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The Prohibition of Abuse of Rights After the ECJ Danish Cases*

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Since they were delivered in February 2019 the judgments of the Court of Justice of the European Union (ECJ) in the well-known 'Danish cases' have already been referred to by several courts of EU Member States to tackle alleged cases of directive shopping. In light of the increased convergence between EU and current OECD standards (notably the Principal Purpose Test), the findings of the ECJ will likely also have an impact in tax treaty practice and with respect to corporate structures involving dividends, interest or royalties. Against this background, this article discusses the findings of the ECJ in light of EU law but also contrasts these findings with tax treaty law and practice, including the rules of the Vienna Convention on the Law of Treaties (VCLT). Following an analysis of the prohibition of abuse of rights under EU and tax treaty law, the authors test the indicators of abuse in concrete cases by distinguishing inter alia between wholly artificial (sham) arrangements, on the one hand and 'real' business structures driven by tax motives, on the other hand. Finally, the impact of the ECJ findings on the interpretation of beneficial ownership is considered by taking into account recent tax treaty case law involving the 2014 OECD Commentary.

Keywords: Abuse of rights, directive shopping, tax treaty abuse, principal purpose test (PPT), general anti-avoidance rule (GAAR), artificial arrangement, conduit company, beneficial ownership

1 Introduction, scope and structure of the contribution

On 26 February 2019, the Grand Chamber of the Court of Justice of the European Union (ECJ) delivered two long awaited landmark judgments – commonly referred to as the *Danish Cases*[1] – dealing with the problem of directive shopping under the Parent-Subsidiary (hereinafter PSD)[2] and the Interest and Royalty (hereinafter IRD)[3] directives. These judgments have already attracted unprecedented attention in scholarly writing.[4] From a practical point of view, the findings of the ECJ are increasingly relied upon by tax authorities of Member States in current audits

Notes

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1 DK: ECJ, 26 Feb. 2019, Joined Cases C-115/16, C-118/16, C-119/16 and C-299/16, *N Luxembourg 1 and Others*, ECLI:EU:C:2019:134 and DK: ECJ, 26 Feb. 2019, Joined Cases C-116/16 and C-117/16, *T Danmark and Y Danmark*, ECLI:EU:C:2019:135.

2 Council Directive (EU) 2015/121 of 27 Jan. 2015 amending Directive 2011/96/EU on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States, OJ 2015 L 21/1 (28 Jan. 2015), at 1–3.

3 Council Directive 2003/49/EC of 3 June 2003 on a common system of taxation applicable to interest and royalty payments made between associated companies of different Member States OJ L 157/49 (26 June 2003), at 49–54.

4 For a general discussion of the Danish cases, *see* inter alia, L. De Broe & S. Gommers, *Danish Dynamite: The 26 February 2019 CJEU Judgments in the Danish Beneficial Ownership Cases – a New Chapter in the History of Tax Abuse,* 28(6) EC Tax Rev. 270–299 (2019); A. Zalasiński, *The ECJ's Decisions in the Danish 'Beneficial Ownership' Cases: Impact on the Reaction to Tax Avoidance in the European Union,* 2(4) Int'l Tax Stud. 1–23 (2019) and, more specifically, on the ECJ's approach on the EU prohibition of abuse of rights, *see* W. Schön, *The Concept of Abuse of Law in European Taxation: A Methodological and Constitutional Perspective*, in *The Dynamics of Taxation: Essays in Honour of Judith Freedman* 185–208 (G. Loutzenhiser & R. de la Feria eds, Hart 2020); R. de la Feria, *EU General Anti-(Tax) Avoidance Mechanisms*, in *The Dynamics of Taxation: Essays in Honour of Judith Freedman* 157–183 (G. Loutzenhiser & R. de la Feria eds, Hart 2020) and A. Martín Jiménez, *The Prohibition of Abuse of EU Tax Law and the Codification of the EU GAAR*, in *The General Anti-Avoidance Rule: Past, Present, and Future* (B. Arnold ed., Canadian Tax Foundation 2021 (in press)).

involving the PSD and the IRD. It is indeed quite clear that the indicators of abuse provided by the ECJ will, in the future, also be referred to for purposes of applying the general anti-avoidance rules (GAARs) included in direct tax directives (notably in the PSD[5]) although these GAARs were not at issue in the cases submitted to the ECJ. Moreover, at the time of the preparation of this article, the national courts of several Member States (in particular Belgium,[6] France,[7] Italy,[8] the Netherlands,[9] Spain[10], and Denmark[11]) have already referred to the Danish cases in order to tackle cases of alleged directive shopping. Interestingly, the Federal Supreme Court of Switzerland has also recently referred to the Danish cases in a case[12] involving the Swiss-EU agreement partially providing equivalent benefits to the PSD and IRD (the Swiss-EU agreement).[13] Last, but not least, the findings of the ECJ may also have ramifications in tax treaty practice, in particular as will be seen regarding the meaning and effect of the beneficial ownership limitation (Articles 10–12 OECD Model Convention (OECD MC)) and its (controversial) relation with GAARs and the Principal Purpose Test (PPT) in Article 29(9) OECD MC.

This article, which builds on the contribution by its authors at a seminar organized in September 2020 by the Tax Policy Center of the University of Lausanne (Switzerland) on the Danish cases, aims at exploring the foregoing issues. The first part of this article is devoted to the prohibition of abuse of rights while (s. 2) the second considers the relation of this prohibition with the beneficial ownership limitation (s. 3). For both parts, a comparative approach is adopted in the sense that the findings of the ECJ are contrasted not only with EU law and past judgments of the ECJ but also with treaty law and practice, including the customary rules of interpretation embodied in the Vienna Convention on the Law of Treaties (VCLT).

In her opinion on the Danish cases, Advocate General Kokott observed that the matter discussed here could, in essence, be summarized as the following question: '*how far a multinational group can go when configuring corporate structures to reduce final liability for withholding tax (…) within the Group*'.[14] Arriving at the end of this contribution, we conclude that the Danish cases undoubtedly represent an important milestone with respect to the prohibition of abuse of rights, not only in European but also in international tax practice. It should finally be observed that this article does not deal with the problem of abuse by states which is, however, well established. As recently observed by Advocate General (AG) Kokott in *Vodafone*: '*This approach can be based on the general legal principle of the prohibition of abuse of rights, which applies throughout the European Union not only to taxable persons (…) I consider that the Member States are also subject to this general legal principle by virtue of Article 4(3) TEU*'.[15] The same holds true under tax treaty law as it is settled that states should perform their treaty obligations in good faith and should not '*dodge*' their international obligations.[16]

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5 Article 1(2) PSD.

6 BE: Hof van Beroep Gent, 1 Dec. 2020, judgments no. 2019/AR/306 and no. 2019/AR/307.

7 FR: Conseil d'État, 5 June 2020, judgment no. 423809, *Sté Eqiom et Sté Enka*, ECLI:FR:CECHR:2020:423809.20200605, also *see* judgments no. 423810, 423811 and 423812.

8 IT: Corte Suprema di Cassazione, 10 July 2020, judgment no. 14756.

9 NL: Hoge Raad, 10 Jan. 2020, case no. 18/00219, ECLI:NL:HR:2020:2 and NL: Rechtbank Noord-Holland, 26 June 2020, case no. 19/862, ECLI:NL:RBNHO:2020:5137 and 26 June 2020, case no. 19/879, ECLI:NL:RBNHO:2020:5138.

10 ES: Tribunal Económico-Administrativo Central, 8 Oct. 2019, decisions no. 185/2017 and no. 2188/2017.

11 DK: Østre Landsret, 3 May 2021, case no. B-1980-12 and B-2173-12. This judgment concerns the two dividend cases which were referred to the ECJ for preliminary rulings, *see T Danmark and Y Denmark* (C-116/16 and C-117/16), *supra* n. 1.

12 CH: Bundesgericht/Tribunal fédéral (Federal Supreme Court), 20 Apr. 2020, judgment 2C_354/2018.

13 Article 15 of the Agreement between the European Community and the Swiss Confederation providing for measures equivalent to those laid down in Council Directive 2003/48/EC on taxation of savings income in the form of interest payments, OJ L 385/30 (29 Dec. 2004), now Art. 9, following the Amending Protocol which renamed the Agreement 'Agreement between the European Union and the Swiss Confederation on the automatic exchange of financial account information to improve international tax compliance', o OJ L 333 (19 12 Dec. 2015), at 12–49.

14 DK: ECJ, 1 Mar. 2018, Opinion of AG Kokott, Case C–117/16, *Y Denmark Aps,* ECLI:EU:C:2018:145, para. 3.

15 HU: ECJ, 13 June 2019, Opinion of AG Kokott, Case C-75/18, *Vodafone Magyarország*, ECLI:EU:C:2019:492, para. 88; *see also* UK: ECJ, 4 Dec. 2018, Opinion of AG Campos Sánchez-Bordona, Case C-621/18, *Wightman and Others*, ECLI:EU:C:2018:978, para. 153.

16 K. Vogel, *Klaus Vogel on Double Taxation Conventions* 65 (3d edn, Kluwer Law International 1997), m.no. 125b; *see* K. Vogel and A. Rust, *Introduction*, in: *Klaus Vogel on Double Taxation Conventions* (E. Reimer & A. Rust eds, 4th ed., Wolters Kluwer 2015), m.no. 149; J. Avery Jones, *Treaty Interpretation,* in *Global Tax Treaty Commentaries* (R. Vann ed., IBFD, online book, version of 1 June 2019), s. 4.6; F. A. Engelen, *Interpretation of Tax Treaties Under International Law: A Study of Articles 31, 32 and 33 of the Vienna Convention on the Law of Treaties and Their Application to Tax Treaties* 502 (IBFD 2004); L. De Broe, *International Tax Planning and Prevention of Abuse: A Study Under Domestic Tax Law, Tax Treaties and EC Law in Relation to Conduit and Base Companies* 272–273 (IBFD 2008); C. De Pietro, *Tax Treaty Override* 216–217 (Kluwer Law International 2014); J. Wouters & M. Vidal, *An International Law Perspective on Tax Treaties and Domestic Law,* in *Tax Treaties and Domestic Law* (G. Maisto ed., IBFD 2006), s. 2.1; E. van der Bruggen, *State Responsibility Under Customary International Law in Matters of Taxation and Tax Competition*, 29(4) Intertax 115–139, at 127 (2001); R. J. Danon, *The PPT in Post-BEPS Tax Treaty Law: It Is a GAAR But Just a GAAR!*, 74(4/5) Bull. Int'l Tax'n. 242–263, at 261 et seq. (2020). Moreover, as observed in 2006 by the UN Committee of Experts on International Cooperation in Tax Matters: '*an abuse of a tax treaty by a State refers to a situation where one of the Contracting States, through the subsequent exercise of its domestic power of taxation, modifies the obligations previously assumed by that State towards the other State and upsets the balance in the division of taxing powers expressed in the tax treaty concluded between these States. By doing so, it may abuse the treaty and cause significant damages to the legitimate financial interests of taxpayers or of the other Contracting State*' (UN, Committee of Experts on International Cooperation in Tax Matters, *Treaty Abuse and Treaty Shopping,* Second session, E/C.18/2006/2 (30 Oct.–3 Nov. 2006), para. 10).

2 On the prohibition of abuse

2.1 *Nature, Contextualization and Effect*

2.1.1 *The EU Principle of Prohibition of Abuse After the Danish Cases*

The question of the nature and rank of the prohibition of abuse of rights under EU law arose in the Danish cases because the referring Danish courts sought to ascertain whether, in order to prevent an abusive practice in the context of the PSD and IRD, a Member State must have adopted a domestic anti-abuse provision.[17] In the area of VAT, in particular after *Italmoda*[18] and *Cussens*,[19] it was settled that the prohibition of abuse of rights is '*inherent in the system*',[20] applies regardless of a national measure giving effect to it and, hence, '*displays the general, comprehensive character which is naturally inherent in general principles of EU law*'.[21] By contrast, in *Kofoed*,[22] the ECJ considered that the anti-avoidance provision of the Merger Directive[23] reflected '*the general Community law principle that abuse of rights are prohibited*'[24] but required, in line with the principle of legal certainty,[25] that the transposition of an anti-avoidance rule be derived from the domestic '*general legal context*'.[26]

The conclusion in *Kofoed* was followed by AG Kokott in her opinion on the Danish cases.[27] The ECJ, however, dismissed this position and held that:

> *in the light of the general principle of EU law that abusive practices are prohibited and of the need to ensure observance of that principle when EU law is implemented, the absence of domestic or agreement-based anti-abuse provisions does not affect the national authorities' obligation to refuse to grant entitlement to rights provided for by Directive 90/435 where they are invoked for fraudulent or abusive ends.*[28]

In essence, the consequence of this finding is twofold. First of all, the ECJ's case law in relation to direct tax and VAT directives[29] is aligned[30] with *Kofoed* being overruled.[31] Secondly, the EU principle of abuse of rights applies irrespective of the possibility offered to Member States by the PSD and IRD to tackle abusive situations through the application of their '*domestic or agreement-based provisions for the prevention of fraud or abuse*'.[32] This principle, however, applies only to rights derived from EU (primary or secondary) legislation but not, of course, to rights purely rooted in domestic or tax treaty law of the Member States.[33] From a policy perspective, the Danish cases nonetheless entail a significant limitation to the Member States' sovereignty[34] and ability to design their

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17 *N Luxembourg 1 and Others* (C-115/16 et al.), *supra* n. 1, para. 95; *T Danmark and Y Denmark* (C-116/16 and C-117/16), *supra* n. 1, para. 68.

18 NL: ECJ, 18 Dec. 2014, Joined Cases C-131/13, C-163/13 and C-164/13, *Schoenimport 'Italmoda' Mariano Previti and Others*, ECLI:EU:C:2014:2455, para. 32.

19 IE: ECJ, 22 Nov. 2017, Case C-251/16, *Cussens and Others*, ECLI:EU:C:2017:881.

20 *Italmoda* (C-131/13), *supra* n. 18, para. 59.

21 *Cussens* (C-251/16), *supra* n. 19, para. 31. In IT: ECJ, 29 Mar. 2012, Case C-417/10, *3M Italia*, ECLI:EU:C:2012:184, para. 32, the ECJ, however, clarified that such a principle cannot apply when EU law is not involved.

22 DK: ECJ, 5 July 2007, Case C-321/05, *Kofoed*, ECLI:EU:C:2007:408, paras 37–44.

23 Council Directive 2009/133/EC of 19 Oct. 2009 on the common system of taxation applicable to mergers, divisions, partial divisions, transfers of assets, and exchanges of shares concerning companies of different Member States and to the transfer of the registered office of an SE or SCE between Member States, OJ L 310/34 (25 Nov. 2009), at 34–46.

24 *Kofoed* (C-321/05), *supra* n. 22, para. 42.

25 *Ibid.*

26 *Ibid.*, para. 44. *See also* L. De Broe & S. Gommers, *Article 29: Entitlement to Benefits (European Union),* in *Global Tax Treaty Commentaries* (R. Vann ed., IBFD online book, version of 30 May 2019), s. 2.4.

27 DK: ECJ, 1 Mar. 2018, Opinion of AG Kokott, Case C-116/16, *T Danmark*, ECLI:EU:C:2018:144, para. 100; *see also* DK: ECJ, 1 Mar. 2018, Opinion of AG Kokott, Case C-115/16, *N Luxembourg 1*, ECLI:EU:C:2018:143, para. 104.

28 *T Danmark and Y Denmark* (C-116/16 and C-117/16), *supra* n. 1, para. 83; *N Luxembourg 1* (C-115/16 et al.), *supra* n. 1, para. 97.

29 *Italmoda* (C-131/13), *supra* n. 18, para. 62; *Cussens* (C-251/16), *supra* n. 19, para. 33.

30 This convergence clearly flows from the references made by the ECJ to its case law in harmonized VAT matters, *see T Danmark and Y Denmark* (C-116/16 and C-117/16), *supra* n. 1, para. 76; *see also* De Broe & Gommers, *supra* n. 4, at 276.

31 *N Luxembourg 1* (C-115/16 et al.), *supra* n. 1, para. 117; *T Danmark and Y Denmark* (C-116/16 and C-117/16), *supra* n. 1, para. 89; De Broe & Gommers, *supra* n. 4, at 278.

32 *N Luxembourg 1* (C-115/16 et al.), *supra* n. 1, para. 104; *T Danmark and Y Denmark* (C-116/16 and C-117/16), *supra* n. 1, para. 77; *see also* De Broe & Gommers, *supra* n. 26, s. 2.4. Even if it was considered that the principles derived from the ECJ judgments represent a change of case law, these principles would nonetheless also apply to transactions and structures carried out before the Danish cases as the principle of legal certainty and the protection of legitimate expectations do not prohibit retrospective application (De Broe & Gommers, *supra* n. 26, s. 2.5. *See also* De Broe & Gommers, *supra* n. 4, at 276).

33 Zalasiński, *supra* n. 4, at 16.

34 De Broe & Gommers, *supra* n. 4, at 278.

anti-avoidance rules.[35] Moreover, the consistency with what the Court held in *Eqiom*[36] and *Deister and Juhler*[37] also arises. Of course, it is arguable that the freedom of Member States in this area is now more limited since the introduction of a GAAR in the PSD.[38] Moreover, the similar GAAR of the ATAD[39] applies to the domestic law of the Member States insofar as the '*corporate tax liability*' is concerned.[40] We revert to these questions below.

Scholars consider that the ECJ[41] has clearly elevated the prohibition of abuse of rights to the rank of general principle of EU primary law.[42] This prohibition of abuse now operates as a genuine GAAR but continues to be based on the definition provided by the Court in *Emsland-Stärke*[43] to which we shall revert. It thus incorporates a subjective element (intention to artificially obtain an advantage) and an objective one (causing the purpose of the applicable rule to be defeated). Such a prohibition comes into play after the establishment of the facts and the interpretation of EU law.[44] The presence of the subjective element emphasizes the difference with the ordinary process of interpretation which may also take into consideration purposive or teleological considerations.[45] For some commentators, the findings of the ECJ in the Danish cases imply that the scope of the EU principle of abuse of rights does not depend on the content of secondary legislation.[46] Moreover, it becomes unnecessary to examine whether and, if so, to what extent the substantive content of the EU prohibition of abuse of rights is compatible with the text of the directives and even with their express anti-avoidance rules.[47] In our opinion, this conclusion should be nuanced. In the Danish cases, the ECJ continued to rely on the foregoing two-pronged tests flowing from *Emsland-Stärke.*[48] Therefore, a finding of an abusive practice requires that the purpose of the applicable rules be defeated.[49] Accordingly, while the principle of abuse of rights is distinct and takes place after the proper interpretation of EU legislation, we submit that the principle remains nonetheless tied to the purpose of such legislation. The codified GAARs recently included in the PSD and in the ATAD express the same principle by requiring that '*the object and purpose of this Directive*' be defeated.[50] For this reason, as discussed later, even if the EU principle of prohibition of abuse of rights is derived from primary law and sits on top of secondary legislation, that principle cannot, for example, override a specific anti-avoidance rule (SAAR) in a directive if it is established that granting the benefit of the directive would be in accordance with the purpose of such specific rule.

2.1.2 *Relevance Under the Amending Protocol to the Swiss-EU Agreement?*

An interesting question that recently arose as a result of a decision rendered by the Swiss Federal Supreme Court[51] is the relevance of the EU prohibition of abuse of rights and the findings of the ECJ in the Danish cases in the framework of the Swiss-EU agreement. Article 9 of this agreement grants partially equivalent benefits (i.e., exemption of qualifying dividends, interest, and royalties) to the PSD and IRD. The provision relating to outbound dividends that was at issue in this decision provides that:

> *without prejudice to the application of domestic or agreement-based provisions for the prevention of fraud or abuse*

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35 Schön, *supra* n. 4, at 198.

36 FR: ECJ, 7 Sept. 2017, Case C-6/16, *Eqiom and Enka*, ECLI:EU:C:2017:641.

37 DE: ECJ, 20 Dec. 2017, Joined Cases C-504/16 and C-613/16, *Deister Holding and Juhler Holding*, ECLI:EU:C:2017:2009.

38 Article 1(2) and (3) PSD.

39 Council Directive (EU) 2016/1164 of 12 July 2016 laying down rules against tax avoidance practices that directly affect the functioning of the internal market OJ L 193 (19 July 2016), at 1–14 .

40 Article 6 ATAD.

41 *See* among others, de la Feria, *supra* n. 4, at 175; R. de La Feria, *On Prohibition of Abuse of Law as a General Principle of EU Law*, 29(4) EC Tax Rev. 146 (2020); Schön, *supra* n. 4, at 202–203 criticizing however the ECJ's approach; *also* De Broe & Gommers, *supra* n. 4, at 276; Zalasiński, *supra* n. 4, at 11.

42 On the legal basis and the rank of EU general principles in the constitutional order, *see* Schön, *supra* n. 4, at 189 et seq. *See also* on the function of general principles of EU law, De Broe & Gommers, *supra* n. 26, s. 2.4.

43 *See N Luxembourg 1* (C-115/16 et al.), *supra* n. 1, para. 124; *T Danmark and Y Denmark* (C-116/16 and C-117/16), *supra* n. 1, para. 97.

44 UK: ECJ, 30 Sept. 2010, Opinion of AG Mazak, Case C-277/09, *RBS Deutschland Holding*, ECLI:EU:C:2010:566, paras 28–30.

45 De la Feria, *supra* n. 4, at 171.

46 Schön, *supra* n. 4, at 198.

47 *Ibid.*, at 199.

48 *See N Luxembourg 1* (C-115/16 et al.), *supra* n. 1, para. 124; *T Danmark and Y Denmark* (C-116/16 and C-117/16), *supra* n. 1, para. 97 referring to DE: ECJ, 14 Dec. 2000, Case C-110/99, *Emsland-Stärke*, ECLI:EU:C:2000:695, paras 52–53.

49 *Emsland-Stärke* (C-110/99), *supra* n. 48, paras 52–53.

50 Article 1(2) PSD; Art. 6(1) ATAD I. Because the ATAD GAAR applies to the domestic 'corporate tax liability', the objective element concerns here the domestic tax law of the Member States which must be interpreted. However, the ECJ is not particularly equipped for this task; *see* thereupon this Martín Jiménez, *supra* n. 4.

51 Bundesgericht/Tribunal fédéral, judgment 2C_354/2018, *supra* n. 12.

in Switzerland and in Member States, dividends paid by subsidiary companies to parent companies shall not be subject to taxation in the source State where: - the parent company has a direct minimum holding of 25 % of the capital of such a subsidiary for at least two years, and, - one company is resident for tax purposes in a Member State and the other company is resident for tax purposes in Switzerland, and, - under any double tax agreements with any third States neither company is resident for tax purposes in that third State, and, both companies are subject to corporation tax without being exempted and both adopt the form of a limited company.[52]

As can be seen, the reservation in favour of domestic anti-abuse rules is substantially identical to that of the PSD.[53] Further, this provision is also subject to a two-year holding period directly inspired from the one that Member States may introduce under this directive.[54]

The Federal Supreme Court held that the interpretation of the Swiss-EU agreement is subject to the customary rules of the VCLT.[55] Moreover, relying on the principle of common interpretation, the Court considered that the ECJ's case law (in particular its findings in the Danish cases) was relevant for purposes of interpreting this provision.[56] According to the Court, this specifically holds true when the provisions of the Swiss-EU agreement are identical to those of the PSD or IRD.[57] For this reason, the Federal Supreme Court held that the findings of the ECJ in the Danish cases were useful as they provided guidance on the consequences of an abuse of rights.[58] As will be shown, the Swiss court's observation on this point is misguided as the ECJ did not deal with this question. Equally incorrect is the conclusion that, under EU law, the benefits of the PSD must be completely denied without the availability of any alternative benefits.[59] Ultimately, however, the question of whether the EU prohibition of abuse of rights is applicable to the Swiss-EU agreement was left open.[60]

The position that the Swiss-EU agreement is subject to the VCLT must, of course, be endorsed. In fact, the ECJ arrived at the same conclusion in relation to the agreement between the European Community and the Swiss Confederation on the free movement of persons (AFMP).[61] By contrast, the agreement is, by essence, not subject to EU primary law. Therefore, the application of the EU principle of abuse of rights to that agreement, as envisaged in the Danish cases, is not possible.[62] As discussed, the entire reasoning of the ECJ is indeed based on the fact that the EU principle of abuse of rights forms part of EU primary law and, for this reason, sits on top of the directives. That position cannot be transposed to the Swiss-EU agreement for which the reference to EU law remains only an interpretative tool. On the other hand, we subscribe to the position based on the principle of common

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52 Similarly, Art. 9(2) of the Swiss-EU agreement dealing with interest and provides that: '*Without prejudice to the application of domestic or agreement-based provisions for the prevention of fraud or abuse in Switzerland and in Member States, interest and royalty payments made between associated companies or their permanent establishments shall not be subject to taxation in the source State where: – such companies are affiliated by a direct minimum holding of 25 % for at least two years or are both held by a third company which has directly a minimum holding of 25 % both in the capital of the first company and in the capital of the second company for at least two years, and; – one company is resident for tax purposes or a permanent establishment is located in a Member State and the other company is resident for tax purposes or other permanent establishment situated in Switzerland, and; – under any double tax agreements with any third States none of the companies is resident for tax purposes in that third State and none of the permanent establishments is situated in that third State, and; – all companies are subject to corporation tax without being exempted in particular on interest and royalty payments and each adopts the form of a limited company*'.

53 Article 1(4) PSD.

54 Article 3(2) PSD.

55 Bundesgericht/Tribunal fédéral, judgment 2C_354/2018, *supra* n. 12, para. 3.1.

56 *Ibid.*, para. 4.5.3.

57 *Ibid.*, para. 3.4.3.

58 *Ibid.*, para. 4.5.3. The Federal Supreme Court simply assumed that the Danish cases were relevant to the Swiss-EU agreement even if these judgments were delivered after the entry into force of the agreement. Unlike the AFMP, the Swiss-EU Agreement does indeed not contain a provision dealing with the issue of reference to the case law of the ECJ and, perhaps more importantly, a cut-off date limiting such reference to case law existing prior to the signature of the agreement. Art. 16(2) of the Agreement between the European Community and its Member States, of the one part, and the Swiss Confederation, of the other, on the free movement of persons – Final Act – Joint Declarations – Information relating to the entry into force of the seven Agreements with the Swiss Confederation in the sectors free movement of persons, air and land transport, public procurement, scientific and technological cooperation, mutual recognition in relation to conformity assessment, and trade in agricultural products, OJ L 114/6 (30 Apr. 2002) (AFMP); *see also* DE: ECJ, 26 Feb. 2019, Case C581/17, *Wächtler*, ECLI:EU:C:2019:138, para. 39 and DE: ECJ, 27 Sept. 2018, Opinion of AG Wathelet, Case C-581/17, *Wächtler*, ECLI:EU:C:2018:779, para. 72 and thereupon R. J. Danon & B. Malek, *Influence of EU Case Law on the Prohibition of International Tax Abuse in Swiss Practice: Critical Remarks on the Federal Supreme Court Judgment 2C_354/2018 of 20 Apr. 2020 and on Its References to the «Danish Cases» Decided by the Court of the Justice of the European Union*, 89(8) Archiv für Schweizerisches Abgaberecht 477–511, at 492 (2021).

59 Bundesgericht/Tribunal fédéral, judgment 2C_354/2018, *supra* n. 12, para. 4.5.3.

60 *Ibid.*, para. 4.5.4.

61 *Wächtler* (C-581/17), *supra* n. 58, para. 35: '*As a preliminary point, since the AFMP is an international treaty, it must be interpreted, in accordance with Art. 31 of the Vienna Convention on the Law of Treaties of 23 May 1969 (United Nations Treaty Series, vol. 1155, at 331), in good faith, in accordance with the ordinary meaning to be given to its terms in their con- text and in the light of its object and purpose(judgments of 2 Mar. 1999, Eddline El-Yassini, C416/96, EU:C:1999:107, para. 47, and of 24 Nov. 2016, SECIL, C464/14, EU: C:2016:896, para. 94 and the case-law cited*'.

62 *See* Danon & Malek, *supra* n. 58, at 495; S. Oesterhelt, *Altreservenpraxis vor Bundesgericht: Führt das Urteil 2C_354/2018 vom 20. Apr. 2020 zu einem Paradigmenwechsel?*, Steuer Revue 12/2020 902–916, at 911 (2020).

interpretation that the case law of the ECJ is relevant to interpret provisions of the Swiss-EU agreement that are substantially similar to those of the PSD or IRD.[63] This line of reasoning has also been endorsed by the ECJ when interpreting the AFMP.[64] In this context, it is unfortunate that the Swiss Federal Supreme Court did not refer to the judgments of the ECJ in *Eqiom*,[65] *Deister*,[66] *Denkavit*,[67] and *Halifax*[68] when it comes to the consequences of an abuse. It flows indeed from these judgments that a reservation in favour of '*domestic or agreement-based provisions for the prevention of fraud or abuse*' such as the one found in Article 9 of the Swiss-EU agreement and in the PSD must be interpreted restrictively and in line with the principle of proportionality.

As shall be seen, this is precisely why a full denial of benefits without considering the availability of benefits available in the absence of the relevant abusive operation is not correct. Moreover, our conclusion is the same if the underlying double taxation convention (DTC) between Switzerland and the relevant EU Member State contains a PPT which would then be regarded as '*an agreement-based provision*'.

We submit that the principle of common interpretation taking into account the foregoing ECJ case law also applies in relation to a DTC concluded by Switzerland with a Member State that incorporates the terms of the Swiss-EU agreement. This is the case, for example, under Article 12 of the Spain-Switzerland DTC relating to royalties.[69] It is unfortunate that the Spanish Supreme Court did not take this aspect into account in the recent *Colgate* case[70] that is reverted to below.

2.1.3 *Comparative Analysis Under Tax Treaty Law*

We now wish to compare the roots and effects of the prohibition of abuse of rights under EU law with that in treaty law. In order to keep the discussion within manageable proportions, we distinguish between DTCs that do not (yet) include a PPT pursuant to Article 29(9) OECD MC and those that do so. The discussion concerning DTCs that do not include a PPT will, of course, ultimately lose some of its importance as Base Erosion and Profit Shifting (BEPS) standards are being implemented. This question remains nonetheless relevant regarding ongoing treaty disputes involving pre-BEPS DTCs.

For DTCs that do not include a PPT, the principle that EU secondary legislation – in particular the PSD and the IRD – is subject to an unwritten prohibition of abuse of rights seems to bear some conceptual similarities to the idea that these DTCs are subject to an inherent prohibition of abuse. Several commentators[71] and courts[72] have indeed supported the position that DTCs are subject to an inherent prohibition of abuse. Klaus Vogel was one of the first scholars to have defended this position and submitted that this inherent prohibition of abuse is universal.[73] According to this author, therefore, whether two contracting states have adopted a general prohibition of abuse and, in the affirmative, what constitutes abuse under domestic law is, by itself, not relevant.[74] From this perspective, the position of Klaus Vogel resembles the one flowing from the findings of the ECJ in the Danish cases. Other scholars, by contrast, require that there be a connection between the alleged abusive conduct and the legal system of the contracting

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[63] The principle of common interpretation is indeed based on the need to interpret a treaty on the basis of its object and purpose pursuant to Art. 31(1) VCLT; *see* Vogel & Rust, *supra* n. 16, m.no. 90. *See also* OECD, *Tax Treaty Override* (OECD Publishing 1989), para. 20: '*the interpretative process should, in the case of tax treaties, rely on the co-ordination of approaches by the tax authorities in order to achieve the main objectives, namely the avoidance of double taxation* (…)'.

[64] *See* for instance, FR: ECJ, 15 Mar. 2018, Case C-355/16, *Picart*, ECLI:EU:C:2018:184 or DE: ECJ, 21 Sept. 2016, Case C-478/15, *Radgen*, ECLI:EU:C:2016:705.

[65] *Eqiom* (C-6/16), *supra* n. 36.

[66] *Deister* (C-504/16), *supra* n. 37.

[67] DE: ECJ, 17 Oct. 1996, Joined Cases C-283/94, C-291/94 and C-292/94, *Denkavit Internationaal and Others*, ECR 1996 I-05063, ECLI:EU:C:1996:387, para. 31.

[68] UK: ECJ, 21 Feb. 2006, Case C-255/02, *Halifax and Others*, ECR 2006 I-01609, ECLI:EU:C:2006:121.

[69] Article 12(7) Spain-Switzerland Double Taxation Convention (1966): '*Notwithstanding paras 1 and 2, royalties arising in a Contracting State and paid between associated companies shall not be subject to taxation in the source State, where: such companies are affiliated by a direct minimum holding of 25 per cent for at least two years or are both held by a third company which has directly a minimum holding of 25 per cent both in the capital of the first company, and in the capital of the second company for at least two years; and such companies are resident in a Contracting State; and under any double tax agreements with any third State none of the companies is resident in that third State; and all companies are subject to corporation tax without being exempted in particular on royalty payments and each adopts the form of a limited company*'.

[70] ES: Tribunal supremo, 23 Sept. 2020, judgment no. 3062/2020, ECLI:ES:TS:2020:3062.

[71] Klaus Vogel was one of the first scholars to express this view (*see* K. Vogel, *Introduction*, in *Klaus Vogel on Double Taxation Conventions: A Commentary to the OECD-, UN- and US Model Conventions for the Avoidance of Double Taxation of Income and Capital with Particular Reference to German Treaty Practice* (Kluwer Law and Taxation Publishers 1991), m.no. 121) which was then endorsed by several commentators. *See* e.g., D. Ward, *Abuse of Tax Treaties*, 23(4) Intertax 176–186, at 180 (1995); R. G. Prokisch, *Artikel 1, Doppelbesteuerungsabkommen der Bundesrepublik Deutschland auf dem Gebiet der Steuern vom Einkommen und Vermögen. Kommentar auf der Grundlage der Musterabkommen* (K. Vogel & M. Lehner eds, 6th ed, C.H. Beck 2015), m.no. 117; F.A. Engelen, *On Values and Norms: The Principle of Good Faith in the Law of Treaties and the Law of Tax Treaties in Particular* 36 (Kluwer 2006); De Broe, *supra* n. 16, at 374–375; A. Rust, *Article 1*, in *Klaus Vogel on Double Taxation Conventions* (E. Reimer & A. Rust eds, 4th ed., Wolters Kluwer 2015), m.no. 57; R. J. Danon, *Article 1*, in *Modèle de Convention fiscale OCDE concernant le revenu et la fortune – Commentaire* (R. J. Danon, D. Gutmann, X. Oberson & P. Pistone eds, Helbing Lichtenhahn 2014), m.no. 144.

[72] IL: District Court of Tel Aviv-Yafo, 30 Dec. 2007, *Yanko-Weiss Holdings 1 (1996) Ltd v Holon Assessing Office*, 10 ITLR 524; CH: Bundesgericht/Tribunal fédéral, 28 Nov. 2005, judgment 2A.239/2005 = *A Holding ApS v. Federal Tax Administration*, 8 ITLR 536. This reasoning was by contrast not accepted in CA: *MIL (Investments) SA v. Canada*, 9 ITLR 29 (Tax Court of Canada) and 9 ITLR 1111 (Federal Court of Appeal).

[73] Vogel, *Introduction*, *supra* n. 71, m.no. 123.

[74] *Ibid.*, m.no. 122.

states[75] that is similar to what the ECJ required in *Kofoed.*[76] Since 2003, the OECD Commentary expressly supports the position that treaty benefits may be denied when '*a main purpose for entering into certain transactions or arrangements was to secure a more favourable tax position and obtaining that more favourable treatment in these circumstances would be contrary to the object and purpose of the relevant provisions*'.[77] This guiding principle, to which we revert, has a dual role. On the one hand, the principle regulates the denial of benefits on the basis of '*the object and purpose of tax conventions as well as the obligation to interpret them in good faith (see Article 31 of the Vienna Convention on the Law of Treaties*'.[78] On the other hand, the principle also serves as a threshold with which contracting states are to comply when relying on domestic anti-avoidance rules in order to set aside a DTC.[79]

This being said, there is a fundamental difference in nature between the EU principle of abuse of rights (insofar as it is considered to form part of EU primary law) and what is described as an inherent prohibition of abuse under tax treaty law. First of all, under tax treaty law, there is essentially no such thing as a general principle of prohibition of abuse that would sit on top of a DTC. Rather, such a principle remains tied to the DTCs themselves. Secondly, the foundation of such a principle must be settled. While it is true that Article 26 VCLT may serve as a justification for a prohibition of abuse of rights that would regulate the performance in good faith of treaty obligations between the contracting states, that justification is more controversial regarding taxpayers.[80] A more convincing approach, on the other hand, is to consider that abusive practice by a taxpayer may be set aside if it is in breach of the object and purpose of the DTC under Article 31 VCLT.[81] In that case and unlike under EU law, treaty benefits are not denied on the basis of a genuine GAAR but rather at the level of the ordinary interpretation of the treaty. For this reason and unlike what the OECD seems to suggest,[82] the guiding principle, which is merely an interpretative tool based on Article 31 VCLT, cannot be equated to the PPT.[83] This has two main implications. First of all, the subjective element (main purpose test) to which the guiding principle refers has little relevance. Under Article 31(1) VCLT, the interpretation based on the object and purpose of the treaty takes place, and its outcome is the same irrespective of the motives of the taxpayer.[84] Secondly and perhaps more importantly, the reference made by the guiding principle to the '*object and purpose of the relevant provisions*' of the DTC does not permit a purposive interpretation beyond the treaty wording. It is settled that this customary provision expresses the primacy of the textual approach in the interpretative process[85] and is deemed to reflect the intentions of its parties.[86] Therefore, any contextual or purposive interpretation that cannot be reconciled with the ordinary meaning of treaty terms is incompatible with Article 31 VCLT.[87] However, this does not mean that a state may never apply a domestic anti-avoidance provision to deny treaty benefits. Rather, the application of such a rule is only possible to the extent that it is established that granting treaty benefits under the relevant circumstances would conflict with the object and purpose[88] or would not be

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75 *See* e.g., W. Haslehner, *Luxembourg,* in *Tax Avoidance Revisited in the EU BEPS Context,* EATLP International Tax Series vol. 15 (A. P. Dourado ed., IBFD, 2017), s. 18.3.1; S. van Weeghel & A. Gunn, *A General Anti-Abuse Principle of International Law: Can It Be Applied in Tax Cases?*, in *Essays on Tax Treaties: A Tribute to David A. Ward* 305–323 at 323 (G. Maisto, A. Nikolokakis & J. M. Ulmer eds, Canadian Tax Foundation/IBFD 2012); A. Martín Jiménez, *Domestic Anti-Abuse Rules and Double Taxation Treaties: a Spanish Perspective – Part I*, 56(11) Bull. Int'l Tax'n. 542–553, at 550 (2002).

76 *Kofoed* (C-321/05), *supra* n. 22, para. 42.

77 OECD Model (2017): Commentary on Art. 1, para. 61.

78 *Ibid.*, para. 59.

79 *Ibid.*, para. 58.

80 *See* van Weeghel & Gunn, *supra* n. 75, at 323; G. Maisto, *Domestic Anti-Abuse Rules and Bilateral Conventions in the Light of Public International Law*, in *Essays on Tax Treaties: A Tribute to David A. Ward* 339 (G. Maisto, A. Nikolokakis & J. M. Ulmer eds, Canadian Tax Foundation/IBFD 2012).

81 De Broe, *supra* n. 16, at 374 et seq.

82 OECD Model (2017): Commentary on Art. 1, para. 61.

83 *See* Danon, *supra* n. 16, at 253 and R. J. Danon, *The Principal Purposes Test Under the OECD and UN Model Tax Conventions: Impact for Taxpayers and Limits for States Under International Law*, in *General Anti-Avoidance Rules: The Final Tax Frontier. Indian and International perspectives* 700 (M. Butani & T. Jain eds, Thomson Reuters 2021).

84 M. Lang, *The Signalling Function of Article 29(9) of the OECD Model – The 'Principal Purpose Test'*, 74(4/5) Bull. Int'l. Tax'n. 264–268, at 266 (2020) has put forward a similar argument to contend that the subjective element under Art. 29(9) OECD MC (2017) is meaningless. This is however because this author sees the PPT as merely clarifying the purposive interpretation under Art. 31(1) VCLT. We on the other hand consider that the PPT has a scope of its own which is distinct and comes after the interpretation of treaty law and permits *a sui generis* purposive interpretation beyond the treating wording. Such *sui generis* purposive interpretation however only comes into play in the presence of an avoidance transaction (i.e., when the subjective element of the PPT is met).

85 Engelen, *supra* n. 16, at 426; Vogel & Rust, *supra* n. 15, m.no. 84.

86 United Nations, *Draft Articles on the Law of Treaties with Commentaries 1966,* Yearbook of the International Law Commission (2005), Commentary on Art. 27, at 220, para. 11.

87 Engelen, *supra* n. 16, at 427; *See also* among many others and in the same vein, D. Ward, *The Role of the Commentaries on the OECD Model in the Tax Treaty Interpretation Process*, 60(3) Bull. Int'l Tax'n. 97–102, at 99 (2006); *See also* in particular FR: Conseil d'État, 28 June 2002, judgment no. 232276, ECLI:FR:CEASS:2002:232276.20020628 = *Re Société Schneider Electric*, 4 ITLR 1077, 1108: '*Even assuming that it had been established that the objective of combating tax avoidance and evasion had been assigned to the Franco-Swiss treaty, this objective may not, in the absence of express provisions to that effect, derogate from the rules stated in the treaty*'.

88 Article 31(1) VCLT.

supported by the treaty context.[89] This is, of course, also taking into account any amending protocol, subsequent agreement, or practice between the contracting states.[90] In other words, while treaty law does not require a purely grammatical interpretation, the limitations imposed by Article 31 VCLT must be observed.[91] For this reason, within this framework, treaty benefits may only be denied in blatant and extreme circumstances that the treaty wording and object and purpose would not support (i.e., in particular wholly artificial arrangements, circular, or round-tripping transactions).[92]

In light of the foregoing, we submit that the indicators of abuse provided by the ECJ in the Danish cases cannot be applied to DTCs not containing a PPT insofar as these indicators cannot be reconciled with the treaty wording, object, purpose, and context at the level of the regular interpretative process pursuant to Article 31 et seq. VCLT.

This being stated, the case of DTCs concluded between by EU Member States deserves a special mention. According to the ECJ, EU law prevails over domestic and tax treaties.[93] Therefore, the ATAD GAAR must be applied by EU Member States to their DTCs even if such agreements do not (yet) include a comparable provision such as the PPT.[94] With respect to DTCs concluded by Member States with third countries, Article 351 TFEU[95] becomes relevant. This provision, however, expressly grandfathers pre-accession treaties concluded by Member States. With respect to these treaties, therefore, Member States may continue to comply with their obligations under public international law irrespective of EU law.[96] By contrast, it is an unsettled question whether Article 351 TFEU may be applied *mutatis mutandis* to post-accession treaties that are not in line with a subsequently adopted directive.[97] In the negative, the ATAD GAAR would thus be applicable to these DTCs with a resulting tension with public international law.[98] Therefore, to the extent it finds application here, the ATAD GAAR may result in the indicators of abuse provided by the ECJ in the Danish cases to become relevant to this first category of DTCs.

The conclusion is the same under post-BEPS DTCs incorporating the PPT of Article 29(9) OECD MC. In essence, the effect of the PPT is to permit a purposive interpretation beyond the treaty wording when its subjective element (one of the principal purposes) is satisfied. This flows from the language of its escape clause: '*unless it is established that granting that benefit in these circumstances would be in accordance with the object and purpose of the relevant provisions of this Convention*'.[99] In that sense, the purposive interpretation under the PPT is broader than under the guiding principle which is tied to Article 31 VCLT.[100] Hence, the indicators of abuse provided by the ECJ in conduit situations may well also be relevant in the context of the PPT's application in similar situations. In fact, as shall be seen, the indicators of the ECJ are largely similar and may be reconciled with the examples provided by the 2017 OECD commentaries in conduit situations.[101] In the same vein, the PPT may also be regarded as a proper implementation of the ATAD GAAR regarding DTCs concluded by EU Member States with third states.[102]

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89 Article 31(2) and (3) VCLT.

90 Article 31(3)(a) and (b) VCLT. *See* e.g., Art. 6 of the 2006 amending protocol to the Spain-Switzerland Double Taxation Convention (1966) preserving the application of domestic anti-abuse rules and the application of CFC legislation: '*(i) The Contracting States declare that their domestic rules and procedures with respect to the abuses of law (including tax treaties) may be applied to the treatment of such abuses. In the case of Spain, abuses of law include situations covered by Art. 15 of Ley General Tributaria (Law 58/2003 of 17 Dec.) or by any other similar provision contained in a tax law in force or to be promulgated and (iii) this Convention does not prevent Contracting States to apply domestic Controlled Foreign Company rules*'.

91 In the same vein, V. Lowe, in: *How Domestic Anti-avoidance Rules Affect Double Taxation Conventions*, Proceedings of a Seminar held in Toronto, Canada, in 1994 during the 48th Congress of the International Fiscal Association, vol. 19c, at 7 (Kluwer Law International 1994).

92 An unlimited application of domestic anti-avoidance rules running counter to Art. 31 VCLT amounts to an impermissible treaty override under international law (Art. 26 and 27 VCLT, *see* inter alia generally M. E. Villiger, *Commentary on the 1969 Vienna Convention on the Law of Treaties* (Martinus Nijhoff Publishers 2009), at para. 5 ad Art. 27 VCLT) and may also fall under the rules on the Responsibility of States for Internationally Wrongful Acts, *see* thereupon Danon, *The Principal Purposes Test Under the OECD and UN Model Tax Conventions*, *supra* n. 83, at 720 et seq.

93 NL: ECJ, 5 Feb. 1963, Case 26/62, *van Gend en Loos*, ECLI:EU:C:1963:1.

94 Martín Jiménez, *supra* n. 4; A. Garcia Prats et al., *EU Report,* in *Reconstructing the Treaty Network*, IFA Cahiers, vol. 105A 60 (IFA 2020).

95 Consolidated version of the Treaty on the Functioning of the European Union, OJ C 326 (26 Oct.. 2012), at 47-390.

96 As mentioned in ES: ECJ, 16 Feb. 2017, Opinion of AG Kokott, Case C-74/16, *Congregación de Escuelas Pías Provincia Betania*, ECLI:EU:C:2017:135, para. 97: '*there is no obligation under Article 351 TFEU to depart from provisions of EU law (…). The Member States are merely given the possibility of continuing to adhere to obligations under public international law incurred before their accession to the EU*'. Further, Art. 351 TFEU provides that '[t]*o the extent that such agreements are not compatible with the Treaties, the Member State or States concerned shall take all appropriate steps to eliminate the incompatibilities established*'.

97 The question was left opened in FR: ECJ, 13 Mar. 2008, Opinion of AG Kokott, Case C-188/07, *Commune de Mesquer*, EU:C:2008:174, paras 94–98. *See also* Garcia Prats et al., *supra* n. 94, at 61; W. Haslehner, *EU-US Relations in the Field of Direct Taxes from the EU Perspective: A BEPS-Induced Transformation?,* in *Implementation of Anti-BEPS Rules in the EU: A Comprehensive Study* (P. Pistone & D. Weber eds, IBFD 2018), s. 3.5.2; P. Arginelli, *The ATAD and Third Countries,* in *The External Tax Strategy of the EU in a Post-BEPS Environment* (A. Martín Jiménez ed., IBFD 2019), s. 8.3.2.

98 Article 27 VCLT.

99 Article 29(9) OECD MC (2017).

100 Danon, *supra* n. 16, at 243. Contra: Lang, *supra* n. 84, at 267 who considers that purposive interpretation under the PPT is equivalent to the one under Art. 31 VCLT.

101 OECD Model (2017): Commentary on Art. 29, para. 187.

102 Martín Jiménez, *supra* n. 4, s. 4.4., fn. 91.

Conversely and in light of this convergence between the findings of the ECJ in the Danish cases, it will also be shown that the examples provided by the OECD commentaries may also be used as inspirational sources to clarify the limits of the EU prohibition of abuse rights (and that of the PSD and ATAD GAARs) in the context of the application of the PSD and IRD.

Finally, a separate issue which is discussed below is the question of whether the indicators of abuse provided by the ECJ in the Danish cases could have some relevance for purposes of interpreting the beneficial ownership limitation in the dividends, interest, and royalties articles.[103]

2.2 *Constituent Elements*

We now move to the evolution of the constituent elements of abuse. We begin with (1) the *Emsland-Stärke* two-pronged test and (2) its evolution and the impact the Danish cases may have on this evolution which is also contrasted with the development of treaty law. Next, (3) we explore the meaning and scope of the subjective and objective prongs under EU and tax treaty law; finally, (4) we focus on one question raised by the Danish cases, namely, whether the existence of an abuse requires an advantage.

2.2.1 *The Emsland-Stärke Two-pronged Test*

The two-pronged test, which the ECJ also relied on in the Danish cases to define an abusive practice, is rooted in the landmark *Emsland-Stärke* case decided by the ECJ in 2000.[104] In that case, to which we shall revert, the ECJ held that '*a finding of an abuse requires, first, a combination of objective circumstances in which, despite formal observance of the conditions laid down by the Community rules, the purpose of those rules has not been achieved*'[105] and, secondly, '*a subjective element consisting in the intention to obtain an advantage from the Community rules by creating artificially the conditions laid down for obtaining it*'.[106] The '*objective*' element relates to the legal purpose of the legislature and whether it has been fulfilled.[107] The '*subjective*' condition concerns the practical purpose of the transactions undertaken.[108]

As can be seen, the artificiality test is relevant for assessing the intention to obtain an advantage. That is, the subjective prong is deemed to be satisfied (objectivation of the intention) when the transaction is of an artificial nature.[109] However, as was the case in *Cadbury Schweppes*,[110] the criterion of a wholly artificial arrangement may also be relevant to determine whether the purpose of the applicable rule has been defeated. As a result, in the presence of a wholly artificial arrangement, the distinction between the subjective and objective component of the notion of abuse becomes blurred. This being said, as rightly observed by AG Bobek in *Cussens*, these two conditions remain independent and should thus not be '*collapsed into one*'.[111] The need to maintain this distinction is also justified because the principle of prohibition of abuse of rights is, by essence, in tension with the principle of legality and legal certainty.[112] As shall be seen, one of the difficulties with the analysis of the ECJ in the Danish cases is precisely that this distinction is not (always) clear.

The recently adopted GAARs of the PSD and ATAD are rooted on the *Emsland-Stärke* two-pronged test (as nuanced by subsequent case law notably *Halifax*) and reads as follows:

Table 1

Article 1(2)(3)(4) PSD	*General Anti-abuse Rule (Article 6 ATAD)*
2. Member States shall not grant the benefits of this Directive to an arrangement or a series of arrangements which, 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. An arrangement may comprise more than one step or part. 3. For the purposes of paragraph 2, an arrangement or a series of arrangements shall be regarded as not genuine to	1. For the purposes of calculating the corporate tax liability, a Member State shall ignore an arrangement or a series of arrangements which, 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 the applicable tax law, are not genuine having regard to all relevant facts and circumstances. An arrangement may comprise more than one step or part. 2. For the purposes of paragraph 1, an arrangement or a series thereof shall be regarded as non-

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[103] *See infra* s. 3.

[104] *Emsland-Stärke* (C-110/99), *supra* n. 48.

[105] *Ibid.*, para. 52.

[106] *Ibid.*, para. 53.

[107] IE: ECJ, 7 Sept. 2017, Opinion of AG Bobek, Case C-251/16, *Cussens e. a.*, ECLI:EU:C:2017:648, para. 60.

[108] *Ibid.*

[109] De Broe & Gommers, *supra* n. 26, s. 2.2 and Martín Jiménez, *supra* n. 4, s. 2.

[110] UK: ECJ, 12 Sept. 2006, Case C-196/04, *Cadbury Schweppes*, ECR I-8031, ECLI:EU:C:2006:544, para. 50.

[111] Opinion of AG Bobek, *Cussens* (C-251/16), *supra* n. 107, para. 77.

[112] *Ibid.*, para. 80.

Article 1(2)(3)(4) PSD	General Anti-abuse Rule (Article 6 ATAD)
the extent that they are not put into place for valid commercial reasons which reflect economic reality. 4. This Directive shall not preclude the application of domestic or agreement-based provisions required for the prevention of tax evasion, tax fraud or abuse.	genuine to the extent that they are not put into place for valid commercial reasons which reflect economic reality. 3. Where arrangements or a series thereof are ignored in accordance with paragraph 1, the tax liability shall be calculated in accordance with national law.

2.2.2 *Evolution of the Two-pronged Test in the ECJ's Case Law*

2.2.2.1 In General

It is fair to say that the two-pronged test derived from *Emsland-Stärke* has been applied by the ECJ in various areas of EU law. In particular, the test has been followed quite clearly in VAT matters.[113] The same holds true regarding, for example, the interpretation of the anti-avoidance rule of the merger directive[114] considered to be an incarnation of the EU prohibition of abuse of rights principle.[115] More controversial in scholarly writing, by contrast, is the consistency of the *Emsland-Stärke* reasoning in the area of fundamental freedoms.[116] With *Cadbury Schweppes*,[117] the question indeed arose as to whether the intention of the taxpayer (subjective prong) is really relevant in this area. Ironically, the reasoning of the ECJ in the Danish cases has prompted the opposite question: is the purpose of the applicable rule still relevant, or has the discussion not completely been shifted to the motives of the taxpayer? Hence, the consistency of the Danish cases with *Eqiom*[118] and *Deister* (which referred expressly to *Cadbury Schweppes)* arises. As will be seen, it is possible to reconcile the Danish cases with *Cadbury Schweppes* in the sense that, in both decisions, the *Emsland-Stärke* test continues to apply. On the one hand, in *Cadbury Schweppes*, the ECJ did not state that the motive test was irrelevant. On the other hand, even after the Danish cases, the existence of an abusive practice requires not only the motive test to be satisfied but also that the purpose of the applicable rule be defeated.[119] Any contrary interpretation would ignore the fact that, in the Danish cases, the ECJ has relied on the *Emsland-Stärke* test. As shall be shown, this matters when assessing the scope of the indicators of abuse provided by the ECJ.

2.2.2.2 Did Cadbury Schweppes Switch off the Subjective Prong (Motive Test)?

The focus on the concept of a wholly artificial arrangement in *Cadbury Schweppes*[120] has been interpreted to mean that the examination of the taxpayer's motivation would only come into play if the actual exercise of the freedoms did not consist in genuine activities.[121] Presumably, the difficulty with *Cadbury Schweppes* is that it is unclear whether the ECJ arrived at its conclusion on the basis of an interpretation of the scope of the freedom of establishment or by relying on the prohibition of abuse as a self-standing justification.[122] By essence, only in this latter case would the subjective element of abuse be relevant.[123]

This discussion regarding *Cadbury Schweppes* is important because, in *Eqiom*[124] and in *Deister,*[125] the ECJ clearly relied on the concept of a wholly artificial arrangement flowing from *Cadbury Schweppes.*[126] Of course, *Eqiom* and *Deister* concerned the compatibility of a domestic anti-

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[113] *Halifax* (C-255/02), *supra* n. 68; IT: ECJ, 21 Feb. 2008, Case C-425/06, *Part Service*, ECLI:EU:C:2008:108; *Cussens* (C-251/16), *supra* n. 19. *See also* generally, Zalasiński, *supra* n. 4, at 12.

[114] Article 15(1)(a) Merger Directive, *supra* n. 22: '*A Member State may refuse to apply or withdraw the benefit of all or any part of the provisions of Arts 4 to 14 where it appears that one of the operations referred to in Art. 1: has as its principal objective or as one of its principal objectives tax evasion or tax avoidance; the fact that the operation is not carried out for valid commercial reasons such as the restructuring or rationalization of the activities of the companies participating in the operation may constitute a presumption that the operation has tax evasion or tax avoidance as its principal objective or as one of its principal objectives*'.

[115] *Kofoed* (C-321/05), *supra* n. 22, para. 42. *See also* PT: ECJ, 10 Nov. 2011, Case C-126/10, *Foggia*, ECR I-1656, ECLI:EU:C:2011:718.

[116] Zalasiński, *supra* n. 4, at 12 and Martín Jiménez, *supra* n. 4, s. 3.1.

[117] *Cadbury Schweppes* (C-196/04), *supra* n. 110, para. 50.

[118] *Eqiom* (C-6/16), *supra* n. 36.

[119] Martín Jiménez, *supra* n. 4, s. 3.

[120] *Cadbury Schweppes* (C-196/04), *supra* n. 110, paras 64 and 50.

[121] Zalasiński, *supra* n. 4, at 14.

[122] Contrast *Cadbury Schweppes* (C-196/04), *supra* n. 110, paras 52–54. *See* Schön, *supra* n. 4, at 194. According to de la Feria, *supra* n. 4, at 172, the prohibition of abuse was used as a standalone exception in *Cadbury Schweppes. See also* generally Zalasiński, *supra* n. 4, at 13–14. The peculiarity of the factual situation considered by the ECJ in *Cadbury Schweppes* is also probably the main reason why it appears that the subjective test has less importance; *see* Martín Jiménez, *supra* n. 4, s. 3.

[123] Schön, *supra* n. 4, at 194.

[124] *Eqiom* (C-6/16), *supra* n. 36.

[125] *Deister* (C-504/16), *supra* n. 37.

[126] *See* with respect to the compatibility with the reservation contained in Art. 1(2) PSD, in relation to domestic anti-avoidance rules, *Eqiom* (C-6/16), *supra* n. 36, para. 30: '*In that context, it should be noted that, in order for national legislation to be regarded as seeking to prevent tax evasion and abuses, its specific objective must be to prevent conduct involving the*

avoidance rule with the PSD and EU primary law which is different from the issue at stake in the Danish cases (i.e., namely, the applicability of the EU principle of abuse of rights in the absence of a domestic anti-abuse legislation or principle). However, the ECJ held that: '*(…) the objective of combating fraud and tax evasion, whether it is relied on under Article 1(2) of the Parent-Subsidiary Directive or as justification for an exception to primary law, has the same scope*'.[127] Moreover, according to the Court, the reservation in favour of '*domestic or agreement-based provisions for the prevention of fraud or abuse*' at issue in *Eqiom* and *Deister* merely reflects '*the general principle of EU law that no one may benefit from the rights stemming from the legal system of the European Union for abusive or fraudulent ends*'.[128]

2.2.2.3 Did the Danish Cases Switch off the Objective Prong (Purpose of the Legislation)?

Scholars have submitted that, in the Danish cases, the ECJ neglected *Cadbury Schweppes* to favour an analysis more strictly incorporating the components derived from *Emsland-Stärke*[129] with, in fact, an emphasis on the subjective element of the abuse test. The ECJ indeed held that:

> *a group of companies may be regarded as being an artificial arrangement where it is not set up for reasons that reflect economic reality, its structure is purely one of form and its principal objective or one of its principal objectives is to obtain a tax advantage running counter to the aim or purpose of the applicable tax law.*[130]

For these reasons, commentators have argued that the focus is now on the motivation of the taxpayer or, if it is preferred, the commercial justification of the transaction.[131] Following this approach, no matter the amount of substance in an entity, the arrangement could still be abusive[132] if it lacks commercial justification. Against this background, the question arises as to whether the Danish cases have switched off (or at least strongly minimized) the objective prong of the *Emsland-Stärke* test. It is true that some passages of the ECJ judgments could at least suggest that the distinction between the subjective and objective components has been blurred. This is particularly apparent when the ECJ makes reference to the objectives of the PSD which:

> *has the aim of facilitating the grouping together of companies at EU level by introducing tax rules which are neutral from the point of view of competition, in order to allow enterprises to adapt to the requirements of the common market, to increase their productivity and to improve their competitive strength at the international level*'[133] and then notes that to: '*permit the setting up of financial arrangements whose sole aim is to benefit from the tax advantages (…) would not be consistent with such objectives and, on the contrary, would undermine the effective functioning of the internal market by distorting the conditions of competition.*[134]

Therefore, does this mean that, when the sole (or even principal) purpose of the taxpayer is to obtain an advantage, the objective of the applicable directive (and its provisions) is also automatically defeated? If that were true, the *Emsland-Stärke* test on which the ECJ relied in the Danish cases would be seriously eroded.

2.2.2.4 Reconciling Cadbury Schweppes and the Danish Cases

In our opinion, the findings of the ECJ in *Cadbury Schweppes* and in the Danish cases may be reconciled. First, in *Cadbury Schweppes*, the ECJ also relied on the two-pronged test derived from *Emsland-Stärke.*[135] Secondly, the Court did not say that the motives of the taxpayer were irrelevant as long as there was no artificial arrangement. Rather, the Court considered that '(…) *there must be, in addition to a subjective element consisting in the intention to obtain a tax advantage, objective circumstances showing that, despite formal observance of the conditions laid down by Community law, the objective pursued by freedom of establishment, (…), has not been achieved (…)*'.[136] In other words, the ECJ did not uphold the existence of abuse by ignoring the motives of the taxpayer (subjective element) but by considering that the purpose of the freedom of establishment (objective element)

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creation of wholly artificial arrangements which do not reflect economic reality, the purpose of which is unduly to obtain a tax advantage (…)'. *See also Deister* (C-504/16), *supra* n. 37, para. 60.

[127] *Eqiom* (C-6/16), *supra* n. 36, para. 64; *Deister* (C-504/16), *supra* n. 37, para. 97.

[128] *Eqiom* (C-6/16), *supra* n. 36, para. 26.

[129] *Emsland-Stärke* (C-110/99), *supra* n. 48, paras 52–53.

[130] *N Luxembourg 1* (C-115/16 et al.), *supra* n. 1, para. 127; *T Danmark and Y Denmark* (C-116/16 and C-117/16), *supra* n. 1, para. 100. *See also* S. Baerentzen, *Danish Cases on the Use of Holding Companies for Cross-Border Dividends and Interest – A New Test to Disentangle Abuse from Real Economic Activity?*, 12(1) World Tax J. 3–52, 25 (2020).

[131] W. Schön, *Interpreting European Law in the Light of the OECD/G20 Base Erosion and Profit Shifting Action Plan*, 74(4/5) Bull. Int'l Tax'n. 286–302, at 300 (2020).

[132] Baerentzen, *supra* n. 130, at 25.

[133] *T Danmark and Y Denmark* (C-116/16 and C-117/16), *supra* n. 1, para. 78.

[134] *Ibid.*, para. 79.

[135] *Cadbury Schweppes* (C-196/04), *supra* n. 110, para. 64.

[136] *Ibid.*

had not been defeated[137] also in view of the specific factual situation considered.[138]

Since, in the Danish cases, the ECJ quite naturally also relied on the same test,[139] as a matter of principle, no contradiction with the Court's findings in *Cadbury Schweppes* can be seen. Two questions nevertheless arise. The first question, which is dealt with below, is whether the purpose of provisions of direct tax directives may simply be equated to that of fundamental freedoms. Arguably, as shall be seen, a wholly artificial arrangement as understood in *Cadbury Schweppes* (i.e., in essence a '*letter-box*' or '*front*' subsidiary[140] akin to a sham[141]) always defeats the very purpose of direct tax directives, notably the PSD and the IRD. The second question is whether the Danish cases may prompt tax authorities to confer an overriding importance to the motive test and uphold the existence of abuse by neglecting to (seriously) consider whether a particular arrangement really defeats the object and purpose of the applicable direct tax directive as required by the *Emsland-Stärke* test.[142] As discussed below, such a risk does exist, first of all, because when providing indicators aimed at identifying the existence of an abuse in conduit situations, the ECJ did not rigorously examine the two components of the *Emsland-Stärke* test. Secondly, unlike AG Kokott, the ECJ did not draw a clear distinction between, on the one hand, the presence of a wholly artificial arrangement[143] (which automatically also defeats the object and purpose of the applicable rule) and, on the other hand, a real-life arrangement lacking commercial reasons[144] (which, while satisfying the motive test, does not necessarily defeat the object and purpose of the applicable rule).

This being said, despite the lack of clarity of the Danish cases on this point, we submit that the ECJ judgments may not be understood as having switched off the objective component derived from the *Emsland-Stärke* test. Not only has the ECJ relied on this two-pronged test in the Danish cases, but the latter is now codified in the GAAR introduced in the PSD in 2015. Such a rule does indeed not only require that an arrangement be '*put into place for the main purpose or one of the main purposes of obtaining a tax advantage*'.[145] Rather, such an arrangement must also defeat '*the object or purpose of this Directive*'.[146]

2.2.2.5 Comparative Analysis under Tax Treaty Law

From a tax treaty perspective, the two-pronged test has, of course, materialized through the inclusion of a PPT in the 2017 OECD MC which, in fact, has inspired the language of the recent PSD and ATAD GAARs. Article 29(9) OECD MC provides that treaty benefits shall be denied when: '*one of the principal purposes of any arrangement or transaction*' (subjective element) was to obtain such benefits, '*unless it is established that granting that benefit in these circumstances would be in accordance with the object and purpose of the relevant provisions of this Convention*' (objective element).

Prior to the adoption of the PPT, on the other hand, a genuine two-pronged test was not, in our view, supported by tax treaty law despite the insertion of a guiding principle in the 2003 OECD Commentary. As discussed, this is because benefits may only be denied for DTCs not incorporating a genuine GAAR when it is established based on regular interpretation that granting such benefits would not be in accordance with Article 31 VCLT, in particular the object and purpose of the DTC, or would not be supported by the treaty context.[147] This, of course, also takes into account any amending protocol, subsequent agreement, or practice between the contracting

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[137] In the same vein, J. López Rodríguez, *Some Thoughts to Understand the Court of Justice Recent Case-Law in the Danmark Cases on Tax Abuse*, 29(2) EC Tax Rev. 71–83, at 78 (2020); Contra: Zalasiński, *supra* n. 4, at 14–15, who reads the *Cadbury Schweppes* judgment to mean that '*tax motives must be set aside if the taxpayer's arrangements consist of genuine economic activities*'.

[138] *See* Martín Jiménez, *supra* n. 4, s. 3.

[139] *Emsland-Stärke* (C-110/99), *supra* n. 48, paras 52–53.

[140] *Cadbury Schweppes* (C-196/04), *supra* n. 110, para. 64.

[141] Schön, *supra* n. 131, at 299 and Martín Jiménez, *supra* n. 4, s. 3.

[142] Zalasiński, *supra* n. 4, at 15.

[143] Opinion of AG Kokott, *N Luxembourg 1* (C-115/16), *supra* n. 27, para. 65 et seq.; Opinion of AG Kokott, *T Danmark* (C-116/16), *supra* n. 27, para. 54 et seq.

[144] Opinion of AG Kokott, *N Luxembourg 1* (C-115/16), *supra* n. 27, para. 69; DK: Opinion of AG Kokott, *T Danmark* (C-116/16), *supra* n. 27, para. 60.

[145] Article 1(2) and (3) PSD.

[146] *Ibid.* The same holds true regarding the GAAR included in the ATAD adopted in 2016; *see* Art. 6: 'For the purposes of calculating the corporate tax liability, a Member State shall ignore an arrangement or a series of arrangements which, 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 the applicable tax law, are not genuine having regard to all relevant facts and circumstances. An arrangement may comprise more than one step or part (…)'. On the other hand, it is true that the anti-avoidance rule of Art. 5(2) IRD only makes reference to the subjective element of abuse: '*Member States may, in the case of transactions for which the principal motive or one of the principal motives is tax evasion, tax avoidance or abuse, withdraw the benefits of this Directive or refuse to apply this Directive*'. The same holds true as regards Art. 15(1)(a) of the Merger Directive: '*A Member State may refuse to apply or withdraw the benefit of all or any part of the provisions of Arts 4 to 14 where it appears that one of the operations referred to in Art. 1: has as its principal objective or as one of its principal objectives tax evasion or tax avoidance; the fact that the operation is not carried out for valid commercial reasons such as the restructuring or rationalization of the activities of the companies participating in the operation may constitute a presumption that the operation has tax evasion or tax avoidance as its principal objective or as one of its principal objectives*'. National provisions putting these rules into effect, however, must comply with the two-pronged test of the EU principle of abuse of rights.

[147] Article 31(2) and (3) VCLT.

states.[148] In other words, the limitations imposed by Article 31 VCLT must be observed. Some scholars have rightly argued that the presence of a wholly artificial arrangement as understood in *Cadbury Schweppes* would defeat the object and purpose of the applicable DTC.[149] As will be discussed, the French *Conseil d'État* arrived at the same conclusion in *Verdannet.*[150] This result does not require a GAAR but may already be derived from a proper interpretation of treaty law based on Article 31 VCLT. On this point, therefore, treaty law (whether or not incorporating a GAAR) converges with EU law.

2.2.3 *Meaning and Scope of the Subjective and Objective Prongs Under EU and Tax Treaty Law*

2.2.3.1 The Subjective Prong

According to the ECJ, the subjective prong of the notion of abuse consists '*in the intention to obtain an advantage from the Community rules by creating artificially the conditions laid down for obtaining it*'.[151] As already discussed, the intention to obtain an advantage is objectified through the artificial nature of the transaction or arrangement.[152]

In scholarly writing, the position has traditionally been taken that the threshold of the subjective element under EU law is rather high. In some leading judgments, the ECJ indeed appeared to restrictively construe the subjective element in the sense of requiring that the '*the essential aim*'[153] or even '*the sole purpose*'[154] of the concerned transactions be to obtain a tax advantage. Following this line of reasoning, the subjective prong would not be met '*where the economic activity carried out may have some explanation other than the mere attainment of tax advantages*'.[155] In the same vein, in *Kofoed*[156] and in *Foggia*,[157] the language of the anti-avoidance rule of the Merger Directive alluding to an operation having tax evasion or avoidance '*as its principal objective or as one of its principal objectives*'[158] has been interpreted to refer to a '*sole*'[159] or at least '*predominant*'[160] purpose test. Moreover, in light of *Kofoed* and *Foggia*, it was submitted that the language of the 2015 PSD and 2016 ATAD I GAAR ('*put into place for the main purpose or one of the main purposes of obtaining a tax advantage*')[161] should be interpreted as '*a sole purpose test*'.[162] From this perspective, therefore, the threshold of the subjective prong under Article 29(9) OECD MC which requires that '*obtaining that benefit was one of the principal purposes of any arrangement or transaction*' would be lower.

Following the Danish cases, however, it is arguable that the meaning of the EU and OECD purpose tests are aligned. The ECJ indeed held that the subjective prong of the abuse test may also be triggered when a structure is '*purely one of form and its principal objective or one of its principal objectives is to obtain a tax advantage*'.[163] Scholars have criticized this alignment that is perceived as a departure from the Court's earlier case law.[164] In *Part Service*, however, the ECJ had already clarified that an abusive practice could also be found to exist when the accrual of a tax advantage constitutes '*the principal aim*' of the transaction.[165] In the same vein, in *Edward-Cussens*, the ECJ made it clear that the subjective element does not require that the accrual of a tax advantage be the '*only objective of the transactions*'.[166] The reasoning and expressions of the ECJ have also very much depended, as in *Cadbury Schweppes*, on the factual situation being considered. It is clear, however, that the ECJ has never required

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148 Article 31(3)(a) and (b) VCLT.

149 Engelen, *supra* n. 71, at 36.

150 FR: Conseil d'État, 25 Oct. 2017, judgment no. 396954, ECLI:FR:CECHR:2017:396954.20171025 = *Re Verdannet*, 20 ITLR 832, 856–857.

151 *Emsland-Stärke* (C-110/99), *supra* n. 48, para. 53.

152 De Broe & Gommers, *supra* n. 26, s. 2.2.

153 *Halifax* (C-255/02), *supra* n. 68, para. 74.

154 UK: ECJ, 21 Feb. 2006, Case C-223/03, *University of Huddersfield*, ECR 2006 I-01751, ECLI:EU:C:2006:124, para. 51.

155 *Halifax* (C-255/02), *supra* n. 68, para. 75.

156 *Kofoed* (C-321/05), *supra* n. 22, para. 38.

157 *Foggia* (C-126/10), *supra* n. 115, para. 35.

158 Article 15(1)(a) Merger Directive.

159 *Kofoed* (C-321/05), *supra* n. 22, para. 38.

160 *Ibid.*, para. 35.

161 Article 1(2) and (3) PSD, Art. 6(1) ATAD.

162 F. Debelva & J. Luts, *Anti-Abuse Rule of the Parent-Subsidiary Directive*, 55(6) Eur. Tax'n. 223–234, at 225 (2015); L. De Broe, *Tax treaty and EU Law Aspects of the LOB and PPT Provision Proposed by BEPS Action 6,* in *Base Erosion and Profit Shifting (BEPS) – Impact for European and International Tax Policy* 197–252, 238 (R. J. Danon ed., Schulthess 2016); De Broe & Gommers, *supra* n. 26, s. 4.3.2.

163 *N Luxembourg 1* (C-115/16 et al.), *supra* n. 1, para. 127; *T Danmark and Y Denmark* (C-116/16 and C-117/16), *supra* n. 1, para. 100. *See also* Baerentzen, *supra* n. 130, at 25.

164 Schön, *supra* n. 131, at 300.

165 *Part Service* (Case C-425/06), *supra* n. 113, para. 45.

166 *Cussens* (C-251/16), *supra* n. 19, para. 53.

an exclusive purpose test and has moved (somewhat unclearly) between a 'primary purpose' and a 'one of the purposes' tests.[167]

This being said, there is a textual difference between Article 29(9) OECD MC and the EU GAARs. Both the 2015 PSD and 2016 ATAD I GAARs not only require that the arrangement be put into place '*for the main purpose or one of the main purposes of obtaining a tax advantage*' but also provide that such an arrangement be '*not genuine having regard to all relevant facts and circumstances*'. For this purpose, an arrangement shall be regarded as not genuine '*to the extent that they are not put into place for valid commercial reasons which reflect economic reality*'.[168] This additional requirement relates to the subjective prong of the abuse test. The genesis of the codified EU GAARs is evidence that this genuine test requirement is intended to align secondary legislation with the case law of the ECJ in the area of abusive practices.

It has been argued that the threshold of abuse under EU law is higher in the sense that the 2015 PSD and 2016 ATAD I GAARs would not apply if valid commercial reasons are present (even if tax motives are also one of the main considerations) because Article 29(9) OECD MC does not include such a genuine test. To the extent they would support a different interpretation, the findings of the ECJ in the Danish cases should thus be reconsidered.[169] In our opinion, this position needs to be refined. While the genuine test in the EU GAARs should be given proper effect, such a test should however be applied to the segment of the fact pattern that triggers the relevant directive benefit. Therefore, with respect to the abolition of tax at source on dividends (PSD), interest, or royalties (IRD), the genuine test would not be satisfied when, for example, a company genuinely established in a Member State and conducting a commercial activity therein enters into an artificial conduit arrangement (for example, a back-to-back arrangement) without any valid commercial reasons reflecting economic reality. In this latter case, it is immaterial that the establishment of such an entity is not fictitious. Rather, the key consideration is that the conduit arrangement lacks commercial justification. It is submitted that this targeted application of the genuine test is also supported by the language of the EU GAARs ('*to the extent that they are not put into place*'). An analogy may be drawn here with limitation on benefits provisions (LOBs) and the PPT; the fact that a company satisfies an active business test (LOB) does not exclude the application of the PPT to an artificial conduit arrangement entered into by that company.[170] On the basis of such an interpretation, it seems that the instances in which the subjective prong of the EU GAARs and the PPT would lead to different outcomes should be rare.

Finally, another source of possible divergence between EU law and the PPT would be the fact that the PPT would incorporate an additional nexus (or substance requirement). The commentaries note indeed that: '*(…) where an arrangement is inextricably linked to a core commercial activity, and its form has not been driven by considerations of obtaining a benefit, it is unlikely that its principal purpose will be considered to be to obtain that benefit*'.[171] Based on this passage, a commentator has recently observed that, as a consequence of the OECD's position, companies for which establishment in a contracting state cannot be justified in light of a core commercial activity will be considered to be abusive.[172] We do not share this position as the level of substance in the state of residence should only be understood as a possible proxy to exclude the subjective element of the PPT. Therefore, for example, the absence of a core commercial activity in the state of residence should not automatically lead to the denial of treaty benefits if other compelling factual elements reveal that the subjective element of the PPT is not satisfied, in particular because the arrangement put in place is predominantly based on valid commercial reasons as foreseen by the EU GAARs. This is also a logical conclusion in light of a proper interpretation of Article 29(9) OECD MC considering Article 31 VCLT: reading an objective core commercial activity requirement into Article 29(9) OECD MC is clearly not supported by the customary interpretative process. Example E of the OECD commentaries dealing with conduit cases, discussed hereafter, illustrates this. In this example, a holding company only keeps a small spread in a licensing and sub-licensing structure and presumably has little organizational substance due to its purpose as a holding company. However, the subjective element is not satisfied because the entity is '*conforming to the standard commercial organization and behaviour of the group*'.[173] From this perspective, any divergence is not seen with EU law in the sense that the presence of predominant commercial reasons may also exclude the application of the subjective element of the PPT. As the ECJ

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[167] *See* Martín Jiménez, *supra* n. 4, s. 2 and s. 3.

[168] PSD, Preamble (6).

[169] Schön, *supra* n. 131, at 301.

[170] OECD Model (2017): Commentary on Art. 29, para. 173.

[171] *Ibid.*, para. 181.

[172] C. De Pietro, *Tax Abuse and Legal Pluralism: Towards Concrete Solutions Leading to Coordination Between International Tax Treaty Law and EU Tax Law*, 29(2) EC Tax Rev. 84–96, at 90 (2020).

[173] OECD Model (2017): Commentary on Art. 29, para. 187, Example E.

rightly held in *Foggia*,[174] however, a mere cost savings following, for example, a restructuring may not be regarded as a qualifying commercial reason. This observation is also valid regarding the PPT.

2.2.3.2 The Objective Prong

The fact that a principal or one of the principal objectives of a transaction or arrangement is to obtain an advantage is not enough to uphold the existence of abusive practice. Rather, as required by the ECJ in *Emsland-Stärke*, the purpose of the applicable rules must be defeated.[175] As discussed, this condition continues to apply without any change after the Danish cases so that the indicators of abuse provided by the ECJ must be understood against this background. The same condition applies under the escape clause of Article 29(9) OECD MC which, once the subjective prong is satisfied, allows treaty benefits to nevertheless be granted when this would be in accordance with the '*object and purpose of the relevant provisions of this Convention*'.[176]

This being said, there is a textual difference between Article 29(9) OECD MC and the EU codified GAARs which refer respectively to '*the object or purpose of this Directive*' (2015 PSD) and to '*the object or purpose of the applicable tax law*' (ATAD I). We submit that, under EU law, the analysis should also more specifically consider the applicable provisions.[177] While the purpose of the legislation or of a DTC in the context of Article 29(9) OECD MC may also be taken into account, the focus should primarily be on determining the purpose of the provisions for which benefits are requested. We indeed find that simply considering the general purpose of a legislation or a DTC in general is in tension with the principle of legal certainty and ignores that individual provisions (specifically those incorporating SAARs) may have specific purposes. On this point, we concur with the observation made by AG Bobek in *Cussens:*

> *case-law does not refer to failure to fulfil the purpose of 'the Directive' in general terms, but rather the "relevant provisions" thereof. That is amply confirmed in the practical application of the condition by the Court. Therefore, a finding that the objective condition is fulfilled in principle requires (i) the identification of "relevant provisions", (ii) the purpose thereof, and (iii) a demonstration that that purpose has not been met.*[178]

The effect of the objective prong is, in our opinion, to allow a purposive interpretation which is then not limited by the strict wording of the applicable provisions. From a tax treaty perspective and when a PPT applies, this is the difference with the regular interpretation under Article 31 VCLT. As will be shown, such purposive interpretation may be relevant for denying directive or treaty benefits in the case of conduit situations and based on some of the indicators provided by the ECJ in the Danish cases. On the other hand, as will be also discussed, what the purposive interpretation based on a GAAR cannot do is build conditions into a directive or a DTC that were never intended and do not flow from the purpose of the applicable provisions. This specifically holds true regarding so-called '*substance requirements*'.

2.2.4 *Does Abuse Require an Advantage?*

Another controversial point raised by the Danish cases is whether the existence of an abuse of rights requires an advantage in the sense, for example, that the interposition of a conduit company in a Member State leads to benefits that would not have been available in the absence of such an arrangement (or only to a lesser extent). Therefore, should abuse be ruled out when, for example, the ultimate recipient of the dividends, interest, or royalties transferred by conduit companies is ultimately a company whose seat is in a third state with which the source Member State has concluded a DTC under which no tax would have been withheld on such items if they had been paid directly to the company having its seat in that third state?[179] AG Kokott answered in the affirmative:

> *In order for abuse of possible legal arrangement to exist, a legal arrangement must be chosen that differs from the arrangement normally chosen and gives a more favourable result than the 'normal' arrangement. In the present case, the 'normal arrangement' would be a direct dividend disbursement between the capital investment companies and the claimant in the main proceedings. That 'normal arrangement' would also have to result in a higher tax burden.*[180]

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[174] *Foggia* (C-126/10), *supra* n. 115, para. 49.

[175] *Emsland-Stärke* (C-110/99), *supra* n. 48, para. 52.

[176] Article 29(1) OECD MC (2017).

[177] *See also* D. Weber, *The New Common Minimum Anti-Abuse Rule in the EU Parent-Subsidiary Directive: Background, Impact, Applicability, Purpose and Effect*, 44(2) Intertax 98–129, at 113 (2016).

[178] Opinion of AG Bobek, *Cussens* (C-251/16), *supra* n. 107, para. 65.

[179] *T Danmark and Y Denmark* (C-116/16 and C-117/16), *supra* n. 1, para. 107; *N Luxembourg 1* (C-115/16 et al.), *supra* n. 1, para. 134.

[180] Opinion of AG Kokott, *T Danmark* (C-116/16), *supra* n. 27, para. 88; Opinion of AG Kokott, *N Luxembourg 1* (C-115/16), *supra* n. 27, para. 92.

Further, the burden of proof of the existence of such a more favourable result lies with the tax authorities.[181]

This being said, the ECJ did not endorse the foregoing reasoning and held that:

> *when examining the structure of the group it is immaterial that some of the beneficial owners of the dividends paid by the conduit company are resident for tax purposes in a third State which has concluded a double taxation convention with the source Member State. The existence of such a convention cannot in itself rule out an abuse of rights.*[182]

At the same time, however, the conclusion on this point remains confusing and uncertain[183] with the ECJ noting that:

> *it remains possible, in a situation where the dividends would have been exempt had they been paid directly to the company having its seat in a third State, that the aim of the group's structure is unconnected with any abuse of rights. In such a case, the group cannot be reproached for having chosen such a structure rather than direct payment of the dividends to that company.*[184]

In our opinion, the two foregoing excerpts of the Danish Cases are misleading. It flows very clearly from the *Emsland-Stärke* test that the existence of abuse requires '*an advantage*'.[185] The Eastern High Court of Denmark thus rightly held that if the ultimate beneficial owner of the dividends is resident of a state with which Denmark has concluded a DTC providing for equivalent benefits, there can be no abuse.[186] This idea naturally flows from the nature and structure of GAARs: they are only triggered if there is a tax benefit, otherwise, the GAAR would not apply. The position defended by AG Kokott is thus the only one in line with settled case law. This position naturally also applies to the 2015 PSD GAAR.[187]

The foregoing question also arises under the PPT. This is because, for example, unlike the conduit arrangement clause found in the UK-US Income Tax Treaty (2001)[188] that inspired the OECD Commentary to the PPT in relation to conduit arrangements,[189] Article 29(9) OECD MC does not expressly provide for the denial of treaty benefits in the absence of an advantage.[190] In our opinion, however, the same result may be achieved by focusing on the subjective prong of the PPT. This conclusion is confirmed by the OECD Commentary. In relation to an example involving a real estate fund, the OECD Commentary notes at the level of the analysis of the subjective element that '*RCO does not derive any treaty benefits that are better than those to which its investors would be entitled*'.[191]

2.3 *The Burden of Proving an Abuse of Rights and the Issue of General Presumption of Abuse*

A procedural matter will now be discussed, namely, the issue of the burden of proof. The ECJ has repeatedly held that a general presumption of fraud, and abuse is incompatible with the principle of proportionality and, as such, defeats the objectives of both primary (fundamental freedoms) and secondary (directives) legislation.[192] For this reason, the mechanical application of predetermined general criteria is equally not admissible.[193] In *Eqiom*, the ECJ found that a provision of the French tax code that had the effect of switching off the benefit of the PSD '*unless that legal person provides proof that the principal purpose or one of the principal purposes of the chain of interests is not to take*

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[181] Opinion of AG Kokott, *T Danmark* (C-116/16), *supra* n. 27, para. 89; Opinion of AG Kokott, *N Luxembourg 1* (C-115/16), *supra* n. 27, para. 93.

[182] *T Danmark and Y Denmark* (C-116/16 and C-117/16), *supra* n. 1, para. 108; *N Luxembourg 1* (C-115/16 et al.), *supra* n. 1, para. 135.

[183] CFE ECJ Taskforce, *Opinion Statement ECJ-TF 2/2019 on the CJEU decisions of 26 Feb. 2019 in Cases C-115/16, C-118/16, C-119/16 and C-299/16, N Luxembourg I et al, and Cases C-116/16 and C-117/17, T Danmark et al, Concerning the 'Beneficial Ownership' Requirement and the Anti-Abuse Principle in the Company Tax Directives,* 59(10) Eur. Tax'n. 487–502, at 500 (2019).

[184] *T Danmark and Y Denmark* (C-116/16 and C-117/16), *supra* n. 1, para. 110; *N Luxembourg 1* (C-115/16 et al.), *supra* n. 1, para. 137.

[185] *Emsland-Stärke* (C-110/99), *supra* n. 48, para. 53.

[186] Østre Landsret, case no. B-1980-12 and B-2173-12, *supra* n. 11, at 244-245. In reaching this conclusion the Court relied on the fact that in such a case the DTC between the state of source and the state of residence of the ultimate beneficial owner remains available, *see* OECD Model (2017): Commentary on Art. 10, para. 12.7 and OECD Model (2003): Commentary on Art. 10, para. 12.2.

[187] Weber, *supra* n. 177, at 110–111.

[188] *Convention between the Government of the United Kingdom of Great Britain and Northern Ireland and the Government of the United States of America for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income and on Capital Gains* (24 July 2001) (as amended through 2002) [hereinafter *UK-US Income Tax Treaty*].

[189] *See* R. J. Danon, *Treaty Abuse in the Post-BEPS World: Analysis of the Policy Shift and Impact of the Principal Purpose Test for MNE Groups*, 72(1) Bull. Int'l Tax'n. 31–55, at 49 (2018), s. 4.6.2.

[190] By contrast, the UK-US conduit arrangement indeed only applies if the ultimate owners '[w]ould not be entitled under a convention for the avoidance of double taxation between the state in which that other person is resident and the Contracting State in which the income arises, or otherwise, to benefits with respect to that item of income which are equivalent to, or more favourable than, those available under this Convention to a resident of a Contracting State' (Art. 3(1)(n) UK-US Income Tax Treaty, *supra* n. 188).

[191] OECD Model (2017): Commentary on Art. 29, para. 182, Example M.

[192] *Eqiom* (C-6/16), *supra* n. 36, para. 31 with references.

[193] *Ibid.*, para. 32.

advantage' of the directive was incompatible with EU law. That principle was again confirmed in the Danish cases.[194]

For these reasons, scholars have argued that the division of the burden of proof under Article 29(9) OECD MC might not comply with EU law. This is because under this rule, the subjective prong is satisfied if the tax authorities manage to demonstrate that it is '*reasonable to conclude*' that obtaining a tax benefit was one of the principal purposes of the arrangement.[195] It is thus not necessary to find conclusive proof of the intent of the taxpayer.[196] The escape clause of Article 29(9) OECD MC then shifts the burden of proof to the taxpayer ('*unless it is established that granting that benefit in these circumstances would be in accordance with the object and purpose of the relevant provisions of this Convention*').[197]

It is debatable whether the division of the burden of proof in Article 29(9) OECD MC is really in contradiction with EU law. As noted by the ECJ in *Eqiom*, it seems that EU law requirements would be complied with if the tax authorities provide prima facie (but not conclusive) evidence.[198] We would also add that the OECD commentaries emphasize that the application of a domestic anti-avoidance rule based on mechanical criteria would not be compatible with both the guiding principle and the PPT.[199] This thus shows that Article 29(9) OECD MC is not a rule that is meant to apply on the basis of predetermined criteria as envisaged by the ECJ.

Recent Dutch case law[200] addressed the burden of proof for assessing whether there is an abusive situation under EU inspired anti-abuse rules in the Netherlands.[201] This case law dealt with the so-called 'look-through approach', which the Dutch tax authorities apply for testing the subjective prong. This approach holds, in brief, that one of the main purposes for interposing a shareholder is presumed to be avoiding Dutch tax – and hence the situation is presumed to be abusive – if the ultimate shareholder in a structure would have had a higher Dutch income tax or dividend withholding tax burden in the hypothetical situation that it had directly held the shares in the Dutch entity. This presumption can be rebutted by the shareholders if they make plausible that holding the shares is not wholly artificial in line with *Cadbury Schweppes*.[202]

According to the Dutch Supreme Court in its decision of 10 January 2020 – and with reference to *Eqiom*[203] and *Deister*[204] – the Dutch look-through approach is compatible with EU law, but it should provide the taxpayer with the possibility to provide counterevidence.[205] However, in our opinion, the approach in fact constitutes a general presumption of abuse that is incompatible with EU law. The aforementioned ECJ judgments provide that application of predetermined general criteria to determine whether abuse is at hand is not allowed. Instead, a case-by-case assessment of the specific situation at stake is needed. Under the Dutch look-through approach, the Dutch tax authorities would basically only need to identify the tax residency of the direct and indirect shareholders without providing evidence of abuse.[206] It therefore does not entail the providing by the Dutch tax authorities of (preliminary) proof of abuse or indications thereto as required by EU law.[207]

The Spanish Administrative Tribunal[1] also required taxpayers to prove the economic rationale of their structures without providing prima facie evidence of abuse. This alters the burden of proof as per the case law of the

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[194] *T Danmark and Y Denmark* (C-116/16 and C-117/16), *supra* n. 1, para. 117; *N Luxembourg 1* (C-115/16 et al.), *supra* n. 1, para. 142: '*On the other hand, where a tax authority of the source Member State seeks, on a ground relating to the existence of an abusive practice, to refuse to grant the exemption provided for in Art. 5 of Directive 90/435 to a company that has paid dividends to a company established in another Member State, it has the task of establishing the existence of elements constituting such an abusive practice while taking account of all the relevant factors, in particular the fact that the company to which the dividends have been paid is not their beneficial owner*'.

[195] De Broe & Gommers, *supra* n. 26, s. 4.3.1.

[196] OECD Model (2017): Commentary on Art. 29, para. 178.

[197] Article 29(9) OECD MC (2017).

[198] *Eqiom* (C-6/16), *supra* n. 36, para. 36.

[199] OECD Model (2017): Commentary on Art. 1, para. 74.

[200] Hoge Raad, case no. 18/00219, *supra* n. 9 and Rechtbank Noord-Holland, case no. 19/862 and case no. 19/879, *supra* n. 9. Appeal is pending against the Dutch lower court decisions.

[201] In the Hoge Raad judgment, *supra* n. 9, the dispute focuses on whether Dutch non-resident corporate income tax (NRCIT) could be levied from a Luxembourg tax resident corporate shareholder over dividend received from a Dutch tax resident BV in 2012. The EU inspired anti-abuse rules in the Netherlands for taxation of the dividend were, at that time, included in the NRCIT rules rather than in the dividend withholding tax rules. The judgment is nevertheless also relevant for the current anti-abuse rules; with the implementation of the mandatory GAAR of the PSD as of 1 Jan. 2016, the NRCIT rules and dividend withholding tax rules were slightly amended rather than entirely overhauled. In the Dutch lower court decisions of 26 June 2020, in dispute is an application of the Dutch domestic dividend withholding tax exemption (as implemented pursuant to the PSD) to a dividend distributed in 2018.

[202] *Cadbury Schweppes* (C-196/04), *supra* n. 110.

[203] *Eqiom* (C-6/16), *supra* n. 36.

[204] *Deister* (C-504/16), *supra* n. 37.

[205] In its decisions of 26 June 2020, *supra* n. 9, the Dutch lower court ruled in line with the Dutch Supreme Court judgment of 10 Jan. 2020, case no. 18/00219, *supra* n. 9, regarding compatibility with EU law of the Dutch look-through approach.

[206] Hoge Raad, case no. 18/00219, *supra* n. 9 and Fiscaal Tijdschrift FED, 2020/73, with commentary by G.F. Boulogne, para. 9.

[207] *Eqiom* (C-6/16), *supra* n. 36, para. 32 and *T Danmark and Y Denmark* (C-116/16 and C-117/16), *supra* n. 1, para. 117.

ECJ, including the Danish cases, since it is tantamount to establishing a mechanical application of a predetermined criteria. A tax advantage would be equivalent to abuse unless the taxpayer proves the economic rationale of the specific arrangement.

A final controversial point in the Danish cases is the ECJ's finding that, in a conduit situation, tax authorities only have the duty to establish that the intermediary company is not the beneficial owner but are not under the obligation to determine who the actual beneficial owners really are.[208] Practical difficulties were in particular put forward by the Court.[209] It has been submitted that this position could be in tension with the obligation flowing from *Halifax* to grant benefits that would have been available in the absence of the abusive arrangement (for instance, the benefit of a DTC concluded between the state of source and the state of residence of the actual beneficial owner).[210] As will be shown, however, the ECJ did not deal with the issue of recharacterization or, more generally, with the consequences of an abuse of rights. The principle derived from Halifax is thus certainly not overruled. Therefore, at the level of a tax audit, for example, the obligation to grant alternative treaty benefits pursuant to a recharacterized fact continues to apply if the taxpayer is able to provide evidence of the actual beneficial owners.

2.4 *Indicators of Abuse in the Danish Cases and Comparative Analysis Under Tax Treaty Law*

Based on the foregoing analysis, a more concrete perspective and exploration will now be taken to determine under which circumstances directive and treaty benefits may be denied on account of abusive practices, in particular in light of the indicators provided by the ECJ in the Danish cases. For purposes of this discussion and although this was not done by the ECJ, we find it appropriate to distinguish between wholly artificial/sham arrangements, on the one hand, and real arrangements, on the other hand. As will be seen, regarding wholly artificial/sham arrangements, the discussion is rather straightforward as, in these instances, both the subjective and objective prongs are generally satisfied. More controversial, by contrast, is the application of these indicators of abuse to real arrangements.

2.4.1 *Wholly Artificial/Sham Arrangements*

There is a consensus that directive and treaty benefits should be denied to wholly artificial arrangements. This is because, in addition to evidencing the intention of the taxpayer to wrongfully obtain a benefit (subjective prong), the wholly artificial nature (sham) of the arrangement also defeats the purpose of the applicable instrument (directive or DTC) and its relevant provisions. From a tax treaty perspective, an actual GAAR like the PPT is not, in fact, even needed to reach this result. Rather, such a conclusion already flows from the regular interpretation of treaty law based on its object and purpose.[211] As observed, for instance, by the French Conseil d'État in *Verdannet* which concerned an artificial round-tripping arrangement to which we revert below:

> *the States that are parties to the Franco-Luxembourg tax treaty cannot be regarded as admitting, in the distribution of the power of taxation, the application of its provisions to situations arising from artificial transactions devoid of any economic substance. It follows that in finding that the operation in question was contrary to the objectives pursued by the two signatory States, the Court did not commit any error of law in its judgment.*[212]

In that sense, the findings of the French Court converge with those of the ECJ in *Cadbury Schweppes.* This being said, it is possible to distinguish several categories of wholly artificial arrangements.

The first categories of situations, which were not at issue in the Danish cases, are so-called '*round-tripping*' or '*circular*' arrangements. From an EU point of view, *Emsland-Stärke* is a good example: an abusive practice was found to exist because export refunds were abusively reclaimed following the importation of goods into Switzerland and their immediate re-exportation into the internal market.[213] In the field of abusive directive and treaty shopping, a round-tripping scheme would typically take place when, for instance, income arising in one state is artificially shifted to an entity interposed in the other contracting state and then moved back to resident investors of the first state. In *Vodafone*, the Indian Supreme Court considered that: '*if a structure (…) for circular trading or round tripping then such transactions, though having a legal form, should be discarded by applying the test of fiscal*

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[208] *T Danmark and Y Denmark* (C-116/16 and C-117/16), *supra* n. 1, para. 118; *N Luxembourg 1* (C-115/16 et al.), *supra* n. 1, para. 142.

[209] *T Danmark and Y Denmark* (C-116/16 and C-117/16), *supra* n. 1, para. 119; *N Luxembourg 1* (C-115/16 et al.), *supra* n. 7, para. 142.

[210] De Broe & Gommers, *supra* n. 4, at 286.

[211] Article 31(1) VCLT.

[212] *Verdannet*, *supra* n. 150, at 856–857.

[213] *Emsland-Stärke* (C-110/99), *supra* n. 48. *See also* Commission Recommendation of 6 Dec. 2012 on aggressive tax planning (2012/772/EU), OJ L 338/41 (12 Dec. 20212), para. 4.4(d).

nullity'.[214] From a tax treaty perspective, a round-tripping arrangement might also involve, for example, capital gains: shares are artificially transferred by a resident of a state to an intermediary entity and then sold shortly after to a resident of the same state. The issue arose in *Verdannet.*[215] As discussed, in these situations, it is possible to conclude that the object and purpose of DTCs has been defeated while, at the same time, remaining within the limits of their wording pursuant to Article 31 VCLT. In the words of the rapporteur public:

> *the primary function of these treaties, beyond this immediate purpose, is to facilitate international economic exchanges (…). It is, therefore, part of their very logic that they be read as not intending to apply to taxpayers who artificially create the conditions of foreignness allowing them to claim, according to a literal interpretation, the benefit of their clauses.*[216]

For the same reasons, the object of directives is also defeated: there is simply no genuine cross-border payment between two EU Member States.[217]

The second category of situations is that in which there is a genuine cross-border payment (absence of round-tripping), but the entity interposed in a state is wholly artificial and akin to a sham.[218] In Case C-117/16 involving a Cyprus entity, AG Kokott arrived at this conclusion:

> *Y Cyprus has no staff and apparently no office premises of its own either. As a result, the company does not incur costs for either staff or premises. Also, the remuneration paid to the members of the management board suggests little activity on their part. Furthermore, asset management activities clearly generated no income of its own for the company. This all appears to be artificial. A natural person would have ceased trading long ago under such circumstances. Even though the Court found recently that the fact that the activity consists in the management of assets and the income results only from such management does not mean that a wholly artificial arrangement exists which does not reflect economic reality, there is doubt here as to whether the activities of the Cypriot company may well take place solely on paper, given that even the treasury function of the company does not generate any income (…). In my view, a legal entity that is passive to the point that any conceivable involvement in transactions is, at most, via third parties and that develops no business of its own from which its own income and costs result is a wholly artificial arrangement. Ultimately, however, that is a question of fact on which it is for the referring court to rule.*[219]

A very similar fact pattern was also submitted to the Swiss Federal Supreme Court in *A Holding ApS:* the interposed conduit entity had not booked any costs in its statutory accounts and, shortly after it was incorporated, the income it derived was simply channelled to its offshore shareholders irrespective of its own corporate interests.[220] In line with what the ECJ held in *Deister*,[221] AG Kokott found by contrast that, in Case 115/16, there could not be a wholly artificial arrangement simply because a company operates as a special purpose vehicle and manages one single loan with very low operating expenses.[222]

The third category of situations is the one in which the intermediary entity exists in real life, but the transaction that it enters into turns out to be a wholly artificial arrangement. In the case of conduit situations, this could be the case when the facts reveal that an entity is not legally able to dispose of its income but is compelled to follow the instructions of its creditor/shareholder.[223] A similar conclusion could be taken if it is established that the income derived by the entity is subject to an implied forwarding obligation (typically an agency agreement).[224] The same would hold true if the transfer of the assets generating the income for which the benefits of the directives or DTCs are requested turns out to be wholly artificial.

When providing its indicators of abuse in the Danish cases, the ECJ makes reference to '*artificiality*' whether, for example, from the perspective of the way the intermediary company operates and the nature of its activities[225] or regarding the contracts into which it has entered.[226]

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214 IN: Supreme Court, *Vodafone International Holdings BV v. Union of India and another*, para. 68, 14 ITLR 431, at 451.

215 *Verdannet*, *supra* n. 150, at 872.

216 *Ibid.*

217 *See* similarly Weber, *supra* n. 177, at 124.

218 *See* recently on the similarity between wholly artificial arrangement and sham, Schön, *supra* n. 128, at 299; *also see* A. Martín Jiménez, *Towards a Homogeneous Theory of Abuse in EU (Direct) Tax Law*, 66(4/5), Bull. Int'l Tax'n. 270–292, at 274 et seq. (2012).

219 Opinion of AG Kokott, *Y Denmark* (C-117/16), *supra* n. 14, paras 54–57.

220 Bundesgericht/Tribunal fédéral, *Holding ApS*, *supra* n. 72, para. 3.6.4.

221 *Deister* (C-504/16), *supra* n. 37, para. 73.

222 Opinion of AG Kokott, *N Luxembourg 1* (C-115/16), *supra* n. 27, paras 65 and 66.

223 De Broe, *supra* n. 16, at 723.

224 C. P. du Toit, *Beneficial Ownership of Royalties in Bilateral Tax Treaties* 229 (IBFD 1999).

225 *T Danmark and Y Denmark* (C-116/16 and C-117/16), *supra* n. 1, para. 104; *N Luxembourg 1* (C-115/16 et al.), *supra* n. 1, para. 131.

226 *T Danmark and Y Denmark* (C-116/16 and C-117/16), *supra* n. 1, para. 105.

However, unlike AG Kokott,[227] the ECJ does not clearly distinguish between, on the one hand, the presence of a wholly artificial arrangement and, on the other hand, the existence of a real-life arrangement that would nevertheless be regarded as abusive. This is in line with traditional case law of the ECJ (*Emsland-Stärke*, *Halifax*) that merges cases of sham within the concept of abuse, even if sham and abuse are conceptually different categories.[228] For example, the ECJ seems to suggest that, when the sole activity of an entity is the receipt and forwarding of dividends, that could amount to the '*absence of actual economic activity*'[229] and constitute an indicator of abuse. If the absence of actual activity is such that the intermediary is a wholly artificial arrangement akin to a sham as envisaged above, both the subjective and objective prongs of the *Emsland-Stärke* tests would be satisfied. The same would hold true under Article 29(9) OECD MC. On the other hand, if the intermediary entity does exist in real life, the fact that its sole activity consists in the receipt and forwarding of dividends may be an indication that such an entity has been incorporated for the sole (or one of the principal purposes) of obtaining a tax advantage. In that case, the subjective prong of the *Emsland-Stärke* test would be met. In other words, the conditions for obtaining a tax advantage would have been artificially created. However, in this latter situation, the ECJ fails to indicate the provisions of the relevant directive whose purpose would be defeated and why (objective prong). Should this be interpreted as an indication that the subjective and objective components of the abuse tests have actually been merged into one? As already indicated, this is not a plausible interpretation as the ECJ, despite some confusing language, clearly relied on the *Emsland-Stärke* test. It is therefore submitted that the indicators of abuse provided by the ECJ must be interpreted to the effect that, in a given situation and when a real-life arrangement is in place, the subjective and objective components of the abuse test must always be considered separately. As will now be shown, whether from the perspective of directives or DTCs, substance requirements are not relevant when it comes to the objective prong of the abuse test.

2.4.2 *Real Arrangements*

The application of the indicators of abuse provided by the ECJ to arrangements that exist in commercial reality (i.e., that are not merely wholly artificial or sham arrangements) will now be considered.

The first category of indicators focuses specifically on the income streams derived by the entity claiming the benefits of the PSD and IRD. First of all, according to the ECJ, an indication of the existence of an arrangement intended to obtain an improper entitlement is that:

> *all or almost all of the aforesaid dividends are, very soon after their receipt, passed on by the company that has received them to entities which do not fulfil the conditions for the application of Directive 90/435, either because they are not established in any Member State, or because they are not incorporated in one of the forms covered by the directive, or because they are not subject to one of the taxes listed in Article 2(c) of the directive, or because they do not have the status of "parent company" and do not meet the conditions laid down in Article 3 of the directive.*[230]

Under this indicator, therefore, an improper entitlement may thus not only stem from the fact that the income is passed to entities that are not residents of the internal market but also when such income accrues, for example, to individual shareholders (whether or not residents of an EU Member State). In the same vein, a second indicator relates to '*the various contracts existing between the companies involved in the financial transactions at issue, giving rise to intragroup flows of funds*'.[231] The focus here is on the inability of a conduit company to '*have economic use*'[232] of the income received. For the ECJ:

> *such indications are capable of being constituted not only by a contractual or legal obligation of the parent company receiving the dividends to pass them on to a third party but also by the fact that, "in substance" (…) that company, without being bound by such a contractual or legal obligation, does not have the right to use and enjoy those dividends.*[233]

Moreover, according to the ECJ, the existence of abuse could stem from the fact that the entity '*makes only an insignificant taxable profit when it acts as a conduit company in order to enable the flow of funds*'.[234]

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[227] Opinion of AG Kokott, *N Luxembourg 1* (C-115/16), *supra* n. 27, para. 69; Opinion of AG Kokott, *T Danmark* (C-116/16), *supra* n. 27, para. 60.

[228] *See* Martín Jiménez, *supra* n. 4, s. 2.8.

[229] *T Danmark and Y Denmark* (C-116/16 and C-117/16), *supra* n. 1, para. 103; *N Luxembourg 1* (C-115/16 et al.), *supra* n. 1, para. 130.

[230] *T Danmark and Y Denmark* (C-116/16 and C-117/16), *supra* n. 1, para. 101; *N Luxembourg 1* (C-115/16 et al.), *supra* n. 1, para. 128.

[231] *T Danmark and Y Denmark* (C-116/16 and C-117/16), *supra* n. 1, para. 105.

[232] *T Danmark and Y Denmark* (C-116/16 and C-117/16), *supra* n. 1, para. 105; *N Luxembourg 1* (C-115/16 et al.), *supra* n. 1, para. 132.

[233] *Ibid.*

[234] *T Danmark and Y Denmark* (C-116/16 and C-117/16), *supra* n. 1, para. 103; *N Luxembourg 1* (C-115/16 et al.), *supra* n. 1, para. 130.

Now assume that an intermediary entity fulfilling the foregoing indicators is interposed in an EU Member State by non-EU persons with the principal (or one of the principal) objectives being to take advantage of the PSD or IRD (subjective prong satisfied). The question that arises is whether this would defeat the object and purposes of the relevant provisions of these directives and, more broadly, their objectives. We would submit that this is the case. The application of the EU prohibition of abuse of rights or the codified GAAR in the 2015 PSD require expressions such as '*distributions of profits received by companies of that Member State*' to be understood from a purposive perspective (objective prong) with a view to prevent directive shopping. In all of these instances, it is possible to consider that there is actually no payment to a resident of an EU Member State. The outcome would be the same under a DTC containing a PPT: the purposive interpretation of terms such '*paid to*' or '*beneficial owner*' would lead to the same outcome.[235]

Now consider the same payment flows but with the difference that the arrangements in place have been entered for valid commercial reasons. We would then submit that the subjective prong of the EU prohibition of abuse of rights or the codified GAAR in the 2015 PSD would not be satisfied so that abusive practice could not be found to exist. The consequence of this is that the purposive interpretation that may stem from the application of a GAAR would not be permitted so that the benefit of the PSD or IRD would have to be granted.

The outcome would be the same under a DTC incorporating a PPT. Enlightening in this respect is example E of the OECD Commentary to the PPT in the framework of possible abusive conduit situations.[236] In this example, a publicly traded company that is resident in state R is the holding company for a manufacturing group in a highly competitive technological field. The manufacturing group conducts research in subsidiaries located around the world. According to the business model of the group, any patents developed in a subsidiary are licensed by that subsidiary to the holding company in state R which then licenses the technology to other subsidiaries that need it. The holding company in State R generally keeps only a small spread with respect to the royalties it receives so that most of the profit goes to the subsidiary that incurred the risk with respect to the development of the technology. One subsidiary of the group, a company that is resident in a non-treaty jurisdiction, happens to have developed a process that will, in particular, substantially increase the profitability of another sister company located in State S. According to the standard practice of the group, the holding company thus sub-licenses the technology developed by the company in the non-treaty jurisdiction to its subsidiary in State S. The end result is therefore that the holding company is substantially paying out to an entity located in a non-treaty jurisdiction all of the royalties it derives from State S. The OECD commentaries conclude that the PPT could not apply to deny treaty benefits for the following reasons:

> *There is no indication that RCO established its licensing business in order to reduce the withholding tax payable in State S. Because RCO is conforming to the standard commercial organization and behaviour of the group in the way that it structures its licensing and sub-licensing activities and assuming the same structure is employed with respect to other subsidiaries carrying out similar activities in countries which have treaties which offer similar or more favourable benefits, the arrangement between SCO, RCO and TCO does not constitute a conduit arrangement.*[237]

Further, according to the exchange of letters between the United Kingdom and the United States concerning Article 3(1)(n) (conduit arrangement clause) of the 2001 *UK-US DTC* from which this example has been entirely inspired:

> *even though the specific fact pattern, as presented, meets the first part of the definition of a "conduit arrangement" at Article 3(l)(n)(i), on balance the conclusion would be that "the main purpose or one of the main purposes" of the transactions was not the obtaining of UK/US treaty benefits. So the structure would not constitute a conduit arrangement.*[238]

We thus read the foregoing example as follows. A purposive reading of the provisions of the DTC dealing with the recipient of the income (i.e., '*paid to*', '*beneficial ownership*') is not possible here because the intentional element of the PPT is not satisfied (presence of valid commercial reasons). As discussed earlier, this example also evidences that, unlike what certain authors seem to suggest, the granting of treaty benefits under the PPT does not necessarily require that a core commercial or substantial activity be exercised in a contracting state. In our view, the outcome of this example should be the same under the IRD after the Danish cases in light in particular of the convergence between treaty and EU law on this point. Therefore, if the arrangement is justified by valid commercial reasons, it is immaterial that the intermediary entity makes only an insignificant taxable profit[239] due to, for example, the limited functions it exercises.

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[235] Weber, *supra* n. 177, at 124.

[236] OECD Model (2017): Commentary on Art. 29, para. 187, Example E.

[237] *Ibid.*

[238] Article 3(1)(n)(ii), UK-US Income Tax Treaty, *supra* n. 188, Exchange of letters, Example 5.

[239] *T Danmark and Y Denmark* (C-116/16 and C-117/16), *supra* n. 1, para. 103; *N Luxembourg 1* (C-115/16 et al.), *supra* n. 1, para. 130.

This being, from both a treaty and EU law perspective, a situation such as the foregoing may raise some difficulties when it comes to the coordination between the prohibition of abuse of rights and the beneficial ownership limitation. If this limitation is indeed implicitly read into the PSD or construed (IRD and DTC) as a substance over form requirement (but without considering the motives of the arrangements put in place), this could lead to the denial of directive and treaty benefits to bona fide commercial structures. We shall revert to this question when dealing with beneficial ownership.

Other indicators provided by the ECJ, on the other hand, seem to deal with the organizational structure and the nature of the activities conducted by an intermediary in an EU Member State. The Court notes that:

> *the fact that a company acts as a conduit company may be established where its sole activity is the receipt of dividends and their transmission to the beneficial owner or to other conduit companies. The absence of actual economic activity must, in the light of the specific features of the economic activity in question, be inferred from an analysis of all the relevant factors relating, in particular, to the management of the company, to its balance sheet, to the structure of its costs and to expenditure actually incurred, to the staff that it employs and to the premises and equipment that it has.*[240]

The main focus here is on the objective prong of the abuse test. Unless the intermediary is a wholly artificial arrangement akin to a sham, we fail to see how the objective and purpose of the PSD or IRD could be defeated here. As the ECJ correctly noted in *Deister,* it is not possible to read any form of '*substance requirements*' into the PSD: '*it should be noted that the Parent-Subsidiary Directive does not contain any requirement as to the nature of the economic activity of companies falling within its scope or the amount of turnover resulting from those companies' own economic activity*'.[241]

The Spanish TEAC decisions of 8 October 2019[242] assumed, in order to attack two EU holding companies, that *Eqiom, Deister Holding,* or *GS* have been overruled by the Danish cases. The absence of any express mention to those cases in the Danish judgments was taken by the Spanish TEAC as proof of its position. These assumptions are, in our view, erroneous since the Danish cases simply refer to the definition of abuse and the indicia to establish it whereas *Eqiom, Deister Holding,* or *GS* basically affected anti-abuse clauses with overkilling effects (like the Spanish one applied by the TEAC) that denied directive benefits to companies that performed a valid economic activity that was also protected by TFEU freedoms. Moreover, in view of our conclusions, the Spanish TEAC decisions are not in line with the Danish cases since exclusion of the benefits of the IRD and PSD still requires the tax authorities to provide prima facie evidence of artificiality.

For this reason and in the case of a holding company, '*the economic activity of a non-resident parent company consists in the management of its subsidiaries' assets or that the income of that company results only from such management cannot per se indicate the existence of a wholly artificial arrangement which does not reflect economic reality*'.[243] The same observation may be made under a DTC incorporating a genuine GAAR such as the PPT. As the Canadian Federal Court of Appeal recently held in *Alta Energy*: '*There is no distinction in the Luxembourg Convention between residents with strong economic or commercial ties and those with weak or no commercial or economic ties*'.[244] Therefore, according to the Court, '*While the GAAR can change the tax consequences from what they would otherwise be, the GAAR cannot be used, in this case, to justify adding a requirement for investment that is not present in the Luxembourg Convention*'.[245] We therefore submit that GAARs, whether they are rooted in a treaty or EU or domestic law, can never be used to alter or elevate the nexus requirements under a directive or a DTC. Rather, this could only be accomplished through a change to the residence test.

This being said, the indicators provided by the ECJ in the Danish cases were confined to conduit situations. On the other hand, these indicators did not deal with a possible abuse stemming from a restructuring alone. Consider the following example. A company that is resident in an EU Member State and having large distributable reserves is wholly owned by a parent company in a third state. The DTC concluded with this third state provides for a 5% residual rate on qualifying dividends. As part of a group reorganization, the EU subsidiary is transferred to an EU parent company with the effect that the distributable reserves of the EU subsidiary are now potentially subject to a nil rate as per the terms of the PSD. Assume further that a minimum two-year holding period has been implemented pursuant to Article 3(2) PSD and that this holding period is satisfied. The question then arises as to whether the restructuring, as such, could still be challenged by relying on the EU prohibition of abuse of rights (or the 2015 PSD GAAR) if it is essentially motivated by tax considerations. First, it should be observed that there is no so-called 'compartmentalization' of distributable reserves under the PSD. Therefore, the fact that the EU subsidiary had large

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240 *T Danmark and Y Denmark* (C-116/16 and C-117/16), *supra* n. 1, para. 104; *N Luxembourg 1* (C-115/16 et al.), *supra* n. 1, para. 131.

241 *Deister* (C-504/16), *supra* n. 37, para. 72.

242 TEAC, decisions 185/2017 and 2188/2017, *supra* n. 10.

243 *Deister* (C-504/16), *supra* n. 37, para. 72.

244 CA: *Alta Energy Luxembourg SARL v. R,* 2020 FCA 43, 22 ITLR 509, para. 65.

245 *Ibid.*, para. 46.

distributable reserves at the time of the restructuring is, as such, irrelevant. Secondly, the relation between the EU prohibition of abuse of rights and the two-years holding period arises. In *Denkavit,* the ECJ held, in relation to the reservation, in favour of domestic anti-avoidance rules contained in the PSD that the holding period of Article 3(2) PSD '*is aimed in particular at counteracting abuse whereby holdings are taken in the capital of companies for the sole purpose of benefiting from the tax advantages available and which are not intended to be lasting*'.[246] This position was again confirmed by the ECJ in *Argenta Spaarbank NV* in 2017.[247] In other words, this is a logical application of *the lex specialis derogat legi generali* principle.[248] The question that then arises is whether the EU prohibition of abuse of rights (or the 2015 PSD GAAR) may still be relied upon if the holding period is satisfied. In our opinion, the answer would be affirmative but only to the extent that the facts include an additional abusive element that is not covered by the holding period. This would typically be the case if a conduit arrangement is in place to shift profits outside the internal market. On the other hand, it seems that the prohibition of abuse of rights may not apply when such an element is not present or, for example, when a conduit arrangement exists but all of the companies in the chain are residents of the European Union. Indeed, even if it is considered that the EU prohibition of abuse of rights forms part of EU primary law and sits on top of directives, abuse may only be found to exist in accordance with the two-pronged test of *Emsland-Stärke* when the purpose of the PSD and its provisions are defeated. Therefore, in our view, abuse may not be found to exist here because, by complying with the holding period, the group has satisfied the object and purpose of both the holding period and the directive regarding the avoidance of abusive short-term concentrations of participations. In other words, the objective prong of the abuse test in the PSD is not met.[249]

From a tax treaty perspective, it is submitted that the reasoning and the outcome should be the same regarding the relation between the PPT and the '*365 days*' SAAR designed to prevent abusive dividend transfer transactions[250] and the circumvention of the look-through principle applying to gains realized on the disposal of interests in real estate entities.[251] If the taxpayer genuinely satisfies this arbitrary 365-day test, granting treaty benefits is then in accordance with the '*object and purpose of the relevant provisions of this Convention*' with respect to the factual element covered by the SAAR.[252]

2.5 *Consequences of an Abuse*

2.5.1 *Directive Shopping: The Halifax Principle After the Danish Cases?*

According to the ECJ, the consequences of abusive practice must be determined pursuant to the principle of proportionality. Accordingly, in *Halifax,* the Court held that it: '*follows that transactions involved in an abusive practice must be redefined so as to re-establish the situation that would have prevailed in the absence of the transactions constituting that abusive practice*'.[253] This principle was later confirmed on numerous occasions, for example, recently in *Weald Leasing*[254] and in *Cussens.*[255] This principle obviously also applies to GAARs codified in directives, namely, the 2015 PSD GAAR[256] and the ATAD GAAR.

Therefore, for example, if the benefits of the PSD or IRD are denied on account of an abusive practice because a conduit company is interposed in a Member State or when assets have been artificially transferred to such an entity, the benefits that would have been available in the absence of such an arrangement should be granted.[257] The same holds true in situations involving a third state and, for instance, a DTC concluded by the state of source.[258]

At first sight, the findings of the ECJ in the Danish cases could suggest a departure from the *Halifax* principle. The Court considered indeed that:

> *whilst taxation must correspond to economic reality, the existence of a double taxation convention is not, as such,*

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246 *Denkavit* (C-283/94), *supra* n. 67, para. 31.

247 BE: ECJ, 26 Oct. 2017, *Argenta Spaarbank*, Case C-39/16, ECLI:EU:C:2017:813, para. 61.

248 O. Marres, *The Parent-Subsidiary Directive,* in *European Tax Law Seventh Edition; Volume I* (Full edition) 272 (P. J. Wattel, O. Marres & H. Vermeulen eds, Kluwer 2019).

249 Similarly, Garcia Prats et al., *supra* n. 94, at 67. In its judgment of 20 Apr. 2020, 2C_354/2018, *supra* n. 12, which involved a similar restructuring under the Swiss-EU agreement, the Swiss Federal Supreme Court was confronted with this issue from the perspective of the reservation of the agreement in favour of domestic anti-avoidance rules but unfortunately did not address it and simply considered that the structure was abusive, *see* thereupon Danon & Malek, *supra* n. 58, at 492 et seq.

250 Article 10(2)(a) OECD MC (2017).

251 Article 13(4) OECD MC (2017).

252 Danon, *supra* n. 16, at 259.

253 *Halifax* (C-255/02), *supra* n. 68, para. 94.

254 UK: ECJ, 22 Dec. 2010, Case C-103/09, *Weald Leasing Ltd*, ECLI:EU:C:2010:804, para. 51.

255 *Cussens* (C-251/16), *supra* n. 19, para. 46.

256 Weber, *supra* n. 177, at 128 and Martín Jiménez, *supra* n. 4, s. 4.3.6.

257 De Broe & Gommers, *supra* n. 4, at 297–298.

258 *Ibid.*, at 299.

> *capable of establishing that a payment was really made to recipients resident in the third State with which that convention has been concluded. If the company owing the interest wishes to benefit from the advantages of such a convention, it is open to it to pay the interest directly to the entities that are resident for tax purposes in a State which has concluded a double taxation convention with the source State.*[259]

This passage could indeed be read to mean that the existence of an abuse of rights does not entail a recharacterization of the facts into a direct payment of the income to the beneficial owners of the income.

This interpretation of the Danish cases may, in our view, not be supported. First of all, the foregoing observation was made by the Court when considering whether there could be an abuse of rights without an actual advantage. As discussed above, the Court dealt with this question in a confusing and inconclusive way probably also because of the issue of whether it was possible to identify the final beneficial owners of the income. On the other hand, in the Danish cases, the ECJ did not explicitly address these consequences of abusive practice[260] and, in fact, was not requested to do so.

We therefore consider that the *Halifax* principle remains unchanged after the Danish cases. When the interposition of an entity (conduit situation) or the transfer of assets to such an entity (restructuring) are disregarded, the benefits (including the benefit a DTC concluded with a third State) that would have been available in the absence of such arrangements must be granted. Any other interpretation would mean that the Court would have overruled its established case law and disregarded the general EU principle of proportionality.[261] It is again worth mentioning here the judgment of 20 April 2020 decided by the Swiss Federal Supreme Court. Relying exclusively on the Danish cases, the Court arrived at the conclusion that, in the case of an abusive restructuring, EU law did not require the re-establishment of the situation that would have prevailed in the absence of the abusive restructuring (i.e., the availability of a 15% residual treaty rate on dividends in the case at hand).[262] As a result, the Federal Supreme Court found that the Swiss-EU agreement has to be interpreted in the same fashion. This conclusion clearly overlooks the *Halifax* principle and, as discussed above, the fact that the Danish cases did not deal with the consequences of abuse under the PSD and IRD.[263]

2.5.2 *Comparative Analysis Under Tax Treaty Law*

The OECD commentaries suggest that, in the absence of an express discretionary relief provision alternative such as Article 7(4) of the Multilateral Instrument (MLI), treaty benefits as envisaged above would not be available when Article 29(9) OECD MC applies.[264] The question thus arises as to whether it may be inferred that, when such an optional mechanism is not included into the applicable tax treaty, a recharacterization of the facts leading to the availability of alternative treaty benefits does not apply. In apparent support of such a strict view is the language of Article 29(9) OECD MC stating that treaty benefits '*shall not be granted*'. In an obiter dictum, the Swiss Supreme Court appeared to favour such an interpretation in its judgment of 20 April 2020.[265]

In our opinion, this position may not be supported for several reasons. First of all, the expression '*shall not be granted*' must be read in relation to the '*principal purposes of any arrangement or transaction that resulted directly or indirectly in that benefit*'. When, however, treaty benefits are granted on the basis of a recharacterized fact pattern (for example, a 15% residual tax treaty rate instead of a 0% residual rate in a rule shopping situation),[266] these benefits are then no longer linked to an abusive arrangement. Therefore, the PPT rule may not restrict these latter benefits. In our view, the object and purpose of the PPT does not contradict this interpretation. Secondly, the systematic argument consisting of contending that, if a discretionary relief mechanism is not included into the tax treaty, it may then be inferred that the PPT rule prevents the state of source from granting treaty benefits on the basis of a recharacterized fact pattern is not a valid one either. Indeed, a systematic argument may only be put forward when one provision that is actually included into the tax treaty is used to elucidate the scope of another provision. Accordingly, when the discretionary relief mechanism does not form part of the relevant tax

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259 *N Luxembourg 1* (C-115/16 et al.), *supra* n. 1, para. 136; *T Danmark and Y Denmark* (C-116/16 and C-117/16), *supra* n. 1, para. 109.

260 De Broe & Gommers, *supra* n. 4, at 297.

261 *Ibid.*

262 Bundesgericht/Tribunal fédéral, judgment 2C_354/2018, *supra* n. 12, para. 4.5.3.

263 *See* Danon & Malek, *supra* n. 58, at 482.

264 This provision would read as follows: '*Where a benefit under this Convention is denied to a person under para. 9, the competent authority of the Contracting State that would otherwise have granted this benefit shall nevertheless treat that person as being entitled to this benefit, or to different benefits with respect to a specific item of income or capital, if such competent authority, upon request from that person and after consideration of the relevant facts and circumstances, determines that such benefits would have been granted to that person in the absence of the transaction or arrangement referred to in para. 9. The competent authority of the Contracting State to which the request has been made will consult with the competent authority of the other State before rejecting a request made under this paragraph by a resident of that other State*' (OECD Model (2017): Commentary on Art. 29, para. 184).

265 Bundesgericht/Tribunal fédéral, judgment 2C_354/2018, *supra* n. 12, para. 4.3.2.

266 De Broe, *supra* n. 162, at 217; M. Lang, *BEPS Action 6: Introducing an Anti-abuse Rule in Tax Treaties*, 74 Tax Notes Int'l 655–664, at 659 (2014).

treaty, the scope of the PPT rule should solely be determined on the basis of its literal wording, object and purpose, and relation with other provisions of this treaty. Moreover, because the BEPS outcome expressly provides for the possibility of granting treaty benefits on the basis of the facts as they would be in the absence of abuse, it must be considered that states wishing to do so – either on the basis of their practice or an express discretionary relief mechanism – still meet the minimum standard provided by BEPS Action 6.

Finally, the dual role of the PPT and the guiding principle should be borne in mind. On the one hand, they represent a foundation to deny benefits on the basis of the DTC itself. On the other hand, they serve as a limitation to states wishing to deny benefits on the basis of their domestic law. Hence, for example, states that have decided not to include a PPT in their DTCs must adopt anti-conduit rules producing the same effect.[267] A good example is the case of the United States whose anti-conduit rules are considered as equivalent to the PPT in conduit cases. However, when treaty benefits are denied pursuant to these rules, alternative treaty benefits remain available.[268] Therefore, if it was to be considered that alternative treaty benefits would not be available absent an express provision like Article 7(4) MLI in the applicable DTC, the outcome would be different depending on whether treaty benefits are denied on the basis of the PPT (or Article 31 VCLT based on the inherent prohibition of abuse) or pursuant to domestic legislation that complies with the PPT and leads to a recharacterization. This conclusion is certainly not correct and not in line with the BEPS outcome.

Therefore, we arrive at the conclusion that, when applying a PPT rule and denying treaty benefits, a jurisdiction is not prevented from granting treaty benefits on the basis of a recharacterized fact pattern even if such jurisdiction has reserved the right not to include the discretionary relief mechanism provided by Article 7(4) MLI in its DTCs.

3 On the Beneficial Ownership Limitation – Selected Issues

We now wish to conclude this contribution by exploring the relation between the Danish cases and the beneficial ownership limitation. Of course, beneficial ownership has been widely discussed in scholarly writing.[269] Therefore, it is not the purpose of this article to thoroughly revisit the topic. Rather, in order to keep the discussion within manageable proportions, the focus will be on selected issues which, we believe, are relevant from an EU and/or treaty law perspective to the Danish cases. First is (s. 3.1.) the question of whether the PSD contains an implicit beneficial ownership limitation that would apply separately from a mere attribution of income requirement and the prohibition of abuse of rights. Next, (3.2) we turn to the meaning of beneficial ownership and explore the impact of the Danish cases and recent national case law on the interpretation of beneficial ownership conveyed by the 2014 OECD Commentary. When an intermediary entity is found not to be the beneficial owner in a group structure, (s. 3.3) it is then considered whether the actual beneficial owner of the income may claim benefits. Finally, (s. 3.4) the possible tension that may arise between the beneficial ownership limitation and the prohibition of abuse in conduit structures is considered and possible options to solve the problem are discussed.

3.1 *Does the PSD Contain an Implicit Beneficial Ownership Limitation?*

It is beyond a doubt that the IRD contains a beneficial ownership limitation as, since 2003, Article 1(4) of this directive states that: '*a company of a Member State shall be treated as the beneficial owner of interest or royalties only if it receives those payments for its own benefit and not as an intermediary, such as an agent, trustee or authorised signatory, for some other person*'.[270] As a matter of fact, as shall be seen, the existence of this limitation may cause – just like under the OECD MC – problems of delineation with the notion of prohibition of abuse of rights.

What is controversial, on the other hand, is whether the PSD includes a beneficial ownership requirement. Article 5 of this directive simply provides that '*Profits which a subsidiary distributes to its parent company shall be exempt from withholding tax*'. A similar question also arises under the Swiss-EU agreement which merely states: '*dividends paid by subsidiary companies to parent companies shall not be subject to taxation in the source State (...)*'[271] Interestingly, the provision of this

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[267] OECD Model (2017): Commentary on Art. 29, para. 187.

[268] *See* US Treasury Regulations § 1.881–3 Conduit financing arrangements: '*Where the participation of a conduit entity in a conduit financing arrangement is disregarded pursuant to this section, it is disregarded for all purposes of s. 881, including for purposes of applying any relevant income tax treaties. Accordingly, the conduit entity may not claim the benefits of a tax treaty between its country of residence and the United States to reduce the amount of tax due under s. 881 with respect to payments made pursuant to the conduit financing arrangement. The financing entity may, however, claim the benefits of any income tax treaty under which it is entitled to benefits in order to reduce the rate of tax on payments made pursuant to the conduit financing arrangement that are recharacterized in accordance with para. (a)(3)(ii)(B) of this section*'.

[269] For a recent discussion of beneficial ownership in DTCs, *see* R. J. Danon, *The Beneficial Ownership Limitation in Articles 10, 11 and 12 OECD Model and Conduit Companies in Pre-and Post-BEPS Tax Treaty Policy: Do We (Still) Need It?,* in *Current Tax Treaty Issues: 50th Anniversary of the International Tax Group* 585–661 (G. Maisto ed., IBFD 2020) and A. Martín Jiménez, *Beneficial Ownership* in *Global Tax Treaty Commentaries* (R. Vann ed., IBFD online book, version of 1 Aug. 2020).

[270] Article 1(4) IRD; *N Luxembourg 1* (C-115/16 et al.), *supra* n. 1, para. 9.

[271] Article 9(1) of the Agreement between the European Union and the Swiss Confederation on the automatic exchange of financial account information to improve international tax compliance, *supra* n. 13.

agreement that is designed to mirror the IRD never contained a beneficial ownership requirement. In particular, when the Swiss-EU Agreement was revised in 2015, the latter was not aligned with the IRD.[272]

Unfortunately, the judgments of the ECJ in the Danish cases have not resolved but rather exacerbated this controversy. Two paragraphs of the judgments relating to the PSD could indeed be interpreted to suggest that the Court has found that the PSD was subject to an objective beneficial ownership limitation that is distinct from the notion of abuse of rights.[273] First of all, according to paragraph 111 '*(…) where the beneficial owner of dividends paid is resident for tax purposes in a third State, refusal of the exemption provided for in Article 5 of Directive 90/435 is not in any way subject to fraud or an abuse of rights being found*'.[274] Secondly, in paragraph 113, the Court goes on to say that the mechanisms of the PSD are not:

> *(…) intended to apply when the beneficial owner of the dividends is a company resident for tax purposes outside the European Union since, in such a case, exemption of those dividends from withholding tax in the Member State from which they are paid could well result in them not actually being taxed in the European Union.*[275]

In four judgments[276] handed down on 5 June 2020, the French Supreme Administrative Court endorsed this reading of the Danish cases and held that beneficial ownership is to be regarded as a '*condition du bénéfice de l'exonération de retenue à la source*'.[277] In essence, therefore, this implies that, when an intermediary entity established in a Member State is not the beneficial owner, the benefits of the PSD may be denied irrespective of the existence of an abuse of rights.[278] By contrast, in its judgment of 20 April 2020, the Federal Supreme Court found that the existence of a beneficial ownership limitation could not be derived from the wording of the Swiss-EU Agreement.[279] Moreover, and from the perspective of the principle of common interpretation, the Swiss Court observed that, as the PSD case was settled on the basis of the EU prohibition of abuse of rights, the question of an implicit beneficial ownership limitation could be left open.[280] In the recently decided *Colgate* case, the Spanish Supreme Court similarly considered that a beneficial ownership limitation could not be read into the royalty article of the Spain-Switzerland DTC absent an express reference to it.[281] Interestingly, the DTC also implements and contains the language of the Swiss-EU agreement[282] with respect to royalties. This decision shall be reverted to below.

In our opinion, the conclusion that the ECJ read an implicit beneficial ownership requirement into the PSD remains questionable. As already argued by some commentators,[283] the foregoing passages of the ECJ judgments may also be read in the context of the questions of the referring Danish courts[284] which, in the PSD case, only foresaw beneficial ownership as provided by an underlying DTC. By contrast, the ECJ was simply not questioned on whether the PSD contains an implicit beneficial ownership limitation. It is also observed that, when referring to '*the conditions of application*'[285] of the PSD, the ECJ did not allude to beneficial ownership. Rather, the Court noted that:

> *it is an indication of the existence of an arrangement intended to obtain improper entitlement to the exemption provided for in Article 5 of Directive 90/435 that all or almost all of the aforesaid dividends are, very soon after their receipt, passed on by the company that has received them to entities which do not fulfil the conditions for the application of Directive 90/435, either because they are not established in any Member State, or because they are not incorporated in one of the forms covered by the directive, or because they are not subject to one of the taxes listed in Article 2(c) of the directive, or because they do not have the status of 'parent company' and do not meet the conditions laid down in Article 3 of the directive.*[286]

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272 *See* Art. 9(2) of the Agreement between the European Union and the Swiss Confederation on the automatic exchange of financial account information to improve international tax compliance, *supra* n. 13 which simply refers to: '*interest and royalty payments made between associated companies*'.

273 D. Gutmann, *Contre la théorie du bénéficiaire effectif en droit fiscal européen et international*, 2 Fiscalité Internationale 1–3, at 2 (2019).

274 *T Danmark and Y Denmark* (C-116/16 and C-117/16), *supra* n. 1, para. 111.

275 *Ibid.*, para. 113.

276 Conseil d'État, judgments no. 423809, 423810, 423811 and 423812, *supra* n. 7.

277 *Ibid.*, para. 5.

278 Conseil d'État, judgments no. 423809, 423810, 423811 and 423812, *supra* n. 7; *Société Eqiom et Société Enka*, Conclusions du Rapporteur Public, at 7.

279 Bundesgericht/Tribunal fédéral, judgment 2C_354/2018, *supra* n. 12, para. 3.3.

280 *Ibid.*, para. 4.

281 Tribunal supremo, judgment no. 3062/2020, *supra* n. 70.

282 Article 12(7) Spain-Switzerland Double Taxation Convention (1966).

283 De Broe & Gommers, *supra* n. 4, at 294.

284 *T Danmark and Y Denmark* (C-116/16 and C-117/16), *supra* n. 1, para. 64.

285 *Ibid.*, para. 101.

286 *Ibid.*

If beneficial ownership was implicit to the PSD, it is difficult to understand why the ECJ would have eluded it as a requirement in the foregoing list. Finally, and in any event, it should be noted that the questions raised by the Danish referring courts did not concern the issue of whether the beneficial ownership limitation was an inherent and objective limitation in the PSD but rather whether it could be regarded as an '*agreement-based provision*' pursuant to the reservation on anti-avoidance rules.[287] As the ECJ focused on the principle of abuse of rights, this question was not even settled.[288]

For these reasons, it is submitted that the judgments of the ECJ relating to the Danish PSD case do not clearly support the position that the beneficial ownership limitation represents an objective requirement that would apply independently from the principle of abuse of rights. While, as shall now be seen, some indicators of abuse provided by the ECJ seem to resemble the language of the 2014 OECD Commentary on beneficial ownership, these indicators should be taken for what they are: indicators of abuse as opposed to an attempt by the Court to define a condition that is simply not in the PSD. As will be shown, this reading of the ECJ judgments – which, in our view, is a fair one – also avoids problems of delineation between beneficial ownership and abuse of rights, and the unintended effects stemming therefrom.

3.2 *Meaning of Beneficial Ownership in the Danish Cases and Under the 2014 OECD Commentary*

The discussion now moves to the meaning of beneficial ownership which may be derived from the Danish cases which will be contrasted with that flowing from the 2014 OECD Commentary and recent national case law. Here, the IRD cases are mostly relevant. In this judgment, the ECJ made several observations that have already been presented in scholarly writing and will thus be presented briefly. First, the beneficial ownership limitation contained in this directive cannot be defined by reference to national law which varies in scope.[289] As is well-known, a similar conclusion applies for tax treaty purposes: beneficial ownership should be given '*an international fiscal meaning*'[290] not derived from the domestic laws of the contracting states.[291] More importantly, according to the ECJ, beneficial ownership should be understood according to '*economic reality*'[292] and designates the '*entity which benefits economically from the interest received and accordingly has the power freely to determine the use to which it is put*'.[293] Finally, the ECJ considered that the OECD commentaries were '*relevant*' for purposes of interpreting the IRD[294] and, on this point, dismissed the position of AG Kokott[295] and that of the applicants.[296] However, then, the question is which version of the OECD Commentary is relevant? In particular, does this include the 2014 OECD Commentary which incorporates the latest clarification on the interpretation of beneficial ownership? In its introductory considerations, the ECJ referred to the evolution of the OECD Commentary (including an express mention of its 2014 update).[297] However, in these introductory considerations, the emphasis was placed on the discussion of the 2003 additions to the commentaries relating to conduit companies[298] with no explicit reference to the new passages introduced in 2014.[299] On the other hand, paragraph 90 of the IRD case seems to suggest a full dynamic interpretation taking into account the 2014 update of the commentaries: '*the concept of "beneficial owner", which appears in the bilateral conventions based on that model, and the successive amendments of that model and of the commentaries relating thereto are, therefore, relevant when interpreting Directive 2003/49*'.[300] Some support for such dynamic interpretation can also be derived from *Berlioz* in which – albeit in the context of administrative assistance – the ECJ relied on a subsequent update of the OECD Commentary.[301] Moreover, it is true that the ECJ held that the existence of an abusive conduit arrangement is:

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[287] Article 1(2) PSD.

[288] *T Danmark and Y Denmark* (C-116/16 and C-117/16), *supra* n. 1, para. 101.

[289] *N Luxembourg 1* (C-115/16 et al.), *supra* n. 1, para. 84.

[290] UK: Court of Appeal (Civil division), *Indofood International Finance Ltd* [2006] EWCA Civ 158, 8 ITLR 653.

[291] OECD Model (2017): Commentary on Art. 10, para. 12.1; Danon, *supra* n. 269, at 599 et seq. with references.

[292] *N Luxembourg 1* (C-115/16 et al.), *supra* n. 1, para. 88.

[293] *Ibid.*, para. 89.

[294] *Ibid.*, para. 90.

[295] Opinion of AG Kokott, *N Luxembourg 1* (C-115/16), *supra* n. 27, para. 55.

[296] *N Luxembourg 1* (C-115/16 et al.), *supra* n. 1, para. 91.

[297] *N Luxembourg 1* (C-115/16 et al.), *supra* n. 1, paras 3–7; *T Danmark and Y Denmark* (C-116/16 and C-117/16), *supra* n. 1, paras 3–7.

[298] *N Luxembourg 1* (C-115/16 et al.), *supra* n. 1, para. 6; *T Danmark and Y Denmark* (C-116/16 and C-117/16), *supra* n. 1, para. 6.

[299] Gutmann, *supra* n. 273, at 2.

[300] *N Luxembourg 1* (C-115/16 et al.), *supra* n. 1, para. 90.

[301] LU: ECJ, judgment of 16 May 2017, Case C-682/15, *Berlioz*, EU:C:2017:373.

> *capable of being constituted not only by a contractual or legal obligation of the parent company receiving the dividends to pass them on to a third party but also by the fact that, "in substance" (…) that company, without being bound by such a contractual or legal obligation, does not have the right to use and enjoy those dividends.*[302]

In our view, however, this passage alone cannot be regarded as an attempt of the ECJ to define beneficial ownership in the first place and, more specifically, in light of the 2014 OECD Commentary. Rather, both in the PSD and IRD cases, the Court was merely providing indicators here designed to detect a possible abuse of rights.

Therefore, in the IRD case in which the issue was most relevant, it is submitted that the ECJ did not clearly settle to what extent the 2014 OECD Commentary would be relevant for purposes of interpreting beneficial ownership in the IRD. Moreover, the Court did equally not clarify whether and, if so, to what extent a meaning of beneficial ownership based on '*economic reality*'[303] would be compatible with the interpretation of this term under the 2014 OECD Commentary. As a matter of fact, this question is controversial in tax treaty practice. The 2014 commentaries indeed state that an obligation depriving the recipient from beneficial ownership '*may also be found to exist on the basis of facts and circumstances showing that, in substance, the recipient clearly does not have the right to use and enjoy the dividend unconstrained by a contractual or legal obligation to pass on the payment received to another person*'.[304] The exact meaning of this passage of the commentaries, however, remains unclear. A first possible interpretation would be to consider that the reference to '*facts and circumstances*' and '*in substance*' used by the commentaries in this passage could suggest that the OECD has, at least not completely, ruled out the possibility of assessing beneficial ownership on the basis of a substance-over-form or economic interpretation as favoured by the ECJ in the IRD case. In that sense, the meaning under the IRD and the 2014 OECD Commentary would converge.[305] A second interpretation of this passage would be to consider that the facts may only serve as a tool here to prove the existence of an unwritten but nevertheless legal or contractual obligation.[306] Under this analysis, beneficial ownership would be subject to a legal interpretation but also considering what could be described as '*legal substance*'. In other words, beneficial ownership could be denied to a conduit company when, for instance, the facts reveal that this entity is transferring the income it receives pursuant to an implied agency agreement and/or that it is a sham.[307] For this reason, a commentator concludes that the 2014 OECD commentaries favour a more narrow and legalistic interpretation of beneficial ownership than the ECJ did in the IRD cases in which the beneficial owner is defined as the person who benefits economically from the income.[308] At the same time, for this author, Member States would be required to take into account the interpretation of the ECJ for purposes of applying their DTCs not only with other Member States but also with third countries.[309] This latter question will not be settled here. Rather, we wish to explore whether and to what extent the interpretation of beneficial ownership under the 2014 OECD Commentary may be reconciled with the meaning given to this term by the ECJ in the IRD cases. For this purpose, we consider recent tax treaty case law in this area.

A contribution to this debate initially came from a jurisdiction whose case law is generally regarded as having favoured an economic interpretation of beneficial ownership, namely, Switzerland. Following the landmark *Swaps Case*,[310] the Swiss Federal Supreme Court has traditionally considered that a person is not the beneficial owner when, on the basis of a legal or factual obligation, this person transfers all or even just an essential portion of the treaty protected income to non-residents.[311] However, in two recent judgments, the Federal Supreme Court was given the opportunity to clarify the consistency of this case law

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302 *T Danmark and Y Denmark* (C-116/16 and C-117/16), *supra* n. 1, para. 105; *N Luxembourg 1* (C-115/16 et al.), *supra* n. 1, para. 132.

303 *N Luxembourg 1* (C-115/16 et al.), *supra* n. 1, para. 88.

304 *Ibid.*

305 C. Hamra & J.J.A.M. Korving, *Beneficial Ownership Interpreted, To What Extent Are the OECD and the EU on the Same Wavelength*, 49(3) Intertax 254, at 266 (2021).

306 *See* inter alia, E. C. C. M. Kemmeren, *Preface to Articles 10 to 12*, in *Klaus Vogel on Double Taxation Conventions* (E. Reimer & A. Rust eds, 4th ed., Wolters Kluwer 2015); O. Weidmann, *Beneficial Ownership and Derivatives: An Analysis of the Decision of The Swiss Federal Court Concerning Total Return Swaps (Swiss Swaps case)*, 44(8/9) Intertax 620–641 at 231 (2016); CFE ECJ Taskforce, *supra* n. 183, at 17.; De Broe & Gommers, *supra* n. 4, at 287.

307 De Broe, *supra* n. 16, at 723.

308 L. De Broe, *Should Courts in EU Member States Take Account of the ECJ's Judgment in the Danish Beneficial Ownership Cases When Interpreting the Beneficial Ownership Requirement in Tax Treaties?,* in *Current Tax Treaty Issues: 50th Anniversary of the International Tax Group* (G. Maisto, IBFD 2020), s. 16.1.4.3.

309 De Broe, *supra* n. 308, s. 16.1.4.3. According to De Broe, this reasoning may be based on Art. 31(3)(c) VCLT as regards DTCs concluded between Member States According to Art. 31(3)(c) VCLT, there shall be taken into account, together with the context '*any relevant rules of international law applicable in the relations between the parties*' which according to this author includes EU law (*see also* F. Avella, *Using EU Law To Interpret Undefined Tax Treaty Terms: Article 31(3)(c) of the Vienna Convention on the Law of Treaties and Article 3(2) of the OECD Model Convention*, 2(4) World Tax J. 96, at 118 et seq. (2012)). With respect to DTCs with third countries, the reasoning may be based on the reference to the laws of the state applying the DTC pursuant to Art. 3(2) OECD MC (2017).

310 CH: Bundesgericht/Tribunal fédéral, 5 May 2015, judgment 2C_364/2012 = *Re Swiss Swaps Case* I/A, para. 5.2.4, 18 ITLR 138, at 180.

311 *Ibid.*

with the 2014 OECD Commentary. First, in a judgment delivered on 16 December 2019[312] involving securities lending and borrowing transactions, the Federal Supreme Court referred to the 2014 OECD Commentary. The case concerned a financial institution, resident in Switzerland, which had borrowed listed Swiss shares, from an affiliated company that was resident in the United Kingdom, under a classic securities lending and borrowing arrangement (SLB). The issue at stake was whether a Luxembourg company could be regarded as the beneficial owner given that its obligation to pay a manufactured dividend was independent from the receipt of dividends from the Swiss shares. In its judgment, the Federal Supreme Court considered that, even if the 2014 OECD Commentary were applicable to the facts at hand and was interpreted as requiring a legal obligation to pass on the income, beneficial ownership would have still been denied. In essence, the Court arrived at this conclusion by considering that, in the present instance, an implied legal obligation to pass on the treaty favoured income could be derived from the concurring intentions of the parties and the circumstances (inter alia from the contractual provisions relating to the transfer of shares, the obligation to make manufactured dividend payments and, finally, to retransfer shares of the same type and quantity under one single contract).[313] Accordingly, the Supreme Court ruled that the Luxembourg entity was subject to an implied obligation to pass on the income so that this entity was, with respect to the Swiss source dividends, in a position comparable to that of a conduit entity acting as an agent or nominee.[314]

Finally, in a judgment rendered on 19 May 2020 involving Switzerland's DTC with the United Kingdom, the Federal Supreme Court took a final stand on the relevance of the 2014 OECD Commentary and the consistency of its case law with it. To begin, with respect to beneficial ownership, the Court found that the OECD commentaries could be applied on an ambulatory basis (i.e., also to DTCs concluded before 2014).[315] In support of this position, the Court relied in particular on precedents of the International Court of Justice.[316] Further, the Federal Supreme Court considered that a proper reading of its findings in the *Swaps Case* entailed that there was no material difference with the interpretation conveyed by the 2014 OECD Commentary in the sense that the denial of beneficial ownership requires a contractual or legal obligation to pass on the income. In essence, for the Federal Supreme Court, the passages of its *Swaps Case* judgment that have been interpreted as supporting a substance over form approach of beneficial ownership (i.e., a de facto obligation to pass on income) were, in fact, just a reference to the factual circumstances used as a tool to identify a contractual obligation.[317] At the same time, in this judgment, the Federal Supreme Court considered that the former conduit arrangement clause contained in the Switzerland-United Kingdom DTC could be regarded as a subsequent agreement[318] between the contracting states regarding the interpretation of beneficial ownership.[319] Under such a clause, however, the existence of a conduit arrangement is much broader than under the beneficial ownership limitation as interpreted according to the 2014 OECD Commentary: the existence of a conduit is upheld not only when the recipient is under an obligation to pass on the payment but, rather, as soon as '*all or substantially all of that income*' is transferred. While, in our opinion, the position of the Federal Supreme Court on this point is erroneous (and evidenced by no actual bilateral understanding),[320] it entails that the distinction between a legal and economic interpretation of beneficial ownership is rather blurred.

Secondly, a judgment rendered by the Supreme Court of Italy on 10 July 2020 in relation to the IRD is also interesting.[321] In essence, the case involved the payment of interest by an Italian company to its shareholder, a Luxembourg sub-holding which, in turn, was controlled by another Luxembourg company. Interest paid by the Italian entity accrued on a loan granted by the Luxembourg entity in the context of a broader merger leverage buy out (MLBO) transaction, which was put in place for the purpose of acquiring certain target companies situated in Italy and Sweden. The Supreme Court

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312 CH: Bundesgericht/Tribunal fédéral, 16 Dec. 2019, 2C_209/2017 = 22 ITLR 435.

313 *Ibid.*, para. 3.4.3.

314 *Ibid.*

315 CH: Bundesgericht/Tribunal fédéral, 19 May 2020, 2C_880/2018, para. 4.1. *See also* thereupon, R. J. Danon, *Tax Treaty Abuse from a Swiss Perspective: Current State of Affairs, Uncertainties and Future Perspective,* in *Au carrefour des contributions, Mélanges de droit fiscal en l'honneur de Monsieur le Juge Pascal Mollard* 434–436 (OREF ed., Stämpfli 2020).

316 International Court of Justice, 13 July 2009, Différend relatif à des droits de navigation et des droits connexes [*Costa Rica v. Nicaragua*], C.I.J. Recueil 2009, at 243 § 66: 'where the parties have used generic terms in a treaty, the parties necessarily having been aware that the meaning of the terms was likely to evolve over time, and where the treaty has been entered into for a very long period or is "of continuing duration", the parties must be presumed, as a general rule, to have intended those terms to have an evolving meaning'.

317 Bundesgericht/Tribunal fédéral, judgment 2C_880/2018, *supra* n. 315, para. 4.4.

318 Article 31(3)(a) VCLT.

319 Bundesgericht/Tribunal fédéral, judgment 2C_880/2018, *supra* n. 315, para. 4.5.2.

320 Rather, Swiss unilateral materials indicate that the conduit arrangement clause initially proposed by the UK was overly broad which is why Switzerland proposed to combine it with a main purpose test (*see* FF 2008 6973, at 6976).

321 Corte Suprema di Cassazione, judgment 14756, *supra* n. 8, with comments by P. Arginelli & M. Tenore in Highlights & Insights on European Taxation 470 (2020).

referred to the Danish cases and held that the beneficial ownership limitation is a rule with anti-avoidance effects. However, it considered, at the same time and in line with the 2014 OECD Commentary, that this limitation focuses exclusively on whether the recipient of the income has the full right to use and enjoy the income free from legal obligations to pass it on to another person. Pursuant to the 2014 OECD Commentary, such an obligation, however, may also be derived from '*facts and circumstances showing that, in substance, the recipient clearly does not have the right to use and enjoy*' the income.[322] Following this line of reasoning, the Supreme Court held that the Luxembourg entity was entitled to the benefits of the IRD for the following reasons: (1) the sole fact that it acted as a sub-holder and carried out limited treasury activities was not *per se* decisive in order to conclude that it was a conduit company not fulfilling the beneficial ownership requirement; (2) there was no contractual or legal obligation for the Luxembourg entity to pass on the interest to another person; (3) the net profits derived by the entity were adequate having regard to the specific activities that were carried out; and, finally, (4) the loan granted by the Luxembourg entity to its Italian subsidiary was only one of several loans granted to other group companies in the context of the MLBO transaction aimed at acquiring target companies in Italy and Sweden. It appears that the Supreme Court did not focus on the specific loan granted by the Luxembourg company to its Italian subsidiary and on the related loans granted along the participation chain. Rather, it assessed the overall functions performed by the Luxembourg entity within the group and in light of the purpose of the relevant MLBO transaction that was aimed at the acquisition of the Italian and Swedish target companies.[323] The reference made by the Italian Supreme Court to both the Danish cases and the 2014 OECD Commentary seem to indicate that the ECJ judgments in the IRD cases may be read as supporting a dynamic interpretation of the OECD commentaries. It also seems that the Supreme Court did not find that the meaning of beneficial ownership under the 2014 OECD Commentary was inconsistent with that based on '*economic reality*'[324] favoured by the ECJ in the IRD case.

A judgment delivered by the French Conseil d'État on 5 February 2021 is also worth mentioning.[325] The case submitted to the Supreme Administrative Court involved a UK resident musical society collecting inter alia royalties arising in France on behalf of its members. Overruling the lower court's decision, the Conseil d'État found that the UK musical collecting society did not satisfy the beneficial ownership limitation of the UK-France DTC as, in practice, the entity was simply redistributing most of its income (approximately 80%) to its members. As the Conseil d'État did not expressly refer to the 2014 OECD Commentary, it is unclear whether the reasoning of the court is based on the existence of an implied legal obligation to pass on the income derived from the facts or simply the result of an analysis based on economic substance. A similar result was also reached by Spanish courts.[326] The 2017 OECD commentaries to the PPT logically confirm that, when the right holders are regarded as the beneficial owners (with the collecting society then being an agent), the DTC between the state of source and their state of residence applies.[327]

Leaving aside these latter decisions that did not expressly refer to the 2014 OECD Commentary, it flows from recent Swiss and Italian case law that an analysis of beneficial ownership taking into account the existence of a legal or contractual obligation to pass on the income received, derived from the facts, will, in most instances, not be so far apart from an economic interpretation of beneficial ownership as favoured by the ECJ in the IRD cases. In that sense, both approaches may be reconciled.[328] Indeed, none of the commentators who argue in favour of a legal interpretation of beneficial ownership considers that the existence of a formal or written obligation is a prerequisite to deny beneficial ownership.[329] Rather, a conduit company should equally not be regarded as the beneficial owner when the facts reveal that the income it receives is subject to an implied contractual obligation (typically an agency agreement).[330] In the same vein, legal interpretation also implies that beneficial ownership

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322 *Ibid.*

323 P. Arginelli & M. Tenore, *Comments to Corte Suprema di Cassazione, judgment 14756,* Highlights & Insights on Eur. Tax'n 470 (2020).

324 *N Luxembourg 1* (C-115/16 et al.), *supra* n. 1, para. 88.

325 FR: Conseil d'État, 5 Feb. 2021, judgment no. 430594, *Performing Rights Society Ltd*., ECLI:FR:CECHR:2021:430594.20210205.

326 ES: Tribunal Económico-Administrativo Central, 22 Sept. 2000, decision RG 6294/1996 confirmed by the Audiencia Nacional in 2003; *see* thereupon Martín Jiménez, *supra* n. 269, s. 5.7.2.1.

327 OECD Model (2017): Commentary on Art. 29, para. 182, example I. This example, in fact, has nothing to do with the PPT or an improper use of a DTC (*see* thereupon Martín Jiménez, *supra* n. 269, s. 5.7.2.1) but simply reaffirms the principle that the limitation of tax in the state of source remains available when an intermediary is interposed between the beneficiary and the payer, but the beneficial owner is a resident of the other contracting state (OECD Model (2017): Commentary on Art. 12, para. 4.6).

328 *See* Danon, *supra* n. 269, at 628–630; *see also* A. Martín Jiménez, *Beneficial Ownership as a Broad Anti-Avoidance Provision: Decisions by Spanish Courts and the OECD's Discussion Draft,* in *Beneficial Ownership: Recent Trends* 51–52 (M. Lang et al. eds, IBFD 2013), s. 8.2.

329 Du Toit, *supra* n. 224, at 229.

330 As observed by Du Toit, *ibid.*

should be denied if the conduit entity has no right to dispose of the income, assets, or claims but is compelled to follow the instructions of its creditor/shareholder[331] irrespective of its own corporate interests and the arrangement in place is a sham. In these instances, the conduit entity would then be regarded as an agent or nominee.[332] The same holds true when, for example, the relevant income is not even reported in the accounts of the recipient as was the case in the judgments delivered by the French Conseil d'État on 5 June 2020.[333] By contrast, unlike what the Swiss Federal Administrative Court suggested in a decision rendered in 2018,[334] the mere fact that, in a group, the board of directors of an intermediary company claiming treaty benefits also includes persons serving on the board of directors of its parent or grandparent company is not *per se* sufficient to consider that the intermediary company is not the beneficial owner.[335] Rather, whether the analysis is based on economic or legal substance, it must be demonstrated that the intermediary has no autonomy of its own.[336] If it is preferred and, in the words of Klaus Vogel, a subsidiary may thus not qualify as the beneficial owner when '*its management is not in a position to make decisions differing from the will of the controlling shareholder. If it were so, the subsidiary's power would be no more than formal and the subsidiary would, therefore, not qualify as a beneficial owner within the meaning of Arts. 10 to 12 MC*'.[337] In the same vein, the Italian Supreme Court has considered that a holding company may be regarded as the beneficial owner to the extent it is in a position to make autonomous decisions regarding its shareholding of other companies.[338]

This being said, even if legal and economic substance may be reconciled when interpreting beneficial ownership, the interaction of this limitation with the notion of abuse of rights may be problematic. This question is reverted to below.

3.3 *Lack of Beneficial Ownership at the Intermediary Entity Level: May the Actual Beneficial Owner Claim Benefits?*

It is now assumed that an intermediary entity does not satisfy the beneficial ownership limitation and considered whether the actual beneficial owner may claim the benefits of the PSD or IRD (intra-EU and Swiss-EU relations), respectively, the the benefits of the applicable DTC concluded by the state of source (third state relations).

Moving first to intra-EU relations and considering the IRD, it seems to us that the benefits of this directive remain available as long the beneficial owner of the interest or royalties is in the European Union. This flows very clearly from the judgment of the ECJ in the Danish cases:

> *It should also be stated that the mere fact that the company which receives the interest in a Member State is not its "beneficial owner" does not necessarily mean that the exemption provided for in Article 1(1) of Directive 2003/49 is not applicable. It is conceivable that such interest will be exempt on that basis in the source State when the company which receives it transfers the amount thereof to a beneficial owner who is established in the European Union and furthermore satisfies all the conditions laid down by Directive 2003/49 for entitlement to such an exemption.*[339]

If it was to be considered, like the French Supreme Administrative Court has held, that the PSD incorporates a beneficial ownership limitation, the same conclusion would also apply under this directive.[340] In its judgment of February 2018, the Federal Administrative Court denied the benefit of the Swiss-EU Agreement for lack of beneficial ownership irrespective of the fact that the case involved a chain of companies all of which were residents within the European Union (i.e., Ireland and Italy). As mentioned, the question of whether the Swiss-EU Agreement incorporates a beneficial ownership limitation was left open by the Federal Supreme Court. However, even if it were to transpire that this agreement is subject to such a limitation, we would then argue – based on the principle of common interpretation favoured by the Federal Supreme Court – that the foregoing conclusion drawn by the ECJ in relation to the IRD should then apply *mutatis mutandis* to the Swiss-EU agreement.

Turning to third state relations, the position of the OECD Commentary on this point is fairly clear. The commentaries have indeed consistently provided that, when the recipient and the beneficial owner of dividends,

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[331] De Broe, *supra* n. 16, at 723.

[332] *Ibid.*

[333] FR: Conseil d'État, 5 June 2020, judgments no. 423809, 423810,423811 and 423812, *supra* n. 7.

[334] CH: Bundesverwaltungsgericht/Tribunal administratif fédéral, 28 Feb. 2018, judgment A-7299/2016 = *A AG v. Federal Tax Administration*, 20 ITLR 625, at 655.

[335] Danon, *supra* n. 269, at 629; Danon & Malek, *supra* n. 58, at 500.

[336] R. Danon, *Le concept de bénéficiaire effectif dans le cadre du MC OCDE: Réflexions et analyse de la jurisprudence récente,* IFF Forum für Steuerrecht 48 (2007).

[337] K. Vogel, *Preface to Articles 10–12*, in *Klaus Vogel on Double Taxation Conventions* 563 (3d edn, K. Vogel ed., Kluwer Law International 1997), m.no. 10.

[338] IT: Corte Suprema di Cassazione, 28 Dec. 2016, judgment no. 27112.

[339] *N Luxembourg 1* (C-115/16 et al.), *supra* n. 1, para. 94.

[340] Gutmann, *supra* n. 273, at 2.

interest, and royalties are not the same persons, the benefits of the DTC concluded between the state of source and the state of residence of the beneficial owner remain available. The commentaries state that:

> *subject to other conditions imposed by the Article, the limitation of tax in the State of source remains available when an intermediary, such as an agent or nominee located in a Contracting State or in a third State, is interposed between the beneficiary and the payer but the beneficial owner is a resident of the other Contracting State.*[341]

As discussed, the 2017 OECD Commentary merely confirms this principle when it states that, when a collecting society collects royalties on behalf of its rightsholders, the DTC between the state of source and their state of residence applies.[342]

In certain countries, courts have had difficulties in applying this interpretation. In this respect, a decision rendered by the Swiss Federal Supreme Court in relation to a conduit entity established in Luxembourg, whose beneficial owners were residents of the United States, is interesting. As it was found that the conduit entity was not the beneficial owner of Swiss source dividends within the meaning of the Luxembourg-Switzerland DTC, the question arose as to whether the benefits of the Switzerland-United States DTC could alternatively and directly be available. This question was answered in the negative with the Court observing that, from a procedural standpoint, the possibility for the shareholders of the Luxembourg entity to claim the benefits of the Switzerland-United States DTC concerned a different person and was thus unrelated to the matter at hand.[343] Insofar as it is justified by purely procedural reasons, this conclusion can be accepted. In a judgment of 29 May 2020, however, the Federal Administrative Court suggested that this position could also be justified by substantive reasons. According to this Court, Since the beneficial ownership limitation does not include an express derivative benefits provision, treaty benefits may not be claimed on the basis of the DTC concluded between Switzerland and the state of residence of the actual beneficial owners.[344] In our view, this position cannot be supported and misses the point. There is no need for a derivative benefits clause as, according to the consistent interpretation of the OECD Commentary, it is the DTC concluded by the state of source with the state of residence of the actual beneficial owner that becomes directly applicable here. The Eastern High Court rightly arrived at this conclusion by expressly referring to the foregoing section of the OECD Commentary (although in the context of an abuse of rights analysis).[345]

The *Colgate* case decided by the Spanish Supreme Court[346] that has already alluded to is also worth mentioning here. The case involved the payment of Spanish source royalties to a Swiss principal company owned by a US based company.[347] The benefit of the Spain-Switzerland DTC had been denied to the Swiss principal on the grounds of lack of beneficial ownership but, at the same time, beneficial ownership of the US parent was not recognized. As already mentioned, the Spanish Supreme Court concluded that the beneficial ownership requirement is not implicit in the Spain-Switzerland DTC. However, this conclusion was aimed at correcting the outcome at which the lower court had arrived. The lower court had indeed considered that the Swiss principal company was not the beneficial owner of the Spanish source royalties. At the same time, however, the lower court agreed with the tax administration that the Spain-US DTC should not apply because evidence had not been given that the royalties were ultimately received by the US parent company (although it was clear that the royalties had ended up in the hands of the US parent). From this perspective, the decision of the tax administration and that of the lower court have been regarded as arbitrary because they interpreted the beneficial ownership requirement as a sort of GAAR or PPT (not in a strict form) but, at the same time, they refused the natural consequences of the GAAR (i.e., the recharacterization of the transaction consisting of seeing a direct payment to the US parent company and hence upholding the application of the Spain-US DTC). The Spanish Supreme Court was aware of the arbitrariness in the decisions of the tax administration and lower court and explicitly criticized it. In the end, however, the manner in which the Supreme Court corrected this arbitrariness was surprising. Access to the Switzerland-Spain DTC was granted on the grounds that this treaty did not incorporate a beneficial ownership requirement.[348] Following the approach of the Court, a more coherent conclusion would have been to grant treaty benefits on the basis of the Spain-US DTC.

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341 OECD Model (2017): Commentary on Art. 10, para. 12.7.

342 OECD Model (2017): Commentary on Art. 29, para. 182, example I.

343 CH: Bundesgericht/Tribunal fédéral, 22 Nov. 2015, judgment 2C_752/2014 (preferred equity certificates), para. 7.

344 CH: Bundesverwaltungsgericht/Tribunal administratif fédéral, 29 May 2020, judgment A-2516/2018, para. 8.

345 Østre Landsret, case no. B-1980-12 and B-2173-12, *supra* n. 11, at 244-245.

346 Tribunal supremo, judgment no. 3062/2020, *supra* n. 70.

347 Initially and before a restructuring occurred, the royalties were paid by the Spanish subsidiary directly to the US parent company.

348 For a full analysis of the *Colgate* case, *see* A. Martín Jiménez, *Beneficiario efectivo, cláusulas generales anti-abuso, Directivas UE, CDIs y sentencias danesas del TJUE: cómo integrar todas las piezas evitando conflictos e inseguridad jurídica (que no elimina el caso Colgate),* Revista de Contabilidad y Tributación CEF 452, 75–124 (2020).

3.4 *Beneficial Ownership Versus Abuse of Rights: The Issue and a Proposal for Coordination*

When it comes to the improper use of a directive or a DTC, the delineation between the beneficial ownership limitation and the principle of abuse of rights naturally becomes relevant.

When such an improper use is triggered by a last-minute restructuring designed to cause the application of a directive or a DTC, or a more favourable provision within the same DTC (rule shopping), this delineation is rather easy to handle. These restructurings are indeed not covered by the beneficial ownership limitation so that the principle of abuse of rights may apply by default.[349]

Conduit situations such as the ones at stake in the Danish cases that may conceptually be addressed by both the beneficial ownership limitation and the principle of abuse of right are more complicated. *A Holding ApS* decided by the Swiss Federal Supreme Court in 2005 is illustrative from a tax treaty perspective.[350] While the Swiss Court denied treaty benefits on the basis of the inherent prohibition of abuse, the case could well have been decided pursuant to the beneficial ownership limitation. On the facts submitted to the Court, A Holding ApS exercised no decisional autonomy. In particular, the immediate redistribution of dividends was not the expression of the intermediary entity's corporate autonomy but rather an arrangement that placed this entity in a position similar to that of an agent or nominee.[351]

Therefore, the next question that comes into play is what happens if, unlike in *A Holding ApS,* the interposition of a conduit arrangement is not abusive. As discussed earlier, a good example is Example E of the OECD Commentary to the PPT involving a holding company entering into a licensing and a sub-licensing structure and keeping only a minimal spread.[352] If this same fact pattern were to be tested against the beneficial ownership limitation under the IRD and as construed by the ECJ in the Danish cases, it is likely that the benefit of the directive could be denied. It is arguable that the intermediary holding company would not be the one '*which benefits economically*'[353] from the royalties and who has '*the power freely to determine the use to which it is put*' because of the licensing and sub-licensing structure in place.[354] The same conclusion could also be drawn under DTCs and based on the 2014 OECD Commentary even if the analysis is confined to legal substance but, as was the case for example in recent Swiss court decisions, facts and circumstances show that, in substance, the recipient clearly does not have the right to use.[355] Therefore, while such an arrangement would not have been considered abusive under a GAAR (such as the PPT), it would nonetheless not pass the beneficial ownership limitation. This is because the PPT is not just triggered due to the existence of an interdependence between two income streams (e.g., in the case of a licensing and sub-licensing situation).[356] Rather, obtaining the relevant treaty benefit must also be one of the principal purposes of the arrangement or transaction. That is, the arrangement must typically be structured with the intention to eliminate the withholding tax that would otherwise have been paid to the state of source.[357]

In any event, however, a diverging outcome produced by the beneficial ownership limitation and a GAAR is unsatisfactory from a policy perspective. Three solutions may be contemplated to resolve the problem. The first would be to switch off the beneficial ownership limitation whenever there is no abuse. This was the approach followed in the United Kingdom following the *Indofood Case* in which the interposition of an intermediary entity did not lead to an increase of tax treaty benefits.[358] As discussed, in a judgment of 19 May 2020, the Federal Supreme Court was inclined to equate the beneficial ownership limitation to the former conduit arrangement clause of the Switzerland-UK DTC.[359] The question is

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[349] However, even in these instances, the distinction between beneficial ownership and the principle of abuse of rights may be blurred. A good example is *Bank of Scotland*, in which the principle of abuse of rights was essentially built into beneficial ownership with the French Supreme Administrative Court focusing also on the restructuring aspect of the case, the temporary cession of the usufruct in respect of non-voting preferred shares was an arrangement made with the only intention of obtaining treaty benefits. FR: Conseil d'État, 29 Dec.. 2006, judgment no. 283314, *Ministre de l'Economie, des Finances et de l'Industrie v. Société Bank of Scotland*, 9 ITLR 683.

[350] Bundesgericht/Tribunal fédéral, *Holding ApS*, *supra* n. 72.

[351] Danon, *supra* n. 269, at 638.

[352] OECD Model (2017): Commentary on Art. 29, para. 187, Example E.

[353] *N Luxembourg 1* (C-115/16 et al.), *supra* n. 1, para. 89.

[354] *Ibid.*

[355] Bundesgericht/Tribunal fédéral, judgments 2C_880/2018, *supra* n. 315 and 2C_209/2017, *supra* n. 312.

[356] *See* R. J. Danon, *Intellectual Property (IP) Income and Tax Treaty Abuse: Relevance of BEPS Actions 5 and 8–10 for the Principal Purpose Test,* in *Taxation of Intellectual Property Under Domestic Law, EU Law and Tax Treaties* at 31–32 (G. Maisto ed., IBFD 2018).

[357] OECD Model (2017): Commentary on Art. 29, para. 187, Examples A and C.

[358] *Indofood*, *supra* n. 290, 8 ITLR 653. *Also see* HMRC, INTM332050, para. 5: '*Where both the intermediate and the underlying lender are resident in states with which the UK has essentially similar DTCs, no issue is likely to arise, even where the intermediate lender is not, under the so-called "international fiscal meaning" of the phrase, the beneficial owner of the interest, as there would be no fiscal evasion or avoidance. This is because in these circumstances it is unlikely that the effect of the arrangement is the avoidance of UK withholding tax, since the level of UK withholding tax would have been the same with or without the intermediate lending*'.

[359] Bundesgericht/Tribunal fédéral, judgment 2C_880/2018, *supra* n. 315, para. 4.5.2.

therefore whether the Federal Supreme Court would then be prepared to push the analogy with this conduit arrangement clause further and build a '*purpose test*' into beneficial ownership and switch off the application of this limitation when there is no actual increase in tax treaty benefits (absence of abuse).[360] However, this has not been the position of Swiss case law to date. In any event, the problem with this solution is that it is difficult to reconcile with the proper meaning of beneficial ownership, pursuant to Article 31 VCLT, which does not include a subjective (principal purpose) test. The same conclusion could also be drawn under Article 1(4) of the IRD. The second approach would be to give beneficial ownership a very restrictive meaning (in the sense that this limitation would practically only apply to pure agents and nominees) and to reserve a broad and purposive meaning of this term whenever the PPT is triggered. This second approach, however, would be difficult to reconcile with the OECD commentaries which, even after 2014, continue to refer to conduit companies. Further, even if beneficial ownership is understood from a legal perspective, it is difficult to dispute that an implied obligation to pass on the income (legal substance) would have to be taken into account. Ultimately, therefore, legal and economic substance may not be so far apart. Moreover, this line of reasoning seems difficult to put in place under the IRD in light of the clear economic interpretation given by the ECJ to the beneficial ownership limitation. The third option, in our view the most promising one, would be to remove the beneficial ownership requirement both in the OECD MC and in the IRD and to consider that conduit cases are to be dealt with exclusively pursuant to the prohibition of abuse of rights.[361] At the same time, however, it is appreciated that this third option may prove to be difficult to achieve in practice in light particularly of the number of DTCs currently in force and containing a beneficial ownership limitation.

4 Concluding remarks

The judgments of the ECJ in the Danish cases undoubtedly represent an important milestone with respect to the prohibition of abuse of rights not only in European but also in international tax practice. In light of the increased convergence between the EU principle of abuse of rights and OECD standards (in particular the PPT), there is little doubt that the indicators of abuse provided by the ECJ in conduit situations involving dividends, interest, and royalties will also have ramifications in post-BEPS treaty practice. In a sense, the findings of the ECJ in the Danish cases may be seen as the European contribution to the internationally accepted notion of a GAAR. This concept, which has now been codified in direct tax directives (notably in the PSD and the ATAD) and in DTCs through the PPT, incorporates two cumulative requirements: a subjective (intention to artificially obtain an advantage) and an objective element (causing the purpose of the applicable rule to be defeated). Such an internationally accepted GAAR also includes two additional features. First, and although we recognize that the findings of the ECJ in the Danish cases were confusing on this point, the application of a GAAR requires the existence of an advantage or, if preferred, a tax benefit. Secondly, the application of a GAAR implies that the transaction at stake must be redefined so that benefits that would have been applicable in the absence of abuse remain available. The ECJ did not deal with this latter issue in the Danish cases. However, it is quite clear that this principle which was affirmed by the ECJ on numerous occasions and flows from the EU principle of proportionality remains applicable in the framework of direct tax directives.

This contribution has attempted to show that the Danish cases and their possible wider impact on future tax treaty practice may only be properly understood if it is borne in mind that the subjective and objective elements of the abuse of rights test must always be considered separately and, therefore, cannot be merged into one. In other words, it is one thing to establish that the principal purpose (or one of the principal purposes) of a corporate structure is to obtain a tax benefit. The question of whether such a structure defeats the object and purpose of the provisions of a directive or a DTC is another and separate one. Of course, there are the obvious cases in which the two prongs of the abuse test are automatically satisfied (wholly artificial, sham, circular, or round-tripping arrangements). The distinction matters when it comes to '*real*' business structures. On this point, we have shown that there are limits to what a GAAR may accomplish. In particular and in the context of the current debate on '*substance requirements*', we find it important to bear in mind that a GAAR cannot, by essence, elevate the requirements to access a directive or a DTC. In our view, therefore, what the ECJ held in *Deister* remains valid after the Danish cases: '*it should be noted that the Parent-Subsidiary Directive does not contain any requirement as to the nature of the economic activity of companies falling within its*

Notes

[360] The conduit arrangement clause only applies when the person to whom the income is passed on: '*would not be entitled under a convention for the avoidance of double taxation between the State in which that other person is resident and the Contracting State in which the income arises, or otherwise, to benefits with respect to that item of income which are equivalent to, or more favourable than, those available under this Convention to a resident of a Contracting State and the main purpose of such structuring is obtaining benefits under this Convention*'.

[361] *See* Martín Jiménez, *supra* n. 269. As argued there, deleting the beneficial ownership requirement does not, of course, mean that the narrow requirement that income be allocated to a taxpayer should not apply.

scope or the amount of turnover resulting from those companies' own economic activity'.[362] This conclusion mirrors that of the Canadian Federal Court of Appeal in *Alta Energy* in a treaty context: '*there is no distinction in the Luxembourg Convention between residents with strong economic or commercial ties and those with weak or no commercial or economic ties*'.[363] Therefore, according to the Court, '*While the GAAR can change the tax consequences from what they would otherwise be, the GAAR cannot be used, in this case, to justify adding a requirement for investment that is not present in the Luxembourg Convention*'.[364]

Finally, the Danish cases have also fueled the controversy surrounding the application of the beneficial ownership limitation. To begin with, it remains unclear whether the findings of the ECJ in the PSD cases should be read to mean that beneficial ownership represents an implicit requirement that would apply separately from the abuse of rights. While some national courts have read the findings of the ECJ in such a way (France), others have left the question open (Switzerland). An equally controversial question is the level of convergence between the meaning of beneficial ownership favoured by the ECJ in the IRD cases and under the 2014 OECD Commentary. The ECJ indeed found that the beneficial owner is the '*entity which benefits economically from the interest received and accordingly has the power freely to determine the use to which it is put*'.[365] The question is then whether this definition coincides with that of the OECD commentaries that exclude beneficial ownership when the recipient is under an obligation to pass on the income which '*may also be found to exist on the basis of facts and circumstances showing that, in substance, the recipient clearly does not have the right to use and enjoy the dividend unconstrained by a contractual or legal obligation to pass on the payment received to another person*'.[366] As discussed, recent tax treaty case law (in particular in Switzerland and Italy) evidences that the two interpretations should ordinarily not be so far apart. This being said, the interaction between the beneficial ownership limitation and the notion of abuse of rights remains problematic. As shown, there could indeed be instances in which the beneficial ownership limitation and the principle of abuse of rights may produce conflicting results. Such may particularly be the case when the recipient is subject to a contractual obligation (or an obligation derived from the facts) to pass on the income but that the arrangement put in place is not abusive. For these reasons, we have found that a more coherent approach from a policy perspective would be to deal with the conduit problem exclusively through the principle of abuse of rights.

Notes

[362] *Deister* (C-504/16), *supra* n. 37, para. 72.

[363] CA: Federal Court of Appeal, *Alta Energy Luxembourg SARL v. R,* 2020 FCA 43, 22 ITLR 509, para. 65.

[364] *Ibid.*, para. 46.

[365] *N Luxembourg 1* (C-115/16 et al.), *supra* n. 1, para. 88.

[366] OECD Model (2017): Commentary on Art. 10, para. 12.4.