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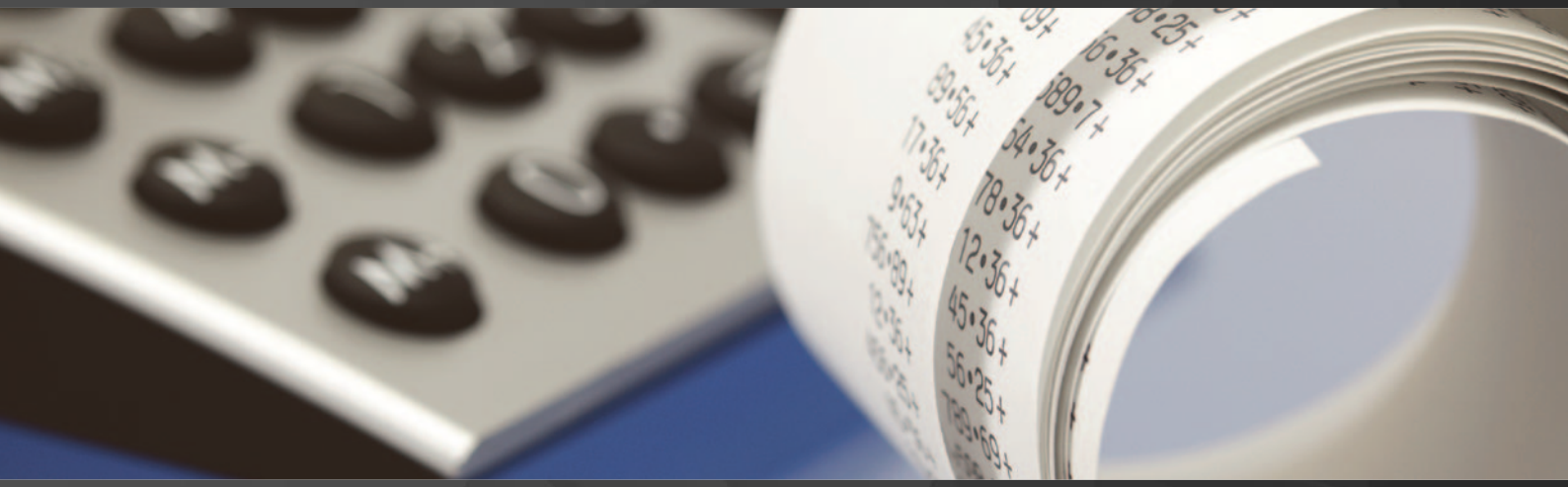

Corporate Tax 2020

A practical cross-border insight to corporate tax law

16th Edition

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The Growing Influence of the EU in the Tax Affairs of Member States – A Legal Perspective

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Maples Group

Introduction

The influence of the EU in the affairs of the EU Member States continues to grow on foot of the principle of "*ever closer union*" enshrined in the 1957 Treaty of Rome. This influence has limited the sovereignty of Member States in many areas. However, tax matters are different in that the passage of EU tax legislation requires unanimous approval. Tax is therefore regarded as an exclusive competency of the Member States. However, this has changed in recent years. This chapter examines the growing influence of the EU in the tax affairs of the Member States and how this is likely to increase in the coming years.

ATAD

The most significant incursion by the EU into the tax affairs of EU Member States is the European Anti-Tax Avoidance Directive ("**ATAD**") which was formally adopted on 12 July 2016 (and modified in 2017) after unanimous approval of all 27 Member States. ATAD contains six measures that draw inspiration from actions proposed by the OECD as part of its BEPS project.

ATAD is noteworthy not only for achieving unanimity amongst all Member States on such significant tax measures but also for the short time between first draft and approval, a mere six months.

An EU directive lays down certain results that must be achieved but each Member State is free to decide how to transpose directives into national laws. The power of EU directives over measures suggested by the OECD on BEPS, for example, is that directives must be followed in each Member State of the EU on pain of penalty for failure to properly implement in the time required.

The following sets out the key provisions of ATAD and considers their impact in Ireland.

Interest limitation rule:

(a) Article 4 contains one of the key provisions of ATAD and mandates the introduction of an interest limitation rule. Essentially, such a rule would restrict borrowing costs to 30% of the taxpayer's EBITDA, subject to certain exceptions. Traditionally, Ireland did not have any such fixed ratio interest limitation rules in place. The interest limitation rule will impact companies based in Ireland, including trading companies, property holding companies, the aircraft leasing sector and securitisation companies which are also known as "*section 110 companies*".

(b) Ireland applied, as permitted in Article 4, to defer introduction of interest limitation until 2024 on the basis that Ireland's existing interest rules are at least equally effective to the rules contained in ATAD. However, it is understood that the EU Commission does not share that view and issued a formal notice to Ireland in July 2019 to begin implementation. In a tax strategy paper released on 17 July 2019, the Irish Department of Finance stated that work has commenced to bring forward the transposition process. This could lead to the introduction of the rules in 2020 or 2021.

(c) Financing arrangements which predate 17 June 2016 are excluded from the interest limitation rules, under so-called "*grandfathering*" provisions, provided the loans are not modified subsequent to that date. In very broad terms, it is expected that Irish financing structures involving Irish entities which hold loans or are engaged in loan origination or financing transactions should not be negatively impacted. In addition, it is expected that Irish regulated funds, such as ICAVs, will not be impacted due to their status as investment funds. Beyond that, it is anticipated that Ireland will seek to implement the exemptions allowed for in ATAD, including for standalone entities.

Anti-hybrid rules:

(a) ATAD includes measures aimed at neutralising so-called hybrid mismatch arrangements in the sphere of international tax planning.

(b) Hybrid mismatches generally arise as a consequence of differences in the legal characterisation of entities or financial instruments due to the interaction between the legal systems of two jurisdictions. Anti-hybrid rules seek to counter adverse tax outcomes that exploit differences in tax treatment between such jurisdictions – for example, where the same instrument generates a payment which is deductible in one jurisdiction but not taxable in another jurisdiction.

(c) The anti-hybrid rules contained in ATAD concern the regulation of hybrid mismatches that arise between associated taxpayers in two or more Member States or structured arrangements between parties in different Member States where either (i) a double deduction, or (ii) a deduction without inclusion outcome is attributable to the differences in the legal characterisation of a financial instrument or entity.

  (i) A double deduction mismatch outcome arises where an expense is deductible for tax purposes twice. Where a hybrid mismatch results in a double deduction, the deduction should be granted only in the Member State where the payment has its source.

  (ii) A deduction without inclusion mismatch outcome covers situations where a payment that is deductible for tax purposes in the payer's jurisdiction but is not included in the taxable income of the receiving taxpayer. ATAD requires EU Member States to either delay and/or deny the deduction of payments, expenses or losses or warrants the inclusion of payments in the computation of taxable income.

(d) However, the above anti-hybrid rules only apply where the hybrid mismatch arises: (i) between head office and Permanent Establishment ("**PE**"); (ii) between two or more PEs of the same entity; (iii) between associated enterprises; or (iv) under a structured arrangement.

(i) An associated enterprise means an entity or an individual which holds, directly or indirectly, a participation of more than 25% (50% in the case of a hybrid entity) in the voting rights, capital ownership or profits of another entity, as well as entities that are part of the same consolidated group for financial accounting purposes or enterprises that have a significant influence in the management of the taxpayer.

(ii) Where a hybrid mismatch arises as a result of a payment under a financial instrument, the "*associated enterprise*" concept also includes a person who "*acts together*" with another person in respect of the voting rights or capital ownership of an entity. That person will be treated as holding a participation in all of the voting rights or capital ownership of that entity holding by the other person.

(iii) A structured arrangement is defined as "*an arrangement involving a hybrid mismatch where the mismatch outcome is priced into the terms of the arrangement or an arrangement that has been designed to produce a hybrid mismatch outcome, unless the taxpayer or an associated enterprise could not reasonably have been expected to be aware of the hybrid mismatch and did not share in the value of the tax benefit resulting from the hybrid mismatch*".

(e) ATAD requires that these measures be implemented in all Member States by 1st January 2020 (with the exception of the rules concerning reverse hybrids which must be implemented by 1st January 2022).

CFC Rules:

(a) Prior to ATAD, Ireland had very limited Controlled Foreign Company ("**CFC**") rules. However, ATAD compliant CFC rules were introduced in the Finance Act 2018 with the legislation taking effect for accounting periods beginning on or after 1st January 2019. Of the two available frameworks under ATAD, Ireland chose to adopt the "*Option B*" model.

(b) Option B focuses on CFC income which is diverted from Ireland. Broadly, CFC income is that which arises to a non-Irish resident company from non-genuine arrangements put in place for the essential purpose of obtaining a tax advantage. CFC income is attributed to the controlling company or a connected company in Ireland where that controlling or connected company has "*significant people functions*" ("**SPF**") in Ireland. The CFC charge is based on an arm's length measurement of the undistributed profits of the CFC that are attributable to the SPF.

(c) The introduction of CFC rules represents a significant change in Ireland's corporation tax landscape and will be relevant to many clients.

(d) Whether a CFC charge is imposed on an Irish controlling company will depend on the extent to which the CFC is regarded as having "*non-genuine arrangements*" in place. A CFC will be regarded as having non-genuine arrangements where: (i) the CFC would not own the assets or would not have borne the risks which generate all, or part of, its undistributed income, but for relevant Irish activities or SPF being undertaken in Ireland in relation to those assets and risks; and (ii) it would be reasonable to consider that the relevant Irish activities were instrumental in generating that income.

(e) The concept of SPF is not defined in the Irish implementing legislation but must be construed in a manner consistent with the use of that term in the OECD report. If there is no SPF in Ireland to which the management of assets and business risks can be attributed, no tax will arise under the new CFC rules.

(f) The CFC charge applies to the undistributed profits that have been diverted to the low-taxed CFC pursuant to non-genuine arrangements. The rate of Irish tax chargeable will depend on the nature of the income. In Ireland, trading income is taxed at 12.5% and non-trading income is taxed at 25%. A credit is available for any foreign tax paid by the CFC on its undistributed income.

Exit Tax:

(a) Ireland has introduced an ATAD compliant exit tax which replaces the existing Irish exit tax regime which applies where a taxpayer moves assets or migrates its tax residence out of Ireland. While the introduction of such an exit tax was required under ATAD, the surprise to the industry came in the timing of its implementation with Financial Resolutions passed by the Irish Parliament on 9th October 2018 bringing the regime into immediate effect from the midnight of that day.

(b) Exit tax will now be levied at 12.5% on any unrealised gains where a company migrates or transfers assets (including IP assets) out of the charge to Irish tax, including where a company ceases to be tax resident in Ireland or where a company that is resident in another Member State transfers assets from an Irish permanent establishment to another territory.

(c) The exit tax will not apply where the assets which are disposed of remain within the charge to Irish tax, such as where the assets continue to be used as part of a trade or permanent establishment in Ireland after the relevant transaction or where the assets consist of Irish land or mining and exploration rights.

(d) The new Irish ATAD-compliant exit tax does not affect the ability to avail of the participation exemption where there is a deemed disposal of shares held in trading companies under an exit tax event. This should ensure that the Irish holding company regime remains attractive for structuring transactions.

General Anti-Abuse Rule:

(a) ATAD includes a general anti-tax avoidance rule ("**GAAR**") which applies to "*non-genuine*" arrangements where one of the main purposes is to obtain a tax advantage that defeats the object or purpose of an applicable tax law. The GAAR permits such arrangements to be disregarded. Arrangements are considered non-genuine if they are not put into place for valid commercial reasons that reflect economic reality.

(b) While ATAD prescribed the need to introduce a general anti-abuse rule to counteract aggressive tax planning when other rules don't apply, no further action was needed in Ireland due to the robustness of Ireland's longstanding GAAR in section 811 of the Taxes Consolidation Act 1997.

Other EU Tax Directives

As mentioned above, ATAD was not the first EU directive dealing with tax matters. However, previous directives were more "*positive*" than ATAD in that they gave benefits to taxpayers and eliminated double taxation.

The EU Parent Subsidiary Directive was introduced in 1990 (and modified in 2003) to eliminate tax obstacles in the area of profit distributions between groups of companies in the EU by:

(a) abolishing withholding taxes on payments of dividends between associated companies of different Member States; and

(b) preventing double taxation of parent companies on the profits of their subsidiaries.

In 2003, the EU Interest and Royalties Directive was introduced to eliminate withholding tax obstacles in the area of cross-border interest and royalty payments within a group of companies by abolishing withholding taxes on interest payments and royalty payments arising in a Member State. Such interest and royalty payments are exempt from any taxes in that State provided that the beneficial owner of the payment is a company or permanent establishment in another Member State.

State Aid

State aid control was formally introduced into the European Union law by the Treaty of Rome to prevent Member States from distorting competition within the European internal market. The state aid rules target the provision of illegal advantages, whatever their form, to specific companies or industries. The European Commission in its capacity as guardian of the EU competition rules is the sole body entrusted with state aid enforcement. In this role, it has shaped the meaning of the concept of "*state aid*" over the past decade and challenged the tax regimes of EU Member States in a wide variety of sectors such as energy, transport and agriculture.

For state aid to exist in a tax context, there must be a reduced tax burden which provides a "*selective advantage*" to certain taxpayers. This is based on established case law from the ECJ which emphasises that the "*loss of tax revenue is equivalent to the consumption of State resources in the form of fiscal expenditure*".[1] Therefore, it follows from this that non-selective measures of general application such as Ireland's 12.5% corporate tax rate do not fall within the scope of the EU state aid rules.

The *Apple* investigation was launched in February 2014 as part of a broader European Commission inquiry into the tax ruling practices of six Member States which included: Cyprus; Ireland; Luxembourg; Malta; the Netherlands; and the United Kingdom.

This foray into the sphere of taxation does not constitute a new domain of activity for the Commission. Rather it is clear that its focus on the Member State practice of issuing tax rulings to large multinational corporations is gradually intensifying. In spite of this recent trend, the European Commission has not historically held a general objection to the practice of tax rulings unless they manifestly infringed the "*arm's-length*" principle. To this effect, the Commission alleges that the wider Apple group utilised non-Irish resident entities as part of their organisational structure in order to internally allocate profits within two Irish incorporated companies which "*only existed on paper*".

The Commission considers that two historical tax rulings issued by the Irish Revenue Commissioners in 1991 and 2007 to the Apple entities endorsed a methodology of computing taxable profits which did not correspond to the economic reality of the situation and which allowed these profits to escape tax. On foot of this determination, the Commission issued a recovery order compelling the Irish state to recover approximately €13bn, in addition to interest from Apple on the basis that it had been granted illegal state aid which enabled it to pay substantially less tax than other businesses over a number of years. After having duly paid the multibillion euro tax bill into an escrow account in accordance with the decision of the Commission, Ireland subsequently initiated its appeal of the decision before the European General Court which is due to be head in the autumn.

It is understood that Apple has joined the appeal which will see the parties involved strongly contesting the state aid allegation. In this regard, the Irish Department of Finance have consistently denied that any state aid was provided and reiterated on numerous occasions that taxation is a "*fundamental matter of sovereignty*" and that "*Ireland's position remains that the full amount of tax was paid in this case. Ireland did not give favourable tax treatment to Apple. Ireland does not do deals with taxpayers*".[2] One pivotal aspect of the decision concerns the selectivity analysis applied by the Commission. It is premised on an objective assessment of the then applicable Irish rules against an OECD arm's-length principle which did not form part of the Irish domestic law at the time.

Whilst the Commission has emphasised that the "*decision does not call into question Ireland's general tax system or its corporate tax rate*",[3] it clearly evidences the growing tension between the obligation to comply with EU rules and the capacity of Member States to express their own domestic fiscal sovereignty. Furthermore, it sends a stark message to large multinational corporations across all industry sectors that EU state aid rules are disregarded at their financial peril.

Digital Tax

On the 21st March 2018, the Commission published its proposals concerning the taxation of the digital economy in an attempt to find its own EU solution as the long debate undertaken at the OECD level since 2011 on the issue was still ongoing. The digital tax package outlined general rules for the allocation of profits by emphasising a required nexus between the generation of value and the requirement to have a significant digital presence in the EU. In addition, the proposals bolstered the existing criteria to ensure the "*fair and efficient*" taxation of digital companies under a coherent harmonised approach throughout the EU in order to acknowledge the global dimension of the issue. The EU digital tax seeks to create an artificial permanent establishment based on the commercialisation of user data in order to tax digital companies that generate profits without maintaining any physical presence in a country.

The digital tax package consisted of two proposed Council Directives. The first of these measures concerned new rules in respect of the allocation of profits in the digital context, entitling Member States to tax profits generated in their territories by both EU and non-EU companies. These rules were to apply regardless of whether there was any physical presence in the Member State in question, provided that there was a "*significant digital presence in the EU*". The second measure proposed would apply only on an interim basis and introduce a 3% tax applicable to revenues generated by digital services which are heavily reliant on the exploitation of user participation or user data – i.e. from the sale of online advertising space or from the sale of data generated from user provided information. Following the discussions of the Economic and Financial Affairs Council ("**ECOFIN**") on 4th December 2018, EU finance ministers agreed to explore a possible instrument with a narrower scope – covering only targeted digital advertising.

From an Irish perspective, whilst generally supporting the need for reform, the Irish government has consistently opposed proposals to tax digital companies on turnover as opposed to profits as this would strongly benefit larger states and prevent Ireland from maintaining and indeed strengthening its competitiveness. Significantly, revenue-based taxes when compared to taxes levied on profits, affect businesses with a low profit margin to a far greater extent than those with a high profit margin. It would appear in this respect that the Directive did not acknowledge this reality and by extension, whether a business is profitable or loss-making.

These sentiments were reflected in a reasoned opinion of the Irish parliament ("the **Oireachtas**") made on 16th May 2018 and addressed to the President of the Council of the European Union. The statement emphatically condemned the Commission proposals, labelling them an illegal encroachment upon the sovereign rights of Member States to impose, administer and repeal taxes. This technical argument questions the legality of the Commission's initiative on the basis that it breaches the fundamental principle of "*subsidiarity*" under EU law. The position of the Oireachtas was that EU action was not "*absolutely necessary*" to achieve the objective of the Commission's proposals. To substantiate this allegation, the Oireachtas is relying upon a particular provision under the EU Treaties which entitles national parliaments to assess EU action against the principle of subsidiarity.

Before being implemented, the two proposals required unanimous approval by the European Council as well as each of the 28 EU Member States (if so approved). Unanimity as distinct from Qualified Majority Voting ("**QMV**") would have been required for the proposed Directives to be approved on the basis that they relate to matters of taxation. In this context, an individual Member State could always have used its veto in the final vote by the European Council and it was anticipated at the time that smaller countries such as Ireland, Sweden, Denmark and Finland would have done so.

The Commission proposal for an EU digital tax has largely been campaigned for by Member States such as France. It represents another example of the challenge which smaller states like Ireland face to preserve fiscal sovereignty. In this instance, the Irish preference for building an international consensus based on proposals from the OECD appears to have prevailed as the Council were unable to reach an agreement on the EU digital services tax on 12th March 2019 and have agreed to postpone the measure until the end of 2020 pending further work at the OECD level.

Despite a halt of progress on an EU-wide basis and the failure to reach a consensus, the French administration enacted its own domestic digital tax measures. Under the domestic framework a 3% tax was levied on companies with annual revenues of more than €750m arising from "*digital activities*" which includes a *de minimis* threshold of €25m of those revenues being generated in France. However, in late August of this year, negotiations between France and the United States of America culminated in a bilateral compromise agreement being reached between Presidents Macron and Trump in respect of large American tech multinationals. Under the agreement France will refund all digital services tax paid by such multinationals once a new international system for taxation in the digital sector is implemented.

Outside of the European context, on 29th January 2019, the OECD announced a further reform package in the sphere of international taxation which would colloquially become known as "BEPS 2.0". The aim of the project is to address the policy challenges which have arisen as a result of the increased digitisation of the global economy. This objective is to be achieved by readjusting the balance of taxation and profit allocation in respect of multinational corporations and scrutinising the jurisdictions where assets are owned whilst at the same time analysing where product users or consumers are based and therefore generating value.

Under BEPS 2.0, it is proposed that a "two-pillar" approach is to be adopted.

(a) **Taxing profits attributable to intangible assets** – this could be achieved by:
   (i) A reconsideration of transfer pricing principles could recognise greater profit attribution to the value contributed by users which are of paramount importance for many large multinational corporations – particularly those which are in the technological sector.
   (ii) A conceptual redefinition of "*taxable presence*" for businesses which operate in a market without a physical presence. This policy objective could be achieved by using the constructs of a "*significant economic presence*" or a "*significant digital presence*". Utilising a revised basis for the taxation of profits generated through intangibles would likely involve a formulaic approach which would deploy an attribution factor to give appropriate weight to the user or consumer market location once the materiality threshold for triggering a sufficient "nexus" in that market has been reached by the entity.

(b) **Global minimum tax**
   (i) This is a global policy imperative with the objective of strengthening tax rights in order to counteract the negative effects of base erosion and profit shifting measures which commonly result in monies being diverted to jurisdictions with a low effective tax rate. With a view to addressing this issue, policy developments in this area will seek to develop an income inclusion rule as well as a tax which would be levied on payments which result in base erosion.
   (ii) For example, if the tax reform measures adopted by the USA are used as a guide for the formulation of a new income inclusion rule, this could result in the creation of a minimum rate of taxation which could be applied by the parent country jurisdiction to the profits of subsidiaries above a routine return. It is possible that this could be deployed in addition to an approach which seeks to tax or deny deductions for payments to entities which are resident in low tax jurisdictions.

DAC 6

Directive 2018/822 (colloquially known as DAC6) is an EU measure which imposes on intermediaries or taxpayers the obligation to report information on a broad range of cross-border arrangements which concern taxes imposed by an EU Member State (other than VAT, customs duties and social security contributions) to their relevant tax authorities. DAC6 is another EU initiative inspired by the work carried out by the OECD in the context of its broader BEPS project and it applies where one of the specified hallmarks outlined in the Directive are present. It is intended to facilitate the automatic exchange of this information between tax authorities of EU Member States and to strengthen global tax transparency by detecting potentially aggressive tax planning with an EU cross-border element.

The new reporting requirements apply to "*reportable cross-border arrangements*", irrespective of whether such arrangements have a tax motive. Therefore, the absence of "aggressive tax planning" does not shield an intermediary or taxpayer from potential reporting obligations under DAC6. In addition, it should also be highlighted that there is nothing preventing Member States from extending the regime to cover purely domestic arrangements. In any event, a domestic transaction will also fall within the scope of DAC6 if it has tax implications for another EU Member State, thus demonstrating a very broad territorial scope of application.

The concept of an "*arrangement*" is intentionally not defined in the Directive in order to encapsulate any course of action regardless of whether or not it is legally binding. Similarly, the definition of "*intermediaries*" is also widely drafted and includes any person that designs, markets, organises, makes available for implementation, or manages the implementation of a reportable cross-border arrangement. Furthermore, this concept also encompasses any person that knows or could be reasonably expected to know that they have provided directly or indirectly "*aid, assistance or advice*" in connection with a reportable cross-border arrangement. However, only persons with an EU nexus such as being incorporated, resident or having a permanent establishment within the European Union can be considered intermediaries for the purposes of DAC6.

For a reporting obligation to crystallise under DAC6, the transaction must involve one or more of the specified hallmarks outlined in the Directive. Specified hallmarks only give rise to a reportable transaction where one of the main benefits of the arrangement is the avoidance of tax. In general terms this is likely to apply where the tax outcome is a significant factor in how the arrangement is structured and not simply incidental – for example, one may consider a scenario involving the acquisition of loss-making companies to reduce overall tax liability or the conversion of income to a category which is taxed at a lower rate. Other hallmarks may trigger a reporting obligation even where one of the main benefits of the arrangement is not the avoidance of tax – for example, intra-group cross-border transfer of risks or assets or intra-group transfer of hard to value intangibles.

Transfer Pricing

Ireland's transfer pricing legislation is primarily influenced by the OECD Transfer Pricing Guidelines of 2010 and the arm's-length principle. Any influence exerted by the EU on Ireland's transfer pricing policy would therefore be indirect (in the form of EU Joint Transfer Pricing Forum recommendations) or via state aid cases, which can have an impact on the application of transfer pricing principles across Europe.

The most significant of these state aid cases from an Irish perspective is the *Apple* case, referenced previously. From a transfer pricing perspective, the key issue was that the historic intra-group pricing adopted at the time had not complied with the arm's-length principle. The legislation introduced by Ireland since then removes

much of the uncertainty that would have existed at the time.

It is also notable that as a significant volume of digital or e-commerce business has proven to be easily relocated to jurisdictions traditionally characterised by low direct and indirect tax rates, EU harmonisation of tax rates and policies has become an increasingly fundamental agenda for bodies such as the European Commission and base protection measures such as transfer pricing legislation have assumed increased importance. This is reflected in the EU Joint Transfer Pricing Forum recommendations which have resulted in the implementation of a multilateral audit mechanism which has been implemented by a number of Member States with resulting adjustments being applied in a coordinated manner.

In response to the increased international focus on the importance of robust transfer pricing policies, in 2016, a review of Ireland's corporate tax systems, including its transfer pricing, was undertaken through the Coffey Report. Subsequently, in February 2019, the Irish Government launched a public consultation regarding Ireland's transfer pricing regime in response to some of the key areas highlighted by the report. It is anticipated that changes will be implemented in Ireland's transfer pricing legislation by late 2019 with effect from 1st January 2020.

Going forward, it is anticipated that the trend of increased transfer pricing audit adjustments within Europe will continue. Further discussions on the appropriateness of existing transfer pricing legislation across EU Member States, particularly in the area of e-commerce will also be expected as tax authorities seek to find common ground across different territorial tax systems.

ECJ Case law – Beneficial Ownership Cases

On 26th February 2019, the Court of Justice of the European Union ("**CJEU**") ruled on six joined cases concerning the payment of withholding tax on dividends and interest by Danish companies. The cases included where dividends were paid by a Danish company to a Luxembourg tax resident holding company, owned indirectly by private equity funds. Interest was also paid by a Danish company to a Cypriot parent company, which made payments to a company in Bermuda, which in turn made payment to a US company.

Whilst the Danish subsidiary paying the interest or dividends up to the holding companies took the position that the dividends or interest were exempt from relevant Danish taxes under the EU Parent Subsidiary Directive ("**PSD**") and the EU Interest and Royalties Directive ("**IRD**") respectively, the Danish tax authorities challenged the exemptions claiming the EU tax resident holding companies were not the "beneficial owner" of these payments.

The ECJ focused its analysis on whether the arrangements were "*wholly artificial*", whether there was an abuse of the EU law, and in the case of the interest payments, if the EU tax resident holding company was the "*beneficial owner*" of the interest payment received. The ECJ did not rule on the outcome but sent the cases back to the Danish courts for a factual determination based on its guidance. These judgments will be extremely important in terms of the application of the PSD and IRD, but also on the interpretation of terms such as "*beneficial owner*" and "*abuse of rights*" in international structures.

The ECJ first considered the meaning of a "*beneficial owner*". It stated that in this context it must have an EU law meaning rather than one based on the domestic law of each Member State. It stated that the concept refers to "*an entity which actually benefits from the interest paid to it*" and not merely a "*formally identified recipient*". Accordingly, the test is aligned with some of the OECD concepts outlined in tax treaties.

Although Denmark did not have an appropriate anti-abuse law in its domestic provisions, the ECJ held that it was still entitled to deny the benefits of Directives where there is an abusive scheme. Indeed it stated that the Member State "*must refuse to grant the benefit of the provisions of EU law where they are relied on not with a view to achieving the objectives of those provisions but with the aim of benefitting from an advantage in EU law although the conditions for benefitting from that advantage are fulfilled only formally*". The Court provided significant guidance on the factors that may indicate an abuse of rights including an inability to economically use interest, rapid onward payment to non-EU entities, and the absence of actual economic activity.

The decisions represent a development of existing EU concepts, which were previously seen in VAT avoidance schemes. They appear to depart from the traditional understanding of cases involving the exercise of EU freedoms under the EU Treaty of Rome, such as the important EU *Cadbury Schweppes* case which "*limited*" itself to imposing a genuine and actual business requirement to avail of the EU freedom of establishment. Here, there is a broad interpretation given to the term "*beneficial owner*" and an application of the abuse of rights principle. This may impact structures which are vulnerable to allegations of acting merely as a conduit. It is important, however, to note that the decision should not generally impact structures involving domestic exemptions, which are not reliant upon the EU Directives. In such cases, absent amendments to the domestic law of the paying jurisdiction, the position should not change.

Financial Transaction Tax

In 2019, the proposal to implement a Financial Transaction Tax ("**FTT**") regained momentum despite a similar proposition being blocked by a significant majority of Member States in 2011. The original Commission proposal for a directive introducing an EU-wide FTT was rejected by Member States such as the UK, Luxembourg and Sweden in September 2011 but a revised proposal was issued on 14th February 2013 under the enhanced cooperation procedure which allows a minimum of nine Member States to adopt EU harmonisation initiatives if all Member States fail to reach an agreement.

We understand that it is the first time that this procedure available under Article 329 of the TFEU is used to bring forward EU legislation in the field of taxation, otherwise typically subject to unanimous approval across the 28 EU Member States. The adoption of the decision authorising enhanced cooperation requires a qualified majority of Member States within the Council and the consent of the European Parliament. The adoption of the new rules then requires unanimity by the Member States participating in enhanced cooperation and the consultation of the European Parliament. Thereafter, the other Member States are free to join the enhanced cooperation process at any time in the future.

The FTT was originally tabled by the Commission in order to address the economic fallout from the global financial crisis. It was designed to apply an extremely low rate of tax across a vast range of financial transactions carried out by financial institutions in order to substantially raise tax receipts without adversely impacting the market or creating distortions of competition.

Following the withdrawal of governmental support for the FTT from the Estonian representatives on 16th March 2016 there are now only 10 participating EU Member States committed to advancing the proposal which are Belgium, Germany, Greece, Spain, France, Italy, Austria, Portugal, Slovenia and Slovakia (the "**FTT Zone**"). The adoption of the Directive introducing the FTT will only require unanimous agreement of the participating countries, after consulting the European parliament. Countries which are non-participating EU Member States cannot therefore influence the discussions in any meaningful way.

Whilst consultations on the revised FTT proposal are still ongoing, it is accepted that the FTT will impact certain defined "financial transactions" entered into by "financial institutions" operating within the FTT Zone through the imposition of a minimum tax rate of 0.1% for equities and bonds and 0.01% on derivatives. Therefore, provided that there is an established economic link to the FTT Zone, it is likely that the cost of conducting such defined transactions will increase significantly in the future. It must be highlighted

that these constitute minimum rates which could be levied and it is possible that higher rates may be imposed by the constituent members of the FTT Zone. The FTT is payable by each financial institution involved in in-scope transactions and not just by the financial institution which has an economic link to the FTT Zone.

It is interesting to note that the FTT is ultimately being brought forward under the enhanced cooperation procedure. Traditionally, the enhanced cooperation procedure had been utilised in policy areas of broader consensus amongst Member States such as matters relating to patents, family law and security affairs. The use of the enhanced cooperation procedure in this instance is all the more interesting that it takes place in the broader context of the Commission advocating a move away from unanimity and towards QMV in matters of fiscal policy decision-making (see further below).

Therefore, the FTT represents a precedent in terms of how the enhanced cooperation procedure can be used to break the deadlock which can prevent a taxation measure from being approved at the EU level. A Member State which is not a participating Member State on FTT cannot vote on FTT and cannot therefore play an active role in shaping the FTT even though counterparties in that state will be impacted by FTT.

Common Consolidated Corporate Tax Base

The Common Consolidated Corporate Tax Base ("**CCCTB**") is a plan by the European Commission for a single set of rules that cross-border companies could use to calculate their taxable profits in the EU, instead of needing to deal with different national systems. The European Commission suggest that this will reduce the administrative burden, compliance costs and legal uncertainties for cross-border companies and would significantly help to combat tax avoidance in the EU. The plan was halted in 2011 but re-launched in 2016.

The new proposal would be mandatory for groups of companies with consolidated turnover exceeding €750m during the financial year, for companies established under the laws of an EU Member State, including permanent establishments. It was approved by the European Parliament in February 2018 and in June 2018 Germany and France issued a common position paper which suggested a number of modifications that are currently under discussion within the EU.

Any proposal on CCCTB currently requires unanimous approval of all Member States to become law across the EU. It is therefore unlikely to be passed in the near future.

Challenge to Member State Veto on Tax Matters

Qualified majority voting ("**QMV**") is a system of weighted votes in the EU that requires 55% of Member States to vote in favour, representing at least 65% of the EU population, in order to pass. QMV is the most common voting method in the EU, with over 80% of matters decided in this way.

Exceptions to QMV consist of certain sensitive issues, which includes taxation. Tax issues still require unanimous voting in the EU. This means that a consensus between all 28 Member States is needed in order for a decision affecting tax matters to pass.

The Commission says that some issues are so serious that EU Member States should work together, such as tax fraud, tax evasion, money laundering, climate change and VAT. In his 2017 State of the Union Address, EU Commission President Jean Claude Juncker stated that:

"*When it comes to important single market questions, I want decisions in the Council to be taken more often and more easily by qualified majority – with the equal involvement of the European Parliament. We do not need to change the Treaties for this. There are so-called "passerelle clauses" in the current Treaties which allow us to move from unanimity to qualified majority voting in certain cases – provided the European Council decides unanimously to do so. I am also strongly in favour of moving to qualified majority voting for decisions on the common consolidated corporate tax base, on VAT, on fair taxes for the digital industry and on the financial transaction tax.*"

Article 48(7) of the Treaty on European Union ("**TEU**") provides for a general *passerelle* clause. To activate this clause, the European Council must come to a unanimous decision with the consent of the European Parliament and have no objections from national parliaments. There are two steps to this; the European Parliament must approve by an absolute majority and national parliaments must be notified of any intended use of a general *passerelle* clause. If they object within six months, the proposal fails. If the preconditions are met, the European Council can replace unanimous voting with QMV.

Given the conditions attached to the use of the *passerelle* clause it is considered unlikely that it could be used by the Commission to overcome unanimity for tax matters. Many Member States have signalled their strong opposition including Ireland, noting that taxation is a sovereign Member State competence and that decisions at Council on tax matters require unanimity.

Conclusion

The freedom of Member States to manage their own tax affairs is seen by the European Commission as both an obstacle to the single market and a potential source of BEPS. They have therefore adopted a much more active approach on tax matters in recent years.

Most significantly, the Commission pushed through direct tax legislation in ATAD which includes detailed rules on interest deductibility, controlled foreign companies, hybrid mismatch and exit taxation. This directly affects the tax system of each Member State. Moreover, the Commission has rigorously enforced state aid rules in the *Apple* case and others. This has led to countries changing their tax rules or shelving proposals that might lead to state aid investigation.

However, the most ambitious proposal of the Commission to date is to change the voting rules on tax matters and thereby remove the Member State veto. This would pave the way to direct legislation on tax matters including the proposal for a common consolidated corporate tax base. This would have a huge impact on the tax treatment of multinationals operating in the EU. However, it is considered unlikely that either proposal has any chance of success in the near term.

While all this is going on, the CJEU continues to interpret the tax laws of Member States so that they are consistent with the aims of the EU and EU law, especially freedom of establishment. This has effectively overridden group loss relief rules in many Member States.

Endnotes

1. Commission Notice 98/C 384/03 (Oct 12, 1998).
2. https://www.gov.ie/en/press-release/f9be45-minister-noonan-disagrees-profoundly-with-commission-on-apple/.
3. Commission Press Release IP – 16-2923 – https://ec.europa.eu/commission/presscorner/detail/en/IP_16_2923

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