LOYENS & LOEFF

IFA Bulgaria

General Anti-Avoidance Rules (GAAR) / Principal Purpose Test (PPT) for Dividends, Interest & Royalties

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GAAR / PPT – implementation BEPS action 6

- MLI - article 7 (minimum standard)
- EU Parent-Subsidiary Directive – GAAR only in relation to dividends
- ATAD – article 6 (‘catch all’ GAAR)

- Interest & royalties
- EU measures vis-à-vis blacklisted jurisdictions?

Prevention of treaty abuse (art. 7 MLI)

- System of art. 7 MLI
  - PPT is the default option (since it satisfies the minimum standard on its own).
  - Parties may supplement the PPT by opting for a simplified LOB.
  - Parties may opt out of the PPT and choose a detailed LOB. However, a detailed LOB should be negotiated bilaterally and is not included in the MLI provision.
  - Parties that choose to bilaterally negotiate a detailed LOB may apply the PPT as an interim measure.
- Compatibility clause
  - Art. 7(1) MLI is a minimum standard and therefore applies in place of or in absence of any existing principal/main/primary purpose rules in a Tax Treaty. It is not intended to restrict the scope of other types of existing anti-abuse rules in a Tax Treaty.

Prevention of treaty abuse (art. 7 MLI) – (ii)

- Most Parties are expected to apply the PPT only, in particular within the EU (given the EU compatibility concerns regarding the LOB).

- Limited guidance

  - The accompanying OECD Commentary on the PPT offers only clear-cut examples that offer little guidance on the structures that will be affected by the PPT (e.g. holding structures).
  - Discussion Draft non-CIV funds January 6, 2017 contains some guidance, but only for non-collective investment vehicle funds?

- Example: LOB in treaty with Japan: is ‘floor’ (if LOB does not apply) compatible with minimum standard?

Different appearances of GAAR / PPT

BEPS/MLI style PPT in tax treaties
(core elements)

- *"**A benefit under this Convention shall not be granted** […] if it is reasonable to conclude, […], that **obtaining that benefit was one of the principal purposes** of any arrangement […]. "*

Status political commitment to implement **How ?** via MLI article 7 (BEPS Action 15)

EU Parent - Subsidiary Directive style PPT
(core elements)

- *"Member States **shall not grant the benefits of this Directive** to an arrangement […] having been put into place for the main purpose or one of **the main purposes of obtaining a tax advantage** that defeats the object or purpose of this Directive, are not genuine having regard to all relevant facts and circumstances. […]"*

Status already effective **How ?** Implementation in domestic law

ATAD Directive style PPT
(core-elements)

- "***For the purposes of calculating the corporate tax liability**, a Member State **shall ignore an arrangement** […] having been put into place for the **main purpose […] of obtaining a tax advantage** that defeats the object or purpose of the applicable tax law, are not genuine having regard to all relevant facts and circumstances. [...]"*

Status implementation date 1 January 2019 **How ?** implementation in domestic law

GAAR in EU Parent Subsidiary Directive and ATAD

- Subjective and objective elements

- No clear guidance on the terms used in the GAAR

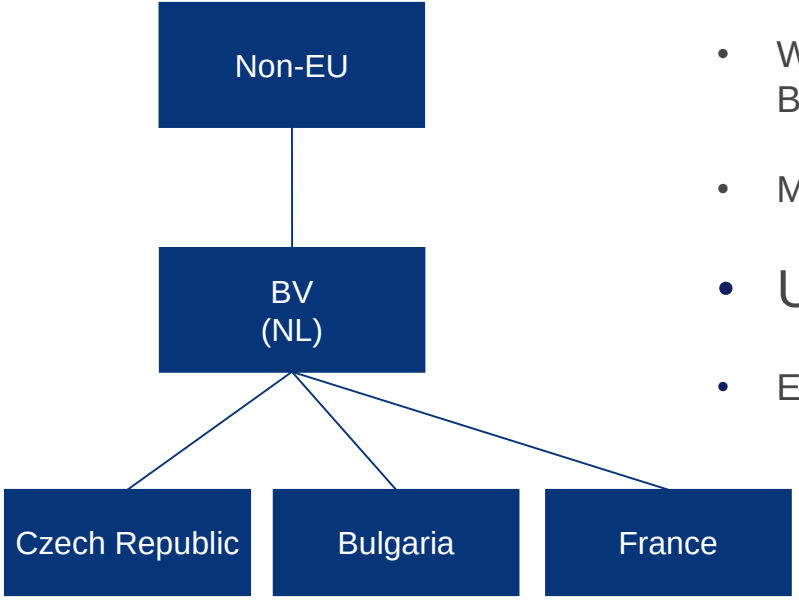
- EU PS Directive GAAR implemented by member states per 1 January 2016
- ATAD GAAR to be implemented by 1 January 2019

- Similar amendments still expected for EU Interest & Royalty Directive?
  - Necessary with article 7 MLI?
  - Measure vis-à-vis payments to blacklisted jurisdictions?

GAAR in EU Parent Subsidiary Directive and ATAD (ii)

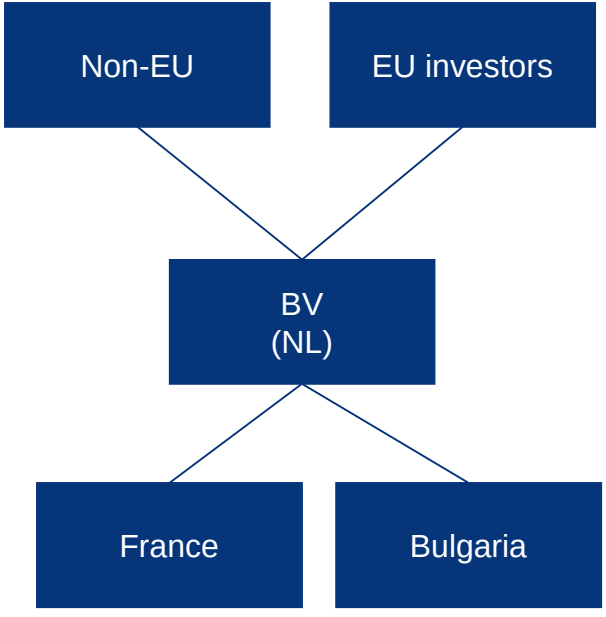
- Is ATAD GAAR legislation required if EU member state applies abuse of law doctrine?
- Is tax payer allowed to choose the most tax efficient route if more options are ‘genuine’?
- GAAR/PPT clearly gives decision power to source country, but who should have the burden of proof? Tax payer or tax authorities?
- Problem with PS Directive GAAR is that tax is always one of the principal purposes in deciding where to locate a company, especially if you look as non-EU investor to Europe as a single market
- The question is therefore whether the structure is:
  (i) genuine, i.e. has been put in place for valid commercial reasons, which reflect economic reality
  (ii) and(/or?) defeats the object or purpose of the Directive / applicable tax law

Example 1: Holding company to enter EU



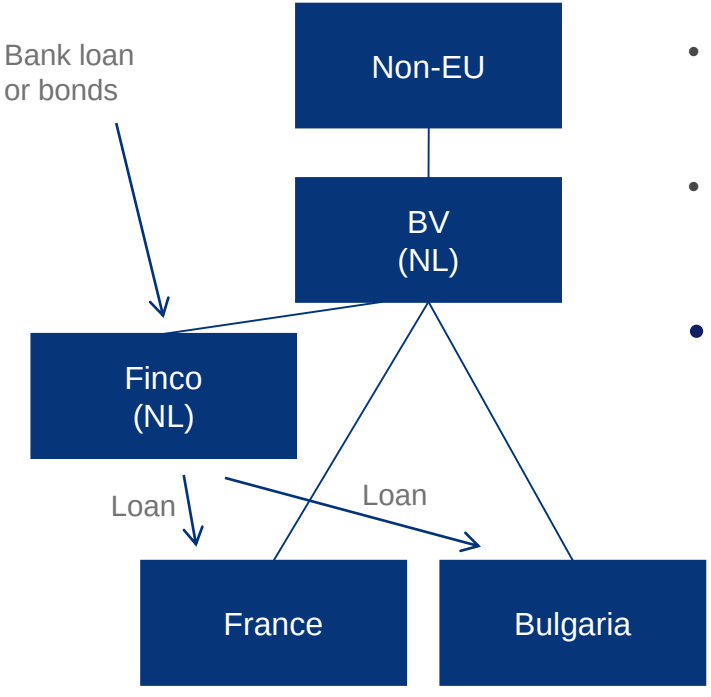
- Non-EU investors looking for 'hub' to invest in Europe
- Want to be able to reinvest dividends from Czech Republic into Bulgaria and France and vice versa
- May also distribute dividends to non-EU shareholder
- USE or ABUSE of EU PS Directive or treaty?
- EU law considerations:
  - What conditions can local GAAR impose within freedom of movement of capital or establishment?
  - Does Cadbury Schweppes case law still apply?

Example 2: JV company for foreign investments



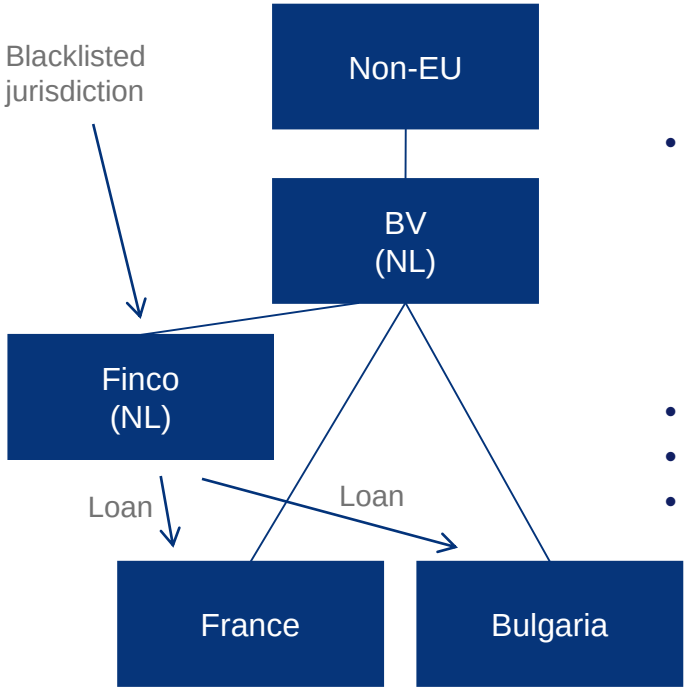
- Investors want ‘neutral’ jurisdiction for Joint Venture
- Example: want to be able to reinvest dividends from Bulgaria into France and vice versa
- May also distribute dividends to investors
- Is this structure genuine?
- USE or ABUSE of EU PS Directive or Treaty?

Example 3: Financing company



- BV raises money from third parties to fund EU business
- Bank / bondholders desire security package and bankruptcy remote SPV
- Any withholding tax will be burden for borrowing group (gross up clause)
- USE or ABUSE of EU I&R Directive or treaty?

Blacklisted jurisdictions – minimum effective tax rates



- Finco borrows from a blacklisted jurisdiction (tax haven) and onlends to EU group companies

- Possible EU measures:
  - Mandatory WHT for all payments to tax haven
  - Automatic denial of access to I&R Directive
  - Mandatory disclosure to source country
  - Presumption of abuse of I&R Directive

- Only if overall effective tax rate below certain minimum?
- Should economic substance in Finco solve the issue?
- Only if tax haven is also group company?

How to deal with PPT/GAAR risk?

Pooling functions

Reinvestment functions

Managerial involvement downstream

Already Dutch footprint, the Netherlands logical route to go

Group services (management, accounting, HR, financial treasury, currency, hedging)

Bilateral investment treaty protection

Skilled labor force , reliable legal system, business friendly, stability, membership of regional grouping etc.

BUT,

1. Case by Case
2. No safe havens
3. Source country driven

Elements inspired on BEPS, EU case law and practice

Conclusions

- Intermediary companies under severe pressure
- Implementation GAAR / PPT will lead to (a period of?) uncertainty
- Presumption of abuse seems the new starting point
- Best solution to combat BEPS/ATAD: business substance must be at the same place as the group entities and the assets.
- Small countries vulnerable to scrutiny, even if they have sufficient economic business reasons?
- Will assets/people come to the structure or will structures go to them?
- In the end the call for FDI will win over too strict local interpretation of anti-abuse rules

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Bartjan R. Zoetmulder, tax partner, heads up Loyens & Loeff's CEE team and Russia/CIS team and is an active member of the real estate team. In addition, he co-chairs L&Ls BEPS committee. He specialises in pan-European tax structuring of investments from and via the Netherlands and Luxembourg vis-a-vis Central and Eastern Europe as well as Russia and the CIS countries. Moreover, he worked in the Tokyo office between 1995 and 1998 and was responsible for the Japanese practice in 2012 and 2013.

Bartjan is chairman of the Dutch Investment Climate team of the Dutch Tax Lawyers Association (NOB). He is a frequently asked lecturer and writer on international tax planning, particularly in relation to structuring investments in and from Central and Eastern Europe and Russia/CIS.

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