Executive summary

On 1 March 2018, European Union (EU) Advocate General (AG) Kokott delivered her opinion in a number of cases pending before the EU Court of Justice (ECJ) regarding Danish withholding tax on dividends and interest paid by Danish companies to companies in other EU Member States, see cases C-115/16, C-116/16, C-117/16, C-118/16, C-119/16 and C-299/16. The ECJ is expected to decide the cases in the fourth quarter of 2018.

Detailed discussion

Dividend cases

C-116/16 deals with a dividend distribution from a Danish company to a Luxembourg parent company that was indirectly owned by a number of private equity funds through another Luxembourg company. C-117/16 deals with a dividend distribution from a Danish company to a Cyprus parent company which used the proceeds to repay interest and principal to its parent company in Bermuda which repatriated the income to the United States (US) parent company in the form of a dividend. The AG has answered the questions raised by the Danish court as follows:
1. A Member State cannot invoke Article 1(2) of the parent and subsidiary directive (PSD) (directive 2011/96/EU) if this provision has not been implemented in domestic law. Article 1(2) provides Member States with the right to apply rules aimed at preventing fraud or abuse.

2. The Danish general provision on source taxation of dividends and the beneficial ownership clauses of Danish tax treaties (similar to Article 10(2) of the Organisation for Economic Co-operation and Development (OECD) Model Income Tax Convention), cannot be considered as sufficient implementation of Article 1(2). Similarly, the general anti-abuse principle of EU law cannot be invoked under Article 1(2). This does not, however, preclude that general anti-avoidance rules and principles of national law can be applied under Article 1(2).

3. A parent company of another Member State that receives a dividend from a Danish subsidiary must be treated as the beneficiary recipient thereof under the PSD. The terms of the directive must be given an autonomous EU law interpretation that is independent of the Commentary on Article 10 of the OECD Model Income Tax Convention.

4. It is left for the national court to determine whether the arrangement of a particular case amounts to an abuse of law. The creation of a holding company in another Member State in order to obtain the benefits offered by its tax legislation is not considered to be abusive. There may be an abuse of law in the event of: (1) a wholly artificial arrangement which does not reflect economic reality; or (2) an arrangement that has, as a main purpose, to circumvent the tax law of a Member State. Regarding the first type of abuse, the creation of a holding company structure does in itself not amount to abuse according to the opinion. However, if a holding company does not have the necessary office and employees in order to achieve its purposes (e.g., a treasury function), if it does not incur any expenses, and if the company structurally is not able to generate any income, then an abuse of the law may exist. Regarding the second type of abuse, the key issue, according to the opinion, is not the use of an intermediary holding company but the use of a tax haven entity. In order to conclude that an abuse of law exists, the tax authorities must prove: (1) that Denmark would have been entitled to levy withholding tax on the dividends if they had been paid directly to the ultimate investors; and (2) that there is a risk that the dividends will not be subject to tax because the tax authorities in the relevant jurisdictions do not receive information about the dividend income. The taxpayers are required to cooperate with the tax authorities in this respect.

5. Finally, a Member State that does not recognize the recipient of a dividend in another Member State under the PSD, must identify the person that it considers to be the beneficiary recipient. In this respect, the taxpayer will be required to cooperate with the tax authorities.

The opinions of the AG in the dividend cases are a clear success for the taxpayers. For the years under review, Denmark had not implemented any specific anti-avoidance rules under Article 1(2) and the Danish general anti-avoidance rules do not capture beneficial ownership issues (the Danish Government and the taxpayers have shared this latter position). The view of the Danish Government that Article 1(2) could be applied without specific implementation based on e.g., the beneficial ownership clauses of the tax treaties or the general anti-abuse principle of EU law was not accepted by the AG. If the ECJ concurs with the AG's opinion, it must be expected that the Danish court will decide that the parent companies in Luxembourg and Cyprus qualified to receive tax exempt dividends from Denmark and that the distributing Danish companies were under no withholding tax obligation.

The analysis of the AG regarding the issue of whether a holding company arrangement is abusive should not have any impact on these cases. However, this analysis may be of great relevance for cases dealing with dividend payments made after 1 May 2015 where Denmark implemented a general anti-avoidance rule in section 3 of the Tax Assessment Act aimed at tax treaty and EU directive cases.

**Interest cases**

Case C-115/16, Case C-118/16 and Case C-299/16 deal with private equity funds that have granted loans to Danish companies through intermediary Luxembourg companies. Case C-119/16 deals with a US multinational group where a Cayman company had granted loans to a Swedish company which had granted loans to a Danish company. The AG has answered the questions raised by the Danish courts as follows:

- A company that is tax resident in a Member State and which owns an interest-bearing receivable must in principle be treated as the beneficial owner under Article 1(1) of the interest and royalty directive (directive 2003/49/EC). However, Article 1(4) provides an exception according to which a company shall be treated as the beneficial owner only if it receives the income for its own benefit and not as
an intermediary, such as an agent, trustee or authorized signatory, for some other person. The “beneficial owner” concept must be given an autonomous EU law interpretation that is independent of the Commentary on Article 11 of the OECD Model Income Tax Convention. According to the AG, a recipient company should not, as the starting point, be treated as an authorized signatory for another person just because a loan granted to a Danish company has been refinanced with a third party on similar terms and during the same period of time (back-to-back loan). This would require that the EU recipient company is subject to wider legal restrictions towards third parties. A recipient company could potentially disqualify as beneficial owner if the expenses of the company were not covered by its interest income because of an obligation to repay the interest income. Other disqualifying facts could be that the interest rates are identical on the loans, that the recipient company does not incur its own operating expenses, and that the credit risk relating to the Danish debtor company solely rests with the ultimate investors rather than the recipient company. Even if the recipient company does not qualify as beneficial owner, the directive may be applicable if the person identified as the beneficial owner meets the condition of the directive.

- A Member State cannot invoke Article 5 of the interest and royalty directive if this provision has not been implemented in domestic law. Article 5 provides Member States with the right to apply rules aimed at preventing fraud or abuse.
- The Danish general provision on source taxation of interest and the beneficial ownership clauses of Danish tax treaties (similar to Article 11(2) of the OECD Model Income Tax Convention), cannot be considered to be sufficient implementation of Article 1(2). Similarly, the general anti-abuse principle of EU law cannot be invoked under Article 5. This does not, however, preclude that general anti-avoidance rules and principles of national law can be applied under Article 1(2).
- It is left for the national court to determine whether the arrangement of a particular case amounts to an abuse of law. The analysis of the AG of this issue in the interest cases is widely similar to the analysis in the dividend cases, see above #4. Regarding the issue of an artificial arrangement which does not reflect economic reality, the existence of an office, telephone number, employees, or operating expenses may indicate that an arrangement is not a wholly artificial arrangement which does not reflect economic reality. It must be taken into account that the management of a loan does not require much economic substance. Similarly, the fact that 98% of the income of a recipient company consists of interest income does not in itself mean that the arrangement is a wholly artificial arrangement which does not reflect economic reality.
- A Member State that will not recognize the recipient of interest income in another Member State as the beneficial owner, must identify the person that it considers to be the beneficial owner. In this respect, the taxpayer will be required to cooperate with the tax authorities.
- A Luxembourg SCA is covered by the scope of the interest and royalty directive if Luxembourg has authorized the company as a SICAR. It is irrelevant that the source country treats the company as transparent for tax purposes, if the company is specifically mentioned in the directive.

The opinions of the AG in the interest cases generally supports the arguments of the taxpayers. EU finance companies should often qualify as beneficial owners under the narrow interpretation of this approach under the interest and royalty directive, even if back-to-back financing arrangements have been put in place. Important facts would include that a finance company is not subject to extensive legal restrictions towards third parties, that it has access to office and employees, that it incurs operating expenses, and that the credit risk relating to the Danish debtor company rests with the recipient company. If the ECJ concurs with the opinion of the AG, it must be expected that the Danish courts will decide many pending cases in favor of the taxpayers meaning that the finance companies qualified as beneficial owners and that the Danish debtor companies were under no withholding tax obligation.

The analysis of the AG regarding the issue whether a financing arrangement is abusive may be of great relevance for cases dealing with interest payments made after 1 May 2015 where Denmark implemented a general anti-avoidance rule in section 3 of the Tax Assessment Act aimed at tax treaty and EU directive cases.
For additional information with respect to this Alert, please contact the following:

**Ernst & Young P/S, Copenhagen**
- Jens Wittendorff  
  jens.wittendorff@dk.ey.com
- Vicki From Jørgensen  
  vicki.from.joergensen@dk.ey.com

**Ernst & Young P/S, Aarhus**
- Søren Næsborg Jensen  
  soeren.n.jensen@dk.ey.com

**Ernst & Young LLP, Nordic Tax Desk, New York**
- Antoine Van Horen  
  antoine.vanhoren@ey.com
- Susanne Hamre Skoglund  
  susanne.skoglund@ey.com
- Nicole Maser  
  nicole.maser1@ey.com
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