# EU Court decides on abuse in Danish dividend tax cases

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## Introduction

On February 26, 2019, the Court of Justice of the European Union (CJEU) decided on two cases (C-116/16 and C-117/16) referred by the Danish Courts regarding the grant or denial of a dividend withholding tax exemption as provided for by the EU Parent Subsidiary Directive (P/S Directive). (See our alert regarding the interest withholding tax exemption cases C-115/16, C-118/16, C-119/16 and C-299/16 here).

## Facts

In case C-116/16, five investment funds incorporated Luxembourg and Danish companies to acquire a target company in Denmark. None of the investment funds were established in a Member State of the European Union or in a country that had concluded a tax treaty with Denmark. In 2011 and 2012, the Danish company distributed significant dividends to its shareholders, among which the Luxembourg company.

In case C-117/16, a US multinational owned a Bermuda company and the Bermuda company incorporated a Danish company in 2000. In May 2005, the Bermuda company incorporated a Cypriot company (with a contributed capital of US$ 2,000) and sold the Danish company to the Cypriot company for €90 million. In September 2005, the Danish company distributed a dividend to its Cypriot parent company of €76 million, which money was used to repay part of the debt owed to the Bermuda company.

Based on the P/S Directive, the Danish companies wanted to distribute dividend to their respective parent companies in Luxembourg and Cyprus free of Danish dividend withholding tax. The Danish tax authorities challenged these claims.

The P/S Directive does not refer to the concept of beneficial owner. The P/S Directive allowed an EU Member State to implement anti-abuse measures in its national law (or in a bilateral tax treaty), but there was no obligation to do so in the relevant years. The Danish tax code did not contain anti-abuse rules with respect to the P/S Directive in the relevant years.

## Are domestic anti-abuse rules required to combat abuse?

The Danish Courts wanted to know whether Denmark had to deny the dividend withholding tax exemption, even though it did not implement anti-abuse rules as referred to in the P/S Directive in its domestic law. The CJEU decided that an EU Member State must deny the dividend withholding tax exemption if the exemption is not claimed to achieve the objectives of the EU P/S Directive, but to obtain this benefit by solely meeting the formal conditions. The CJEU recalls that a taxpayer has the right to choose the most beneficial tax alternative, but not if this is realized through a purely artificial structure that does not reflect economic reality and is aimed at avoiding the laws of an EU Member State.

The CJEU further answers that an EU Member State is not required to implement anti-abuse rules in domestic law to combat abuse of EU law. An EU Member State is obliged to deny tax benefits stemming from EU law in case of abuse of EU law, whether anti-abuse rules are implemented in its domestic law or not.

# What are indicators of abuse of EU law?

In order to demonstrate that there is abuse of law, it requires (i) a combination of objective circumstances in which, despite formal observance of the conditions laid down by the EU rules, the purpose of those rules has not been achieved, and (ii) a subjective element consisting of the intention to obtain an advantage from the EU rules by artificially creating the conditions laid down for obtaining it. Therefore, all relevant facts of the cases need to be assessed and judged by the Danish Courts. The CJEU provides the Danish Courts with guidance and states that a certain number of the following indicators may demonstrate there is an abuse of law, as long as these indicators result in a consistent conclusion:

a. A group that is not established for reasons that reflect the economic reality, is purely formal and is mainly meant to obtain a tax advantage that is not in line with the object of the applicable law, can be regarded as an artificial structure. For example, if a conduit company is interposed to obtain a tax benefit and that company receives dividends and pays them (to a large extent) shortly thereafter to its shareholder (the former beneficial owner), who is not entitled to the same tax benefit, this forms an indicator of abuse of law.
b. The receipt of dividend is the sole activity of the conduit company, and the conduit company does not perform any economic activities. Whether the latter is the case needs to be assessed based on how the company is managed, its balance sheet, its costs structure, its expenses, its staff and its premises and equipment.
c. An artificial arrangement may also be constituted by thinly capitalized structures through intra group debt and interest payments, resulting in the conduit company’s inability to have economic use of the dividend. This does not only have to be the case if there is a contractual or legal obligation to pass on the dividend. Also if ‘in substance’ the conduit company does not have the right to use and enjoy the dividends. For the interpretation of the concept of beneficial ownership, the CJEU refers to the OECD commentaries.
d. The introduction of new tax legislation (such as in Denmark or the USA) and the interposition of a conduit company around the time of introduction may also be an indicator of abuse of law.

# Who has the burden of proof?

The company that claims the withholding tax exemption must demonstrate that the parent company meets the formal conditions for the exemption. If the tax authorities want to refuse the exemption based on an abuse of law, then the tax authorities have the burden of proof to demonstrate this. In case of a conduit company, the tax authorities do however not have any duty to demonstrate who the actual beneficial owner of the dividend is. It seems that if the company is of the view that without the interposition of a conduit company, the dividend withholding tax would have been less than re-assessed, that company must demonstrate who the actual beneficial owner is and what the dividend tax burden would have been.

# Relevance for the Dutch tax practice

Dividends paid by a Dutch company are subject to 15% dividend withholding tax unless an exemption applies, such as the one implemented on the basis of the P/S Directive. The exemption applies if (in a nutshell) the parent company owns at least 5% of the nominal paid-up share capital, is the beneficial owner of the dividend and is established for valid commercial reasons that reflect economic reality. If the parent company has no legal or contractual obligation to pass on the dividend and the parent company is not thinly capitalized, the parent company should be regarded as the beneficial owner, provided that anti dividend stripping rules do not apply.

In addition to the beneficial owner test, the parent company must be established for valid commercial reasons that reflect economic reality. In case of an interposed parent company that creates a link between the activities of its parent company and the Dutch company, Dutch law provides for a safe harbor to assess whether the interposed parent company is established for valid commercial reasons that reflect economic reality (see below). Having regard to the above EU cases, if an interposed parent company's sole or main activity is the holding of shares in the Dutch company, special care must be given to the main reasons to interpose that parent company as well as to its level of economic substance. With respect to the latter, the safe harbor rule could function as guidance.

# Substance requirements for a non-resident holding company

1. At least 50% of the total statutory and executive members of the board of directors live or are established in the state in which the holding company is a resident ('resident directors');
2. The resident directors of the holding company have the necessary professional knowledge to perform their duties well. These duties consist of at least the decision taking on basis of the holding company's own responsibility and within the framework of the usual involvement of the holding company's headquarter, with respect to transactions to be concluded by the holding company as well as the proper dealing of the concluded transactions;
3. The holding company has qualified personnel for the adequate execution and registration of the holding company's transactions;
4. The board decisions are taken in the state in which the holding company is a resident;
5. The main bank accounts of the holding company are kept in the state in which the holding company is a resident;
6. The bookkeeping of the holding company takes place in the state in which the holding company is a resident;
7. The wage costs that form a remuneration for linking the activities within the shareholder chain amount to, translated to Dutch standards, at least €100,000; and
8. The holding company owns or rents office space in the state in which the holding company is a resident for a period of at least 24 months, and which office is equipped to perform the linking role referred to under 7, which role is actually performed from that office.

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