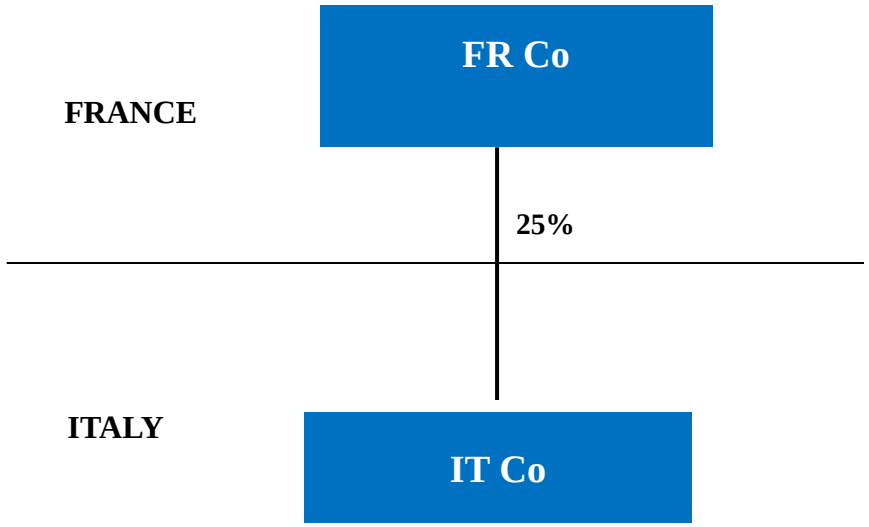
Danish tax authorities claimed that the result would not be compliant with ATAD II. Correct?

- ATAD II, recital 28: OECD BEPS action 2 report, examples where “bad investors” may taint good investors if they are “associated”, e.g. example 11.2 and 11.5.
- Issue that Denmark requalifies the entity in full with no consideration for investors who treats the reverse hybrid as transparent. Over implementation or acceptable when minimum directive?
  - Last part of ATAD II, art. 9a (1) omitted in Danish law: *“… the hybrid entity shall be regarded as a resident of that Member State and taxed on its income* ***to the extent that that income is not otherwise taxed under the laws of the Member State or any other jurisdiction.***“
- Criteria of abuse and proportionality?
  - ATAD II, whereas no. 12: *“In order to ensure* ***proportionality****, it is necessary to address* ***only the cases*** *where there is a* ***substantial risk of avoiding taxation*** *through the use of hybrid mismatches. It is therefore appropriate to cover hybrid mismatches that arise between …”*
- Change of law if practice is not compliant? Something to keep us occupied in 2024 …

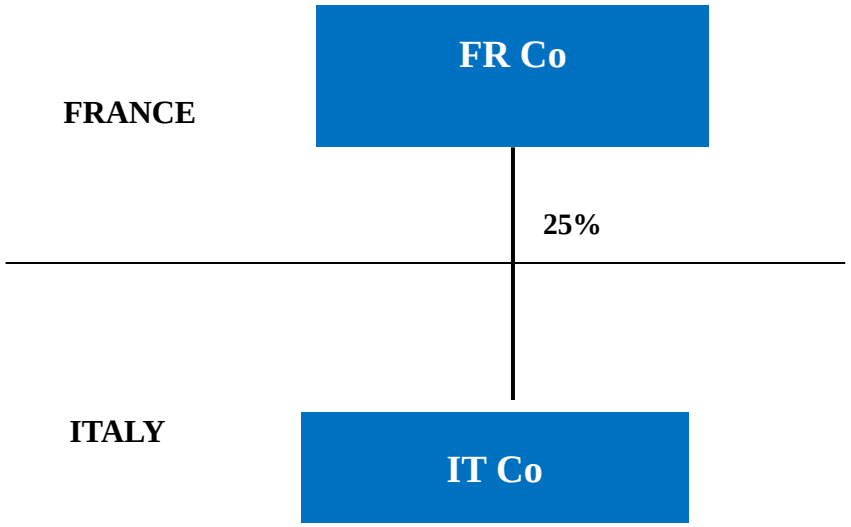
Italian Supreme Court n. 21261/23
Italian Pex Regime

Italian Pex Regime – Supreme Court n. 21261/23

No PEX:
Capital gain is taxed (also) in Italy at 26% rate



PEX:
Capital gain is taxed (also) in Italy at 1,2% rate



- **Capital gains** realized by foreign companies upon the disposal of **participations in Italian resident companies** are generally exempt from taxation in Italy due to the Article 13 of the Italian DTTs that normally reserves the right to tax the capital gain to the **State of residence of the selling company**.

- A few Italian DTTs give the right to tax also to the State where the subsidiary is located.

- The **Italy – France DTT** (Article 8(b) of the Protocol) states that capital gain deriving from the disposal of a **"substantial participation"** shall be taxable in **both States**.

Italian Pex Regime – Supreme Court n. 21261/23

- **Non resident companies are not allowed** to benefit from the Italian participation exemption ("**PEX**") regime. Therefore, the entire capital gain is (also) taxed in Italy at a rate of 26%.

- The **Italian *PEX* regime** provides that capital gains realized upon the disposal of shareholdings are **95% exempt** from the ITC when:
  - ✓ the participation has been held continuously for at least 12 months prior to the disposal;
  - ✓ the participation was classified under the financial fixed assets in the first financial statement closed after the acquisition of the participation;
  - ✓ the subsidiary is not resident in a black list country;
  - ✓ the subsidiary carries out a commercial activity.

Italian Pex Regime – Supreme Court n. 21261/23

- **Corte di Cassazione decision No 21261/2023**: **French companies** without a PE in Italy **are entitled** to benefit from the **Italian *PEX* regime** on capital gains realized upon the sale of "substantial participations" held in an Italian resident company when all the relevant requirements are met.

- The non-application of the *PEX* regime constitutes a **discriminatory treatment** not compatible with the **Freedom of establishment** and **the Free movement of capital principles**.

- Such a discrimination **is not eliminated** by the **tax credit** granted by art. 24 of the DTT, since French companies may recover only part of the tax paid in Italy due to the *PEX* regime applicable in France and, in any case, because the tax credit aims at eliminating the "juridical" double taxation, whilst the Italian *PEX* regime intends to remove the "economic" double taxation of the profits generated by the participated company.

UK Upper Tribunal
JTI Acquisition Company (2011) Ltd v HMRC
[2023] UKUT 194

JTI Acquisitions Company (2011) Ltd v HMRC [2023] UKUT 194

The context and facts:

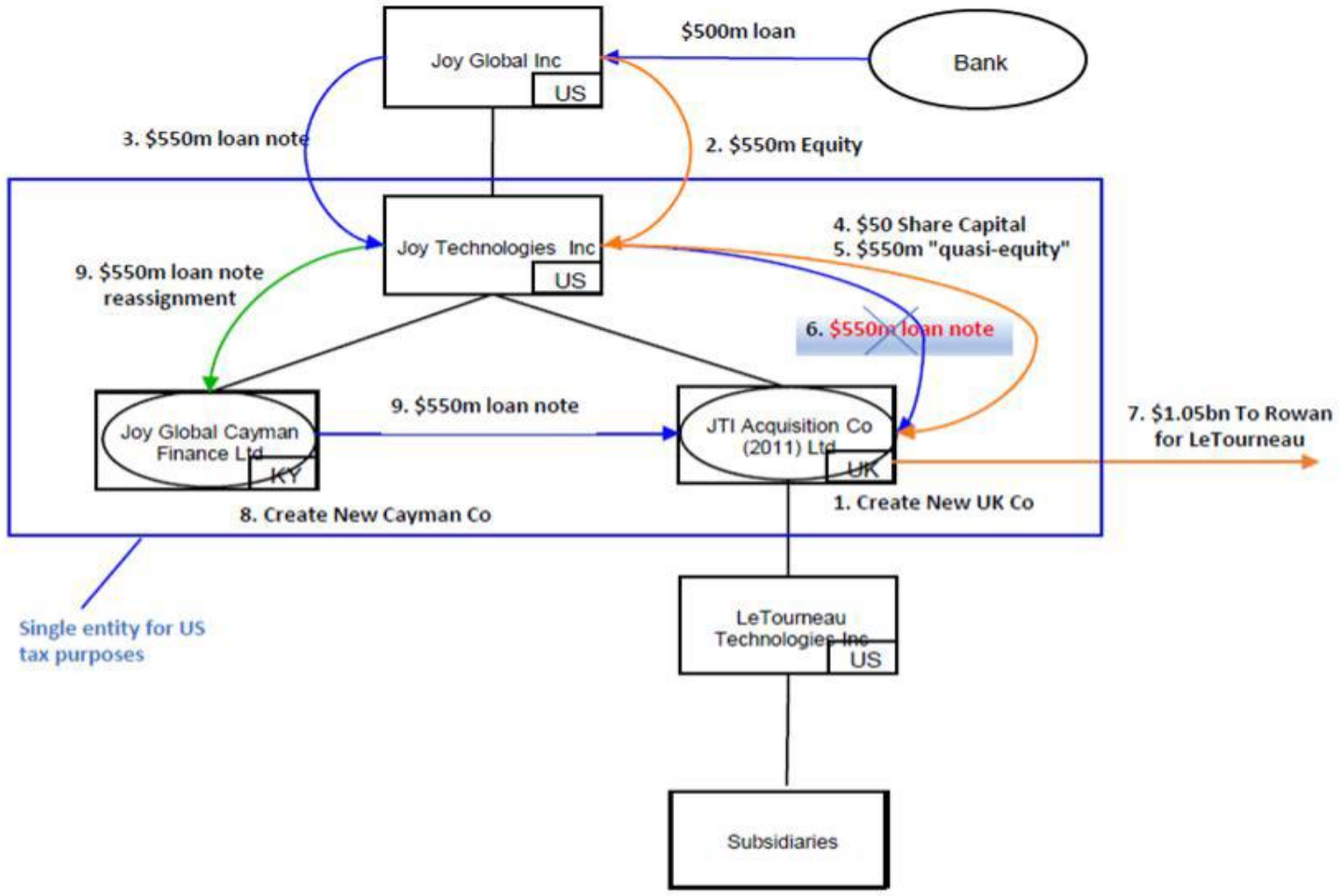
- HMRC published updated guidance on the application of the unallowable purpose rule.
- On appeal the Upper Tribunal (UT) affirmed the decision of the First-tier Tribunal (FTT).
- The case concerns a UK newco (JTI) of a US group. JTI was formed to borrow monies from its US parent to acquire shares in another US company from a third party. (See structure chart)
- Common ground that the finance was on arm's length terms and was used to make a commercial acquisition.
- The borrowing was subject to an advance thin capitalisation agreement (ATCA) with HMRC, which was entered into approximately a year after the arrangements.

HMRC's case:

- The main reason that JTI was inserted into the structure was to secure a tax advantage (UK interest costs which were surrendered to other UK group companies).
- The arrangements, which were advised on by Deloitte, also had an overall US tax advantage: US parent borrowed monies from a third party bank but, since it had checked-the-box on the UK subsidiary, was not treated as receiving any interest payments in the US.

JTI Acquisitions Company (2011) Ltd v HMRC [2023] UKUT 194

Chart X



Line colours
Equity = Orange
Loans = Blue
Re-assignment = Green

JTI Acquisitions Company (2011) Ltd v HMRC [2023] UKUT 194

Findings of FTT: the unallowable purposes rules applied - securing a tax advantage was the main purpose of the appellant being a party to the loan relationship.

- The intra-group borrowings of a UK subsidiary which was incorporated as part of arrangements to acquire a US group should be disallowed as the loan had an unallowable purpose.
- The court was entitled to look at the reason the subsidiary was brought into existence as part of the wider arrangements, rather than simply looking at the narrow purpose for which the loan was taken out.
- It gave more weight to the contemporaneous documentation in concluding that the UK tax deductions were the main purpose of the arrangements, which was borne out by tax planning documentation put forward by Deloitte.
- In considering the purpose or motive of JTI in entering into the loan, it was entitled to have regard to the wider group purpose of the arrangements, including the US parent's decision to incorporate JTI to undertake the borrowing.

UT Findings on appeal: Accepted the FTT findings of fact. Focused on three key technical questions of statutory interpretation of the rules in CTA 2009 ss 441 and 442:

- As a matter of statutory interpretation, "the natural reading of s442 and the words "the main purpose for which… the company is a party to a loan relationship…" invite the straightforward question "why are you a party to the loan relationship?" : stand back and ask, where relevant, why that company in particular (as opposed to someone else) was a party to the loan relationship".
- There is no hard and fast rule that, where the borrowing is used to purchase a commercial asset, a finding of unallowable purpose must be precluded. "There is no carving out or privileged treatment for purchases of commercial assets with arm's length borrowing from the legislation's acknowledgment that a purpose of securing a tax advantage may nevertheless be found amongst the company's business or commercial purpose."
- The borrowing's use was a relevant factor, but not determinative. Instead, a wide ranging and fact sensitive enquiry of all the circumstances is required.

JTI Acquisitions Company (2011) Ltd v HMRC [2023] UKUT 194

Key issues:

- Relevance of documents and evidence: It had to weigh witness and documentary evidence and reach a conclusion.
- The ATCA of itself did not provide blanket clearance to other targeted anti-avoidance provisions such as unallowable purpose rule.
- The reason why a particular company has been used is a relevant consideration in this context and the mere fact the borrowing is used to make a commercial acquisition will not be sufficient to take it outside the scope of the anti-avoidance rules.
- Look at overall international context and not only at UK tax component.

Supreme Court ofCanada
Deans Knight Income Corp. v. Canada, 2023 SCC 16

Deans Knight Income Corp. v. Canada, 2023 SCC 16

- General anti-avoidance rule (GAAR) case involving a plan to monetize tax losses (a.k.a. “loss trading”)
- Canadian tax rules generally permit taxpayers to carry over and apply losses against income earned in prior and subsequent taxation years
- A specific anti-avoidance rule (SAAR) restricts non-capital loss carryovers for corporations if there has been a change in *de jure* control
- *Deans Knight* concerns an attempt to avoid that SAAR by acquiring significant non-voting equity rights under contractual arrangements that provided the functional equivalent of majority voting power
- **Issue**: What is the “object, spirit and purpose” of the SAAR?

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Deans Knight Income Corp. v. Canada, 2023 SCC 16

- Majority (7-1) of the Supreme Court held that GAAR applied
- The court took a liberal approach to discerning parliamentary intention:

> *"… it does not follow that the provision's rationale is fully captured by the de jure control test. Rather,* ***de jure control was the marker that offered a roughly appropriate proxy for most circumstances with which Parliament was concerned*** *— particularly given that the GAAR exists as a last resort. To ascertain the rationale underlying s. 111(5), more is needed than the simple fact that Parliament settled on this test to operationalize its intent."* – para 94

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Deans Knight Income Corp. v. Canada, 2023 SCC 16

"… Indeed, the rationale of s. 111(5) is illuminated by related provisions which both extend and restrict the circumstances in which an acquisition of control has occurred. These provisions ***suggest that de jure control is not a perfect reflection or complete explanation of the mischief that Parliament sought to address***." – para 95

"… To define the object, spirit and purpose of s. 111(5) based on Parliament's choice of test or substitute it for another test would, in this case, result in ***prioritizing the means (the* how*) over the rationale (the* why*)****."* – para 115

"… In this case, s. 111(5) demonstrates ***Parliament intended to deny unused losses to unrelated third parties who take the reins of a corporation and change its business****. This explains what Parliament sought to prevent through the provision, understood in light of its text, context and purpose."* – para 118

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Deans Knight Income Corp. v. Canada, 2023 SCC 16

- Dissenting judge strongly criticized the majority's decision
- Should courts be able to effectively re-write / supplement legislation?

> *"…When articulating the object, spirit and purpose of a provision, a court is not repeating the test for the provision, nor is it crafting a new, secondary test that will apply to avoidance transactions.* ***Discerning the object, spirit and purpose does not rewrite the provision****; rather, the court merely takes a step back to formulate a concise description of the rationale underlying the provision, against which a textually compliant transaction must be scrutinized."* – para 60

- *Deans Knight* highlights the risk that taxpayers take when attempting to plan around precisely drafted legislation

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English Court of Appeal
Royal Bank of Canada v HMRC [2023] EWCA 695 (Civ)

Royal Bank of Canada v HMRC [2023] EWCA 695 (Civ)

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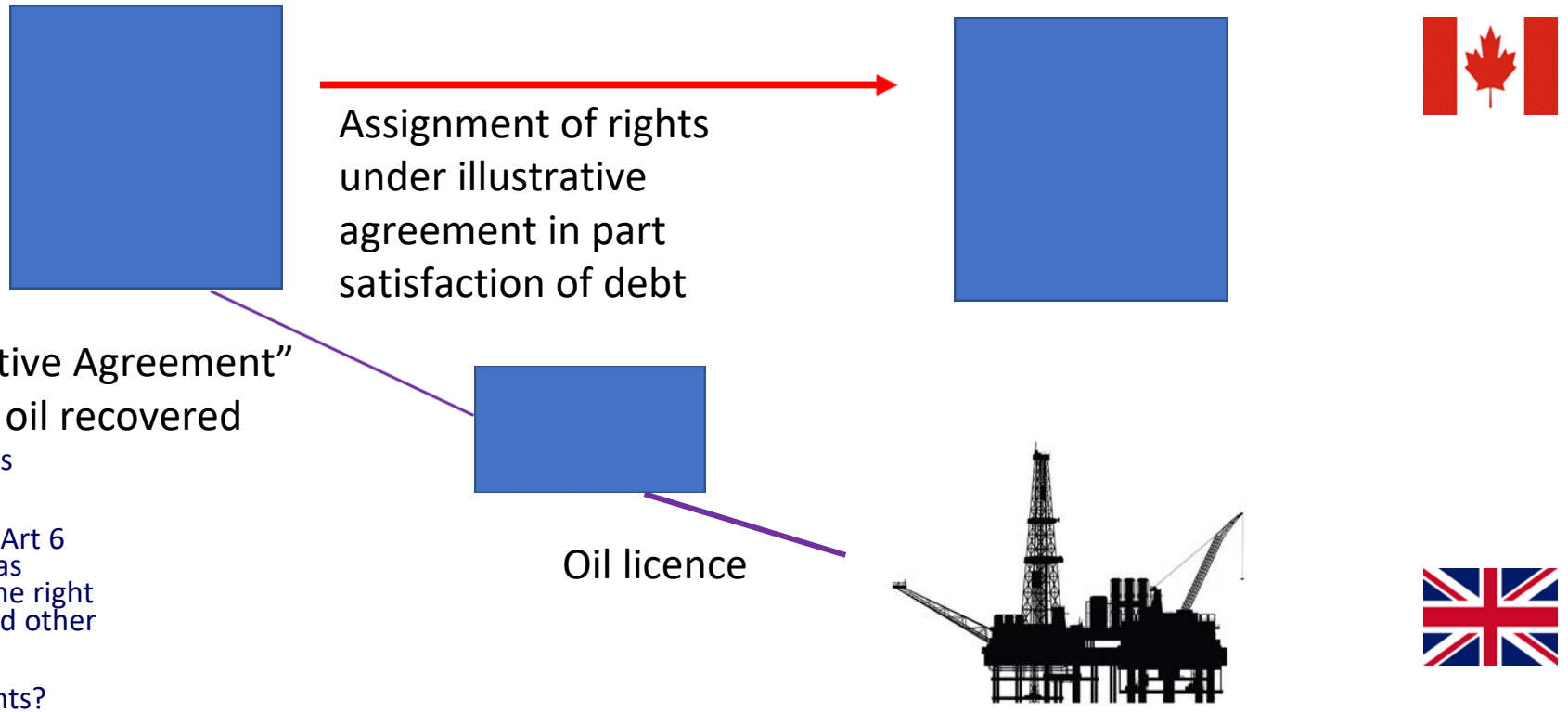

Was the amount RBC received from rights assigned to it:

- Income from immoveable property – Art 6 "rights to variable or fixed payments as consideration for the working of, or the right to work, mineral deposits, sources and other natural resources"?
- Is this limited to the grant of such rights?
- Business profit – Art 7?

Royal Bank of Canada v HMRC

Temple tax chambers

- Treaty interpretation
- Art31(1) VCLT requires a treaty to be "… interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose."
- Article 31 also provides that the context extends beyond the treaty itself to certain other sources, including subsequent agreements between the parties in respect of the interpretation of the treaty, subsequent practice that establishes such an agreement and any relevant rules of international law.
- Article 32 permits recourse to further supplementary means of interpretation in order to confirm the meaning resulting from the application of Article 31, or to determine that meaning when it would otherwise be ambiguous or obscure or leads to a result which is manifestly absurd or unreasonable.
- [Art 33- Treaties concluded in more than one language]

Royal Bank of Canada v HMRC

Temple tax chambers

- Focus on Context: the treaty as a whole, notably the whole of art 6, arts 12, 13, and 27A
- Departures from the OECD Model
- OECD Commentary and academic writing
- French text of the treaty
- Finding:
  - RBC does not hold, and indeed has never held, an interest in the Buchan field. What it acquired was a contractual right to receive payments calculated by reference to the sale proceeds derived from sales of oil, to the extent that the price obtained exceeded $20 a barrel. Although RBC accepted that it "stood in the shoes" of Sulpetro as regards its entitlement to the Payments, that cannot alter the fact that it has at no stage held an interest in the Buchan field.

Panel bios

Liesl Fichardt, who specialises in complex tax, finance and debt related investigations and disputes is recognized in the Chambers & Partners Global Guide, ranking Band 1 for Tax: Contentious. Chambers wrote, "She is first-class; she is a very good international lawyer who is highly respected, extremely hard-working and a brilliant strategist and tactician." "She is a very skillful and determined litigator.". Further, Liesl has been recognized by Legal 500 in the Tax Litigation & Investigations Hall of Fame. Legal 500 wrote, “Liesl Fichardt is a superb lawyer, for whom there are not enough superlatives. Technically brilliant in the principles and details of domestic and international taxation law, she has a fantastic strategic nous and great skill and experience in dealing with tax authorities.”. Liesl was also listed in the Hot 100 List by The Lawyer

Liesl leads this international practice from London. Previously, Liesl was head of the Tax Investigations and Disputes practice at Clifford Chance. She is one of the leading experts advising corporates and multi – nationals and high net individuals. Her experience is wide-ranging as solicitor, advocate, arbitrator and former acting judge.

Given the complex and sensitive nature of the work, she often provides strategic guidance to Boards and how to assess, manage, minimize or mitigate risks and exposure. In the past few years, she has been very active in the following areas: tax and debt structuring / debt instrument disputes; disputes on taxation relevant to the Sport industry; the Media and Entertainment industry; the taxation of partnerships; private equity, funds and asset managers and disputes in that area; complex cross border taxation, financing and regulatory issues for corporates including the finance, insurance, asset management, hedge funds, mining, oil and gas sectors. She conducts many tax disputes against HMRC and multiple other tax authorities and regulatory bodies.

Liesl is former Chair of the British Branch of the International Fiscal Association and also sits on the International Taxes Committee of the Law Society of England and Wales. She has published widely in this field.

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Bodil Tolstrup is specialized in tax controversy within all areas of tax. She has represented clients varying from individuals and small independent businesses to venture funds; labor-unions and listed companies.

Bodil has published several articles in both Danish and international tax journals and is a member of the Tax Committee of the General Council of the Danish Bar and Law Society.

In 2016 she founded Bjørnholm Law a boutique tax law firm specializing in tax litigation together with Nikolaj Bjørnholm. Bodil and Nikolaj works collectively on all the firm's cases drawing on their collective and individual strengths.

Bjørnholm Law is ranked in e.g. Chambers; Legal 500; and International Tax Review.

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Stefano is a tax lawyer and is an expert in corporate and international taxation issues, corporate acquisitions and restructuring and tax litigation. He is a regular consultant for companies, including listed companies, and industrial and financial groups, both Italian and foreign. He assists clients in all stages of tax assessment and litigation up to the higher courts.

He has in-depth experience in generational business transitions and family business transfers.

In the field of corporate crisis management, he has gained significant experience in the conclusion of debt restructuring agreements and in the management of judicial arrangements, with particular reference to tax settlements ex art. 182ter L. Fall. concluded with the *Agenzia delle Entrate* (**Italian Revenue Agency**) and with social security institutions, in which he was the author of some of the most relevant and innovative agreements signed in Italy.

Stefano has been included among the "**Top 10 Influencial Tax Lawyers in Italy**" by Business Today and has been prized during the Legalcommunity Tax Awards 2023 as "**Professional of the year for Tax Litigation**".

In 2019 and 2017 during the Legalcommunity Tax awards he was prized for "**Best Practice Tax Litigation**".

During the TopLegal Awards 2012 Stefano was prized for "**Tax Professional of the Year**".

He is ranked in **Chambers and Partners** and **The legal 500** since 2010.

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Christopher Slade

- Canadian tax lawyer at Aird & Berlis LLP in Toronto specializing in tax litigation
- Acts for a wide range of clients, including multinational corporations, financial institutions, pension funds and ultra high net worth individuals, on complex cases involving:
  - Litigation in Canadian courts
  - Contentious audits and tax amnesty
  - Challenging administrative action of revenue authorities
  - Cross-border tax disputes
- Recognized by *Chambers and Partners* as a leading lawyer in the area of Tax: Litigation and recognized since 2019 in International Tax Review's *World Tax* Guide for expertise in Tax Controversy
- Co-author of the *Chambers Tax Controversy 2023 Global Practice Guide* (Canada Chapter)

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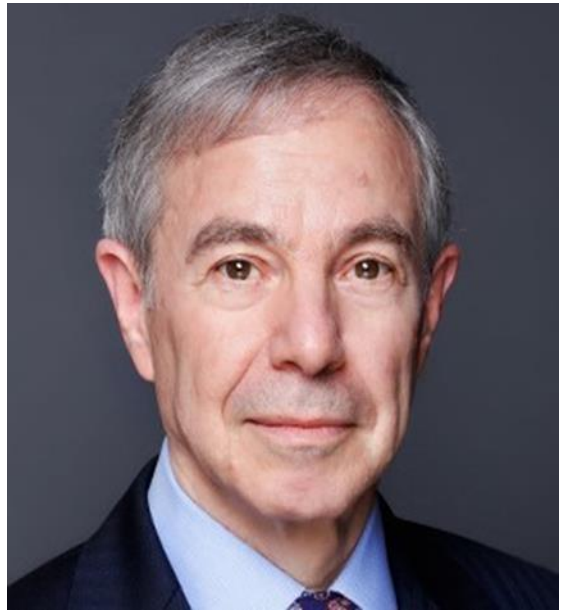
- English Barrister at Temple Tax Chambers in London. Also a South African Advocate and a Canadian and an Irish Barrister.
- Practice focuses on international tax disputes as counsel and as an expert and advises on solving cross-border tax problems.
- Visiting professor King's College London and programme director International Tax Law LLM
- Author of *Schwarz on Tax Treaties* and of *Booth and Schwarz: Residence, Domicile and UK Taxation* among other publications and a contributor to *Transfer Pricing and Business Restructurings: Streamlining all the way*.
- See www.taxbarristers.com for details.



Further Information

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- Jonathan Schwarz:
- *Schwarz on Tax Treaties* (6th Ed)
  - https://bit.ly/SchwarzTaxTreaties6
- *Booth & Schwarz: Residence, Domicile and UK Taxation* (21st Ed)
  - https://bit.ly/SchwarzResidenceandtax
- Blog: Kluwer International Tax
  - http://bit.ly/1Dm2hcZ