

The CJEU's 'Danish beneficial ownership cases': Tax exemption of dividends under the Parent-Subsidiary Directive and indications of abuse of rights

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The Court of Justice of the European Union points to indications of abuse of rights in the failure to meet the requirements for applying the exemption of dividends, as provided for in Council Directive 90/435/EEC of 23 July 1990 on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States, when such dividends are earned through a conduit company.

The Court of Justice of the European Union ('CJEU'), in its Judgment of 26 February 2019 (Joined Cases C-116/16 and C-117/16), examines the conditions necessary to apply the tax exemption of dividends regulated in the Parent-Subsidiary Directive ('Directive 90/435') when these are received by intermediary EU companies that are ultimately controlled by companies not meeting the conditions laid down in Directive 90/435 in order to enjoy the aforementioned tax advantage.

In particular, the CJEU interprets Directive 90/435 in the light of proceedings between the Danish Ministry of Taxation and two tax resident companies in Denmark relating to the obligation imposed on those companies to pay withholding tax by reason of the payment by them of dividends to non-resident companies regarded by the tax authority as not being the beneficial owners of those dividends and, accordingly, as incapable of being entitled to the exemption from withholding tax provided for by Directive 90/435.

In this context, a number of questions are referred to the CJEU for a preliminary ruling, which can be summarised as follows:

- (a) The first relates to the need for a legal basis enabling a Member State to refuse, on account of the commission of an abuse of rights, to grant the exemption provided for in Article 5 of Directive 90/435 to a company that has distributed profits to a company of another Member State, of which it is the subsidiary.
- (b) The second concerns the constituent elements of any abuse of rights and the conditions for proving it.

In relation to the first of the above matters, the CJEU does not share the view of the defendants in the main proceedings, which contend that entitlement to the advantages provided for by Directive 90/435 can be refused by the Member State concerned only where the national legislation contains a distinct and specific legal basis in that regard. On this point, the CJEU, after invoking the principle of prohibition of abuse of rights in Union law and recalling the objective of Directive 90/435 - which focuses on facilitating the grouping together of companies at EU level by introducing tax rules which are neutral from the point of view of competition - concludes that the absence of domestic or agreement-based anti-abuse provisions does not affect the national authorities' obligation to refuse to grant entitlement to rights provided for by Directive 90/435 where they are invoked for fraudulent or abusive ends.

That said, the CJEU addresses the second of the above matters, trying to determine what the constituent elements of an abuse of rights are and how those elements may be established.

To that end, the CJEU recalls that proof of an abusive practice requires, first, 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, second, a subjective element consisting in the intention to obtain an advantage from the EU rules by artificially creating the conditions laid down for obtaining it. Although it is pointed out in the judgment that the analysis of the presence of such circumstances can only be carried out in the light of each individual case, that does not preclude the CJEU from pointing to the indications that may serve as a guide to national courts for the purpose of detecting the existence of an arrangement intended to obtain improper entitlement to the exemption provided for in Article 5 of Directive 90/435.

The CJEU thus refers, first of all, to the fact that all or almost all of the aforesaid dividends are, very soon after their receipt, passed on by the company that has received them to entities which do not fulfil the conditions for the application of Directive 90/435.

In addition, it points out that being able to establish that such recipient's sole activity is the receipt of dividends and their transmission to the beneficial owner or to other conduit companies will also be an indication that it operates as a conduit company. In turn, the absence of actual economic activity must, in the light of the specific features of the economic activity in question, be infe-

rrered from an analysis of all the relevant factors relating, in particular, to the management of the company, to its balance sheet, to the structure of its costs and to expenditure actually incurred, to the staff that it employs and to the premises and equipment that it has.

Another indication of the existence of an artificial arrangement will also be constituted by the fact that the recipient of the dividends has a contractual or legal obligation to pass the dividends on to a third party or, even without being bound by such obligations, does not have the right to use and enjoy those dividends. In such circumstances, there may be various indications of an artificial arrangement between the companies involved in the financial transactions at issue, such as the existence of intragroup flows of funds, the way in which the transactions are financed, the valuation of the intermediary companies' equity and the conduit companies' inability to have economic use of the dividends received.

Finally, the CJEU also notes as an indication of the existence of abuse of rights, the simultaneity or closeness in time of, on the one hand, the entry into force of major new tax legislation and, on the other hand, the setting up of complex financial transactions and the grant of intragroup loans, as was the case here.

Thus, completing its traditional stand on purely artificial arrangements, the CJEU mentions the indications it considers relevant to demonstrate that there is an abuse of rights, in so far as those indications are objective and consistent, abuse which may be established - the CJEU itself states - even where the beneficial owner of dividends transferred by conduit companies is ultimately a company whose seat is in a third State with which the source Member State has concluded a tax convention under which no tax would have been withheld on the dividends if they had been paid directly to the company having its seat in that third State.

Furthermore, the CJEU, in addition to pointing out that the existence of such a convention does not in itself preclude an abuse of rights, submits that, if the beneficial owner of dividends paid is resident for tax purposes in a third State, refusal of the exemption provided for in Article 5 of Directive 90/435 is not in any way subject to fraud or an abuse of rights being found. This is because the mechanisms provided for therein were not intended to apply when the beneficial owner of the dividends is a company resident for tax purposes outside the European Union since, in such a case, exemption of those dividends from withholding tax in the Member State from which they are paid could well result in them not actually being taxed in the European Union.

To conclude, and in relation to the burden of proof of abuse of rights, it is interesting to note the conclusion of the CJEU based on the usual complexity of such artificial arrangements, by virtue of which and in order to refuse to accord a company the status of beneficial owner of dividends, or to establish the existence of an abuse of rights, the CJEU states that a national authority is not required to identify the entity or entities which it regards as being the beneficial owner(s) of those dividends.