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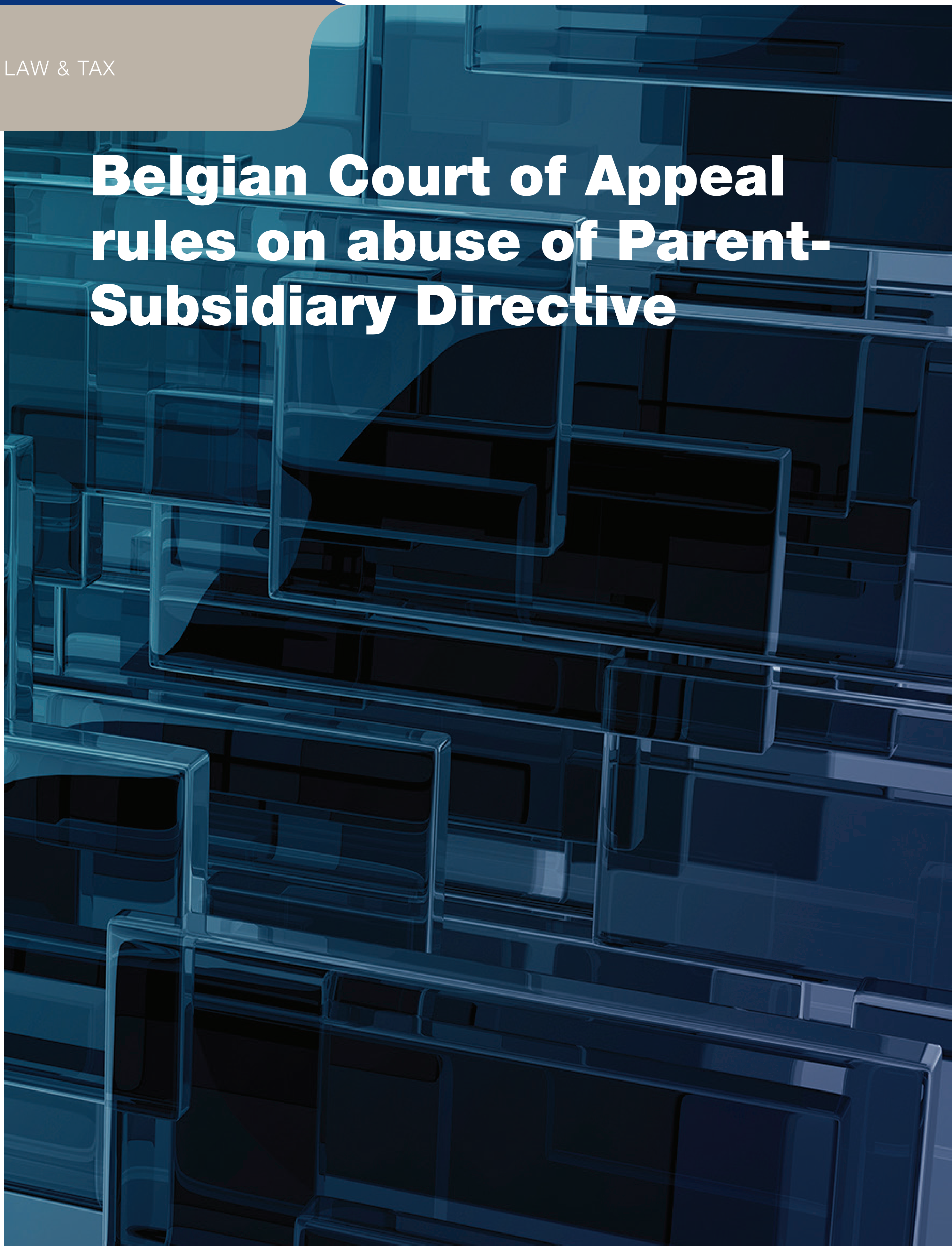
LAW & TAX



Belgian Court of Appeal rules on abuse of Parent-Subsidiary Directive

On 1 December 2020, Ghent Court of Appeal ruled on the question whether the exemption of withholding tax (WHT) laid down in the Parent-Subsidiary Directive (PSD) could be refused on the basis of abuse. The case is particularly relevant because it is the first time that a Court of Appeal has applied the Danish cases (See EU Tax Alert - April 2019 for more information on this case). The implications cannot be underestimated, especially in an M&A environment.

I. Facts

A US private equity group acquired a Belgian group in 2003 via a Dutch CV. As a result, the Dutch CV held the shares of a Belgian holding company, which in turn held the shares in a Belgian operational company that subsequently held shares in an operational company located in the Czech Republic. In 2006/2007 a restructuring took place whereby a.o. new Belgian and Czech holding companies were incorporated, capital decreases and increases took place, shares were transferred between group companies and financed via a bank loan, a debt-push down was achieved by merging the Czech companies and the generated cash was distributed to the ultimate shareholders in a tax-free manner. In 2012, following the entry of a third-party investor, a second restructuring took place. This restructuring included a.o. mergers of the Belgian holding companies (as a result of which capital was created), the incorporation of a Luxembourg holding company, the conversion of the CV from a closed to an open CV, the transfer of shares between group companies which were financed with a bank loan, the incorporation of a new Czech company followed by a debt-push down by merging the Czech companies, a capital reimbursement by the surviving Belgian company following the mergers and the distribution of the generated income to the ultimate shareholders without a tax leakage. In this respect, the withholding tax exemption laid down in the PSD (as implemented in Belgium) was relied upon in respect of the dividend distributed by the Belgian company to the Luxembourg holding company.

This case essentially deals with the following two legal issues: (i) the application of (general) anti-abuse rules denying the benefit of a withholding tax (WHT) exemption and (ii) the (non-) application of the tax-neutral merger regime. In the present newsletter, we will only discuss the former element.

II. Decision of the Court

1. Belgian legal framework on abuse – general considerations

The Belgian domestic legal framework on abuse – as relevant to the present case – consists of two elements, being (i) the general anti-abuse rule (GAAR) and (ii) the specific anti-abuse rule (SAAR) as implemented by the (amended) PSD.

The current GAAR, laid down by article 344, §1 of the Belgian Income Tax Code (ITC), was implemented as of tax year 2013, since its predecessor was perceived as ineffective. In order to apply the GAAR, the Belgian Tax Administration (BTA) should be able to show that the taxpayer has implemented a (series of) legal act(s) which allow him (i) to avoid the application of a tax-increasing measure in the ITC or the Royal Decree thereto, or (ii) to obtain the application of a tax benefit included in the ITC or the Royal Decree thereto, whereas such result is incompatible with the purpose of these provisions (the so-called “objective component”). Secondly, the taxpayer should have chosen for said (series of) legal act(s) precisely in view of obtaining a tax benefit (the so-called “subjective component”). If the BTA meets this burden of proof, the taxpayer can still provide counterproof by evidencing sound business motives for the transaction (other than obtaining a tax benefit). If such counterproof cannot be procured, the BTA can “restore” the taxable basis as if the abuse had never occurred.

In addition to the GAAR, Belgium implemented the PSD SAAR in the ITC as from 1 January 2017, which specifically targets abuse of (i) the PSD-based WHT exemption and (ii) the exemption of qualifying dividend income (“dividend received deduction” regime) and qualifying capital gains.

2. Application of the anti-abuse provisions in the case at hand

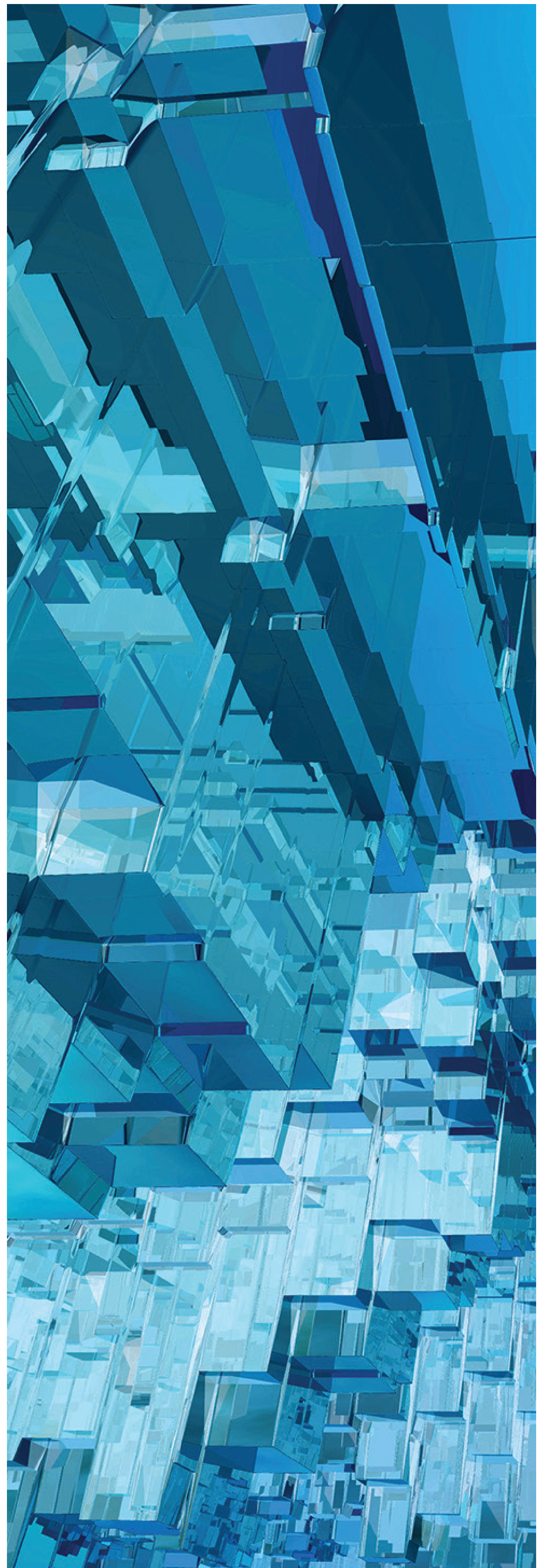
A. Assessment of the relevant anti-abuse provisions

Considering the dates of entry into force of the new GAAR and the PSD SAAR, neither applied to the case at hand and, hence, only the "old" and ineffective GAAR could be applied. The BTA therefore sought to apply the general principle of EU law that EU law cannot be relied on for abusive or fraudulent ends (principle of prohibition of abuse of rights). Indeed, pursuant to the Danish Cases the Court ruled that the prohibition of abuse should be considered a general principle of EU-law and that, consequently, the Court has the obligation to prevent abuse under the terms of this principle even if there is no adequate legal basis in national law (i.e. the "old" GAAR). The Court therefore held that, although the new GAAR cannot as a matter of principle be applied, abuse of the PSD can still be sanctioned under the general EU law principles. The Court then continues to refer to the GAAR in the framework of this general EU principle (since these are "comparable principles").

The importance of the EU-based abuse principle is declining: the new GAAR is based upon this European principle (and also appears to be interpreted as such), as is the PSD SAAR. Hence, Belgian taxpayers should presently already take this EU-angle into consideration when assessing the (potential) application of the GAAR/SAAR.

B. The notion of "taxpayer"

Before addressing the question whether the facts of the case could be considered abusive, the Court clarified the notion of "taxpayer" in the framework of abuse. The Court adheres to a very broad interpretation: both the payer of a dividend (paying agent of the WHT) and the beneficiary thereof (legally/economically bearing the WHT) can be considered a "taxpayer" for the purpose of this provision and, consequently, can be petitioned to pay WHT further to the GAAR. The Court specifically reiterated in this respect that "the distributing company has cooperated to the [abusive] construction" and that consequently, the GAAR can also be applied in its hands. Furthermore, the Court decided that, for the application of the GAAR, it is not required that the taxpayer pursues a tax benefit for himself: it is sufficient that he (knowingly) cooperates in abusively obtaining a tax benefit for another taxpayer.



C. The notion of "abuse"

As reiterated above, the presence of abuse is assessed by the Court of Appeal by investigating the objective and subjective elements present in this case. This is in line with the Danish cases, where the CJEU stated 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." According to the CJEU, a group of companies may be regarded as an artificial arrangement where it is not set up for reasons that reflect economic reality, its structure is purely one of form and one of its principle objective is to obtain a tax advantage running counter to the aim of the PSD.

The Court of Appeal first recalls the indications of abuse presented by the CJEU in the Danish cases. These include a.o. the fact that all or almost all of the income is - very soon after its receipt - passed on to entities not benefitting from the PSD, the interposed company only makes an insignificant taxable profit because it is required to pass on the income, the absence of economic activity and substance, the way in which transactions are financed, the various contracts existing between the companies, the valuation of the equity of the interposed company and the inability to have economic use of the income received. With the last element, the CJEU suggests that the lack of beneficial ownership has become an indication of abuse.

These indications are then evaluated in the case at hand: it can be inferred from the judgement that – according to the Court of Appeal – a.o. the following facts pointed towards abuse:

- Via the transfer of group companies, creation of capital, dividend distributions, capital reimbursements and changes to the financial year-end, income is up-streamed shortly after the receipt thereof, to the ultimate beneficial owners that cannot benefit from the PSD. The shareholders of the Dutch CV consisted of (a.o. Austrian and American) individuals, a Dutch STAK, US LLC's and a Swiss company.
- A Luxembourg holding company is interposed as a sub-holding which appears to have limited substance (however no further details were given) while the group has no economic activity in Luxembourg;
- A similar reorganisation was already implemented in 2006 (were the Court of Appeal also raised concerns regarding the correct transfer pricing) whereby a burdensome 'double holding' structure was created in order to upstream cash and internal capital gains to the shareholders without tax leakage;
- The representative of the Dutch CV stated that the CV was only converted from a closed to an open CV in order to facilitate a tax-free distribution to the shareholders. It should be noted in this respect that a closed CV is considered transparent from a Dutch tax perspective and cannot invoke the benefits of the PSD, whereas an open CV is subject to Dutch income tax and generally entitled to PSD-benefits;
- A ruling was obtained in the Netherlands to ensure that, at the occasion of the conversion into the open CV, the fiscal capital of the CV would equal the market value of its Belgian participation (increasing the amount of later tax-free capital reimbursement by the CV). This ruling was obtained under the condition that the Belgian subsidiary would not distribute a dividend. According to the Court, this condition was circumvented by interposing the Luxembourg holding company, the beneficiary of which would be unknown to the Belgian tax authorities.

Since indications of abuse are present, the burden of proof shifts to the taxpayer, i.e. the taxpayer needs to demonstrate that, despite such indications, there is no abuse.

D. Weighing the tax and non-tax motives

The Court subsequently analyses whether there are sufficient non-tax motives to support the transactions that occurred.

It follows from the indications provided in the Danish cases and other CJEU case law that the finding of abuse must be the result of an analysis of all facts and circumstances and an overall balance between the indications of abuse and the business interests relied upon. In this respect, the Court states that one single economic justification does not necessarily excludes the presence of abuse (in a construction or set of legal acts).

The Court first observes that the entry of the third party investor may provide an economic explanation for the existence of a vehicle which serves as a joint venture, but it does not provide a justification for setting it up in Luxembourg nor for all other restructuring operations.

According to the Court, no concrete economic reasons are given for the various transactions. The taxpayer only offered general justifications (e.g. cost saving, structure is part of daily consultancy practice, normal market practice for international groups to be financed externally for a healthy "debt to equity ratio"). The Court also adds that simplification is not a valid argument for a structure the taxpayer created itself. The Court therefore concludes that the taxpayer did not provide sufficient counterproof.
The fact that similar restructuring steps took place in 2006 demonstrates, according to the Court, that the third party investor was not a justification for the restructuring steps in 2012 but solely a trigger to upstream capital gains in a tax-free manner.

E. Concept of beneficial ownership

In line with the interpretation of the term "beneficial ownership" by the CJEU in the Danish cases, the Court states that the term beneficial owner should be given a broad economic interpretation (substance over form approach). This implies that the recipient of the income is only the beneficial owner if it economically benefits from the income and has the power freely to determine how to use this.
This interpretation goes against the rather legalistic/formalistic/form-based interpretation that has always been given by the Belgian Minister of Finance in the past, and which taxpayers in the past relied upon. Although applying this new interpretation retroactively may be in line with EU law, it clearly raises fairness issues.

3. Conclusion of the Court

The Court concludes that, taking into account all facts and circumstances, there is no doubt that the Luxembourg holding company was used as a flow-through company with the intention to allow the profits (including capital gains) to accrue tax-free to the ultimate shareholders. The Court thus holds that the entire context provides sufficient proof of the subjective and objective element of abuse of the PSD.

Consequently, the Belgian tax authorities could rightfully "restore" the taxpayer's taxable base as if the abuse had not taken place. As a result, withholding taxes become due on the dividend distributions and capital reimbursement.

III. Lessons learned

Although a critical analysis of this Court case goes beyond the scope of this newsletter, we notice in practice that the BTA increasingly raises questions in relation to substance as well as beneficial ownership in cases where a withholding tax exemption is claimed or a refund is requested, even for the past. As in the case discussed here, we also see in practice that the BTA addresses these questions not only to the Belgian company that distributes the dividend or pays the interest, but also to the foreign parent company. In such cases, a consistent approach by all group companies is highly recommended, especially since the Belgian subsidiary may not always have sufficient knowledge about its parent company and the underlying reasons for certain transactions to provide an accurate answer. Furthermore, the cross-border exchange of information between tax administrations is becoming more and more effective.
An increased focus on abuse and beneficial ownership can also be observed in other countries.
In order to ensure that holding and finance structures are acceptable from a tax perspective, taxpayers will need to pay much attention to the proper documentation of the business reasons for the use and location of the holding/finance company and for the restructuring steps and financial transactions that are taken, and their actions should be consistent with those reasons. Since the interpretation of the beneficial ownership concept has evolved into an economic concept, it will equally be imperative to monitor the cash flows going forward if third countries are involved.
Forewarned is forearmed: this age-old adage takes on even greater significance when it comes to taxes.

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