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## Advocate General's Opinion on the Beneficial Owner concept under the Interest and Royalty Directive and the Parent-Subsidiary Directive

Beneficial Owner – Interest and Royalties Directive – Parent-Subsidiary Directive - Denmark Anti-abuse Provision – Wholly Artificial Arrangements - OECD's Commentaries

On March 1, 2018, Advocate General (AG) Kokott of the Court of Justice of the European Union (CJEU) issued three milestone Opinions regarding the interpretation of the beneficial owner concept in cases where the Interest and Royalties Directive (Z Denmark case and joined cases N Luxembourg, X Denmark, and C Danmark) and the Parent-Subsidiary Directive (joined cases T Danmark and Y Denmark) are applicable. The AG concluded that the recipient of the income should in principle be considered as the beneficial owner, but that it is for the referring courts to assess whether the arrangements under review constitute an abuse under EU law.

### Background

The Z Denmark case (C-299/16) and the three joined cases N Luxembourg 1 (C-115/16), X Denmark (C-118/16) and C Danmark 1 (C-119/16) all involve back-to-back financing transactions, under which a Danish resident subsidiary is financed by its non-resident parent company via a series of loans granted to intermediary holding companies resident in another EU Member State. On the other hand, the two joined cases T Danmark (C-116/16) and Y Denmark (C-117/16) both concern dividend distributions made by a Danish resident company to an intermediary holding company resident in the EU.

In all cases, the Danish company requested an exemption of the Danish withholding tax levied on the payments made to the EU company, based respectively on the Interest and Royalties Directive (2003/49/EC) and on the Parent-Subsidiary Directive (90/435/EC). The Danish tax

authorities denied the exemption, arguing that the company receiving the income was a conduit structure and could not be considered as the beneficial owner of the payment.

The taxpayers challenged these conclusions before Danish courts. The Eastern and Western High Courts in turn asked the CJEU to clarify whether Denmark may deny the benefits of the EU Directives and impose withholding tax (1) on interest payments, based on the beneficial owner concept included in the Interest and Royalty Directive and on (2) dividend distributions, based on the beneficial owner concept included in the Danish provisions implementing the Parent-Subsidiary Directive. The Courts also requested clarifications on the applicability of the OECD's Commentaries on the Model Tax Convention in this respect, and on the requirements for a domestic or a Double Tax Treaty provision to qualify as anti-abuse provisions under the respective Directives.

## The AG's Opinion in the Parent-Subsidiary Directive cases

The AG starts her assessment with the question whether the case under review is constitutive of an abuse or fraud under EU law. In this respect, she first underlines that neither the wording nor the objectives of the Parent-Subsidiary Directive subjects the obligation for Member States to exempt dividends from withholding tax to a condition of beneficial ownership. In this regard, the only limitation foreseen is the potential application of domestic or agreement-based anti-abuse provisions under Article 1(2) of the Directive.

As a consequence, the AG proceeds to examine whether the concept of abuse in EU law is applicable in the case at hand. Considering in turn the existence of a wholly artificial arrangement, the presence of non-fiscal reasons and the potential circumvention of the purpose of Danish tax law, the AG concludes that there may be an abuse under EU law. This would particularly be the case if the arrangement is designed to prevent the effective taxation of the dividends in the hands of the ultimate beneficiaries, by taking advantage of an absence of information exchange between the states involved. However, this should be determined by the referring court, taking all facts and circumstances into account.

As regards the interpretation of the concept of beneficial owner, the AG goes on to observe that the provisions of the Parent-Subsidiary Directive must be interpreted under EU law independently of the OECD Commentaries and irrespective of the Interest and Royalties Directive, which follows a different approach. She further notes that a Member State should be required to identify the person it deems to be the beneficial owner of the income, as this information is necessary to assess whether the artificial arrangement results in a tax advantage and therefore can be considered as abusive.

The AG closes her assessment by examining whether Denmark can rely on Article 1(2) of the Parent-Subsidiary Directive, if it has not transposed it, and concludes that the principle of legal certainty precludes the direct application of directives. In this respect, the CJEU case law on VAT is not applicable, and neither the Danish law nor the provisions of the applicable double tax treaties may be regarded as sufficient transposition of the Parent-Subsidiary Directive.

Finally, the AG briefly addresses the potential infringement of the fundamental freedoms and concludes that any restriction would be justified under the existing case law of the CJEU.

## The AG's Opinion in the Interest and Royalties Directive cases

Based on the definition provided in the Interest and Royalties Directive, the AG first argues that the holding company receiving the interest income should be considered as the beneficial owner, unless it is not acting in its own name and on its own account, pursuant to a trust relationship. In this respect, a refinancing agreement would not, according to the AG, be sufficient to assume that such a relationship exists. On the contrary, circumstances such as identical interest rates for the back-to-back financing transactions, or the absence of any costs at the level of the holding company, may indicate otherwise. Nevertheless, the AG leaves to the Danish courts the responsibility to determine whether these circumstances apply.

Following a similar reasoning as in the Parent-Subsidiary Directive cases, the AG further notes that the existence of an abuse under EU law should be assessed by the referring courts. In addition, the OECD Commentaries cannot have a direct effect on the interpretation of the beneficial owner concept under the Interest and Royalty Directive and a Member State should be required to identify the deemed beneficial owners of the income.

Finally, the AG observes that neither the Danish provisions nor the applicable double tax treaties qualify as anti-abuse provisions in light of Article 5 of the Interest and Royalty Directive, although Denmark has effectively transposed the Directive into its domestic legislation. Nevertheless, certain general principles of the domestic legislation can be applied by the Danish Courts to prevent artificial arrangements or abuse, to the extent that they are in conformity with EU law.

## EU Tax Centre comment

As expected, the AG mostly relies on the referring courts to assess whether the corporate structures under review should be considered as abusive, based on the available facts and circumstances. However, she also provides some much needed guidance on the interpretation of the beneficial owner concept under the Interest and Royalties Directive, although it remains to be seen whether the CJEU will follow the opinion of its AG in those cases.

Should you have any queries, please do not hesitate to contact KPMG's EU Tax Centre, or, as appropriate, your local KPMG tax advisor.

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