Joined cases C-115/16, C-118/16, C-119/16 and C-299/16 and joined cases C-116/16 and C-117/16

The CJEU rules on the abuse of the Interest and Royalty Directive and of the Parent Subsidiary Directive

Today the Grand Chamber of the Court of Justice of the European Union ("CJEU") issued its judgments in joined cases C-115/16, C-118/16, C-119/16 and C-299/16 and in joined cases C-116/16 and C-117/16, respectively concerning the Interest and Royalty Directive (Directive 2003/49/EC; "IRD") and the Parent Subsidiary Directive (Directive 90/435/EEC as applicable at the time of the cases; "PSD" and together with IRD, the "Directives"). The CJEU touched on many important issues concerning the interpretation and application of the Directives and in particular:

a. The general principle prohibiting abusive practices
b. The notion of "abuse"
c. The notion of "beneficial owner"
d. The burden of proof regarding the abuse
e. Abuse of rights and fundamental freedoms
f. The requirement of "being subject to corporate income tax without being exempt" of the IRD

a) The general principle prohibiting abusive practices

The CJEU stated that, in accordance with the general principle prohibiting abusive practices, Member States are obliged to deny the benefits of the Directives if these benefits have been claimed abusively. This conclusion applies regardless of whether the Member States implemented domestic or agreement based anti-abuse provisions in their tax systems.

The CJEU also clarified that the benefits of the Directives should be denied if the tax advantage is the essential aim (and not necessarily the sole aim) of the transactions carried out by the taxpayer.

b) The notion of "abuse"

Based on previous case law, the CJEU confirmed that the notion of abuse relies on two elements, i.e.: (i) the existence of objective circumstances showing that, despite formal compliance with the conditions laid down by the Directives, the purpose pursued by the Directive has not been achieved, and (ii) the intention to obtain an advantage from the Directives by artificially creating the conditions required to obtain it.

The Court also indicated a set of indicia which the national court must take into account in assessing whether a transaction is abusive, in particular whether:

- the immediate recipient only plays a conduit role and is obliged to pass the income (in a short timeframe) on to entities established in third countries that would have been taxed in the State of source had they received the payments directly. Such obligation does not necessarily need to stem from a formal contractual or legal obligation but may also be a *de facto* obligation, which results from the analysis of various factual circumstances (such as whether the conduit entities actually have the right to use and enjoy the income received);

- the immediate recipient lacks an economic substance and carries out very limited activities (including the receipt of the income and its transfer to the beneficial owner or to other conduit companies). Such circumstancemust be inferred from an analysis of all the relevant facts, including the management of the company, the cost structure, the presence of staff, premises and equipment;
- the group structure was put in place simultaneously or shortly after the introduction of changes in law that would have otherwise created additional tax burdens if the group had not changed its structure.

c) The notion of "beneficial owner"

With regard to the IRD, the CJEU held that in order to qualify as beneficial owner of the interest the recipient must economically benefit from the interest and must retain the power to determine the use of the income. The Court also stated that the amendments to OECD Model Tax Conventions and related commentaries occurred after the adoption of the IRD must be taken into account.

With reference to the PSD, the Court stated that the benefit of such directive must be denied if the beneficial owner of the dividends is a company resident in a non-EU jurisdiction. Such conclusion applies regardless of the existence of an abusive practice.

d) The burden of proof regarding the abuse

The CJEU held that the burden of proof as to the existence of abuse lies primarily on the authorities of the Member State that challenged the application of the Directive. However, contrary to the opinion of the AG, the Court stated that such authorities are not required to identify the beneficial owner of the income but they can just provide evidence indicating that the foreign recipient is a conduit company.

e) Abuse and fundamental freedoms

The CJEU ruled that, in circumstances in which a company is denied the application of the Directives based on the general principle prohibiting abusive practices, such principle equally prevents the company from challenging taxation in the Member State of source on the basis of the fundamental freedoms.

f) The requirement of "being subject to corporate income tax without being exempt" of the IRD

The Court held that this requirement cannot be considered as being met by a company that, although being liable to corporate income tax in its State of establishment, is effectively not subject to such tax on the interest received. Accordingly, the Court found that, if the domestic Court were to confirm that a Luxembourg company authorised to operate as SICAR benefits from an exemption that specifically applies to interest income, such company does not qualify for the application of the IRD.

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