Tax authorities' seminar: Enforcing ATAD1 and ATAD2
Chair: Paolo Valerio Barbantini | Italian Tax Authorities]

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Panel discussion Tax authorities' seminar: Enforcing ATAD1 and ATAD2
The panel focused on how the tax authorities (TAs) in the panel are currently enforcing the ATADs and, in particular, addressed three specific topics such as hybrid mismatches, CFC and the GAAR. This selection was necessary, since a complete discussion on all ATAD regulations would have been too broad. Each panellist introduced one topic and described how the relevant measure had been implemented. Then a case would follow and be discussed among the panellists, with a view to highlight potential differences and similarities between the three different countries.

Hybrid mismatches

Hybrid mismatches occur since there are differences in qualification, potentially creating a 'double deduction' or a 'deduction without inclusion' structure. A mismatch that occurred quite often in the Netherlands was the 'CV/BV'-structure, mostly in combination with a US mother. The Netherlands considered the CV transparent while the CV was elected as a regarded entity in the US. These mismatches were addressed by the OECD in BEPS action point 2 and by the EU with the ATADs. Countries stayed autonomous in qualification, but linking rules aimed to neutralize the tax effects.

The Dutch practice of 'prior consultation' (*vooroverleg*) resulted, after the implementation of the ATADs in the Netherlands, in discussions between tax advisors and the Dutch TA about interpretational questions relating to the ATADs. A recurring topic were the Dutch consequences of foreign qualifications, mostly relating to the US. Some of the real life examples have been summarized in a formally published Decree (Decree hybrid mismatches), in which the Dutch TA explain their position in certain fact patterns. The examples in the Decree have been shared with and approved by the European Commission.

Furthermore, the Dutch TA has centralized knowledge and experience concerning the ATADs in expert groups. Tax inspectors are obliged to ask for binding advice from these groups before deciding on a position, enabling uniform administration of the rules. Within existing international platforms (e.g. JITSIC), knowledge is also exchanged between different countries to learn from each other as much as possible.

<u>Case introduction</u>
A US mother directly holds a Dutch BV, which is disregarded (transparent) for the US and non-transparent for the Netherlands. The BV, as a low risk entity with routine functions, receives a cost-plus renumeration, incurs 100 million cost of sales from third parties and receives a 110 million cost plus renumeration from the US. The US mother has 130 million sales revenue from third parties. Strictly speaking, a double deduction occurs due to these circumstances.
All panellists consider the application of ATAD2 here unwanted, since it would frustrate a genuine economic business activity, without any abuse. Therefore, ATAD2 should not be strictly applied in this case since it would lead to double taxation of 100 million (the costs that would not be deductible in the Netherlands). A practical and fair solution is that only the 10 million of profit would be taxed in the Netherlands.

CFC

The aim of CFC legislation is to tackle the risk that multinationals can strip the tax base of the country of residence by shifting income to a non-genuine controlled foreign company (the CFC), in a country that has a very low or no corporate taxation. CFC legislation allocates (parts of) the CFC income to the shareholders. In BEPS Action Point 3, the OECD makes certain recommendations for CFC legislation. For example on the broad application of legal forms and control of shareholders, thresholds like the effective tax rate (ETR) and the type of income that is subject to the rule (either the jurisdictional or the transactional approach).
The Italian CFC rules were adopted in 2000 and in line with the OECD guidelines. It was based on two pillars: the jurisdictional approach and a dual system for the thresholds, with a black and white list. The white list was for EU countries and was similar to the current ATAD regime, for non-EU countries there was a more extensive approach.

With the ATAD implementation, Italy dropped the dual system and made the approach equal between the EU and non-EU countries. The thresholds are met if the ETR is less than half of the Italian ETR *and* there is an ownership of passive income. Furthermore, there was chosen for a mixed approach and the notion of control was very broad. The only exemption is made for companies that carry out an effective economic activity with adequate resources.

Case
A parent company allocates assets generating passive income to a CFC eligible for exemption (on standalone basis the company carries on an actual economic activity), without related substantive activities nor valid economic reasons. As a consequence, there might be a 'swamping' effect, with the non-genuine activities generating passive affecting income the actual economic activities (relevant for the exemption from the CFC rules).

Sweden had CFC legislation before ATAD and the threshold of control is 25% to qualify for a CFC, they follow a jurisdictional approach. Sweden applies a substance carve out only for jurisdictions within the EEA. In addition, Sweden has a so called "white list" that provides an exemption from the CFC rules for income (or certain types of income) from jurisdictions listed in an appendix to the law .

The Netherlands chose with the implementation of this legislation for the entity approach, however the transactional approach can be considered already implemented by the codification of the arm's length principle. Companies are obliged to have transfer pricing documentation or the burden of proof for the taxpayer is reversed. Just like Sweden, the Netherlands has an exemption in applying the CFC legislation for genuine economic activities, using a list of substance requirements that have to be met by the taxpayer.

The approaches of all three TAs are quite similar. They would begin with the review of the TP documentation. The TA will also check if the economic ownership of the asset belongs with the parent company or with the CFC. If the documentation is not (adequately) present, the TA will already adjust the national tax base and neutralize the swamping effect directly. All panellists conclude as well that their TA would exchange information, that is found during the investigation of the TP documentation, on a

spontaneous base with other countries, when this information is considered useful for other states in relation to potential profits diverted from their respective jurisdictions.
If the TA would apply the ATAD CFC rule, all countries have an exemption for genuine economic activity conducted by the CFC (although for Sweden this only applies for jurisdictions within the EEA). It is likely that the economic activities are exempted from the CFC legislation.

GAAR

In Sweden, a country that tends to stay close to the letter of the law, a national GAAR was already implemented in 1995. This GAAR was not changed by article 6 of ATAD, it was deemed to fulfil the purpose of ATAD. There have been discussions whether or not the Swedish GAAR is compliant with EU law. For example, the Swedish GAAR does not contain a criteria of artificiality and the subjective criteria differs. Swedish withholding taxes are excluded from the domestic GAAR. These taxes have since 1970 a specific anti-avoidance rule that is more similar to a dividend stripping rule, since it focuses on lending situations. This rule was deemed to be in line with the anti-abuse rule of the Parent Subsidiary Directive (PSD) of 2016. Currently, there is a revision of the Swedish withholding taxation and the question if the GAAR needs to be applicable is included in this update.

Case
This case was a request for a ruling in 2017, so before ATAD and the Danish Beneficial Ownership cases. Sweden has a council where companies can ask for a binding tax ruling. The facts of the case are as follows: a Swedish natural person, A, has transferred al his shares in two operational Swedish companies to X Ltd., based in Malta. With this transaction, there is no capital gains tax due in Sweden. X Ltd. is a holding company, the asset management is done by a bank in Luxembourg and a service company in Malta is appointed to perform the formal obligations. Dividends from Sweden are not redistributed in the same year but in the following year. Then, A emigrates to Portugal, where the dividends from X Ltd. are tax exempt. Due to the narrow scope of the Swedish withholding tax anti-abuse rule, the Council for Advance Tax Rulings found the anti-abuse rule not applicable to this case. The decision was appealed to the Supreme Administrative Court and was rejected due to unclear conditions (and thus the ruling did not become binding). The Supreme Court did imply that the anti-abuse rules should be viewed in light of the PSD. After 2017 the Swedish TA has continued to challenge these structures, based on the anti-abuse rule of the withholding tax act, interpreted in the light of the directive.

The Netherlands has implemented a part of the PSD in an exemption on the domestic dividend withholding tax for distributions to EU member states. These rules include an anti-abuse doctrine which looks at the structure (wholly artificial) and whether the entity has been interposed to avoid taxes. In this case, both conditions seem to fail and therefore the Netherlands would likely disallow the exemption of the PSD. Moreover, the Danish cases and GAAR disallow directive benefits in case of abuse of the law, so in this case, with an apparent wholly artificial structure, the benefit will highly likely not be given to the taxpayer. Besides the anti-abuse rules of the PSD, the domestic GAAR (*fraus legis*), which is the implementation of article 6 ATAD too, applies to non-genuine (artificial) structures, where tax avoidance is the motive of the structure.

Italy had before the ATAD Directive already a domestic GAAR, that was found to be compliant with ATAD. In this Swedish case, the structure could be countered by the application of a specific anti-abuse rule tailored to the concept of beneficial owner or the GAAR.

Lastly, panellist agree that it might be argued that if the domestic implementation of the GAAR is not sufficient, and anti-abuse legislation does not cover an abusive structure where it should be covered by EU law, the TA does not only have the possibility, but the obligation to apply the anti-abuse principle from the Danish cases, as EU primary law.

What is the general feeling with ATAD?
The panellists concluded that one of the common perceived outcomes related to the implementation of ATAD legislation is represented by the deterrent effect, leading multinationals to dismantle or not to enter into aggressive structures. Implementation of the DACs possibly contributed to this effect too.

Another interesting aspect reported by TAs relates to the importance of reputation for multinationals and tax advisors, so that application of ATADs is not limited to tax adjustments only. However, TAs reported that taxpayers often argue that the compliance costs related to the application of ATADs is quite relevant, especially when it requires to access to information on local tax rules of other jurisdictions (e.g. linking rules).
Finally, it was interesting to note that panellists concluded in almost all the cases with similar approaches and solutions, as shown in the summary of the cases.

Panel members:

- Emma Barrögård | Swedish Tax Authorities
- Harry Roodbeen | Dutch Tax Authorities
- Marco Zonetti | Italian Tax Authorities