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The New *De Minimis* Anti-abuse Rule in the Parent-Subsidiary Directive: Validating EU Tax Competition and Corporate Tax Avoidance?

Romero J.S. Tavares & Bret N. Bogenschneider*

In this study, the authors propose that the 2014 amendment to the EU Parent-Subsidiary Directive (which introduces a new minimum 'anti-abuse' rule) effectively sets a standard definition of abuse under EU law that would only curb 'wholly artificial arrangements' and likely fosters tax avoidance, in spite of the express intent of the Directive to allow Member States to adopt stricter norms. The study explores hypothetical fact patterns to illustrate multiple instances of seemingly abusive or artificial structures, or functionally thin interposed entities, that could be deemed valid under the terms of the amended directive by one state and trigger disproportionate tax relief in other states irrespective of their national tax policies, thus fostering tax competition and base erosion within Europe, particularly in fact patterns wherein third-country capital is (re)invested in the EU/EEA. Furthermore, this study discusses whether fundamental principles of primary EU law would systematically and coherently condone such result.

I INTRODUCTION

The Council of the European Union ('EU Council') recently announced an amendment to the EU Parent-Subsidiary directive (2011/96/EU) to provide for a '*de minimis*' (i.e., minimum) anti-abuse rule to be enacted in each of the Member States.¹ Such minimum anti-abuse rule is intended to deny the benefits of the Parent-Subsidiary Directive to any 'arrangement' that is effected with the 'main purpose' of obtaining a tax advantage which 'defeats the purpose of the directive', and is not 'genuine' with regard to all the relevant facts and circumstances. The Parent-Subsidiary Directive currently applies to corporate entities and permanent establishments,² but not to individual shareholders.³ The amendment version of Article 1, paragraph 2 provides as follows:

Member States shall not grant the benefits of this Directive to an arrangement or series of arrangements that, having been put into place for the main purpose or one of the main purposes of obtaining a tax advantage which 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.*⁴

Therefore, under the new rule, Member States are expressly allowed to subject to withholding taxes 'dividends' paid within the EU in fact patterns that are deemed to fall within the definition of 'abuse' purported in the new rule. Similarly, no relief from economic double taxation would be available at the recipient State.

The standards of the Directive, however, set the bar at a very low level – i.e., fact patterns that are quite thin in terms of legal or economic substance, or even artificial, would not likely qualify as abusive under the new rule and would therefore be legitimized under EU Law. The effectiveness of this rule may be rather limited not only in light of its own wording and by its own making – the potential interpretation of the new rule under *sui generis* principles enshrined in primary EU Law can turn the minimum rule into an EU standard, and level the playing field where artificiality in EU tax avoidance would be expressly validated. That is, anti-abuse standards that are

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¹ Council Directive 16435/14 amending Council Directive 2011/96/EU of 30 Nov. 2011 on the Common System of Taxation Applicable in Case of Parent Companies and Subsidiaries of Different Member States, Annex I, 2011 O.J. (L345) 8 (hereafter, the 'Amended Directive').

² ECJ 28 Jan. 1986, 270/83, *Commission v. France* ('Avoir Fiscal') [1986] ECR 273; ECJ 21 Sep. 1999, C-307/97, *Saint-Gobain* [1999] ECR I-6161.

³ Amended Directive at Arts 2, 3 Subjective Scope: Definition of 'Company of a Member State'; See also, Michael Tumpel, *Legislative Action and Cross-Border Dividends*, 62 Tax L. Rev. 77 (2008).

⁴ Amended Directive at Art. 2(2).

stricter than the aforementioned rule could be viewed as potential infringements to primary EU Law, as it can be expected that ‘negative integration’ would exert a major role in the application of this new rule.

The fact patterns that are most disconcerting are those that combine the aggressive practices of ‘directive shopping’ and ‘treaty shopping’, which one would reasonably expect EU tax policy to address and to restrain. The new rule apparently does neither.

Suppose a multinational enterprise (MNE) headquartered in a third country establishes an intermediary holding company in Europe which would itself own permanent establishments and control legal entities in multiple countries throughout the European Union and the European Economic Area (‘EEA’ of 1994 and its predecessor the European Free Trade Area ‘EFTA’ of 1960). Suppose dividends paid out of most if not all of such countries would, absent the application of the Parent-Subsidiary Directive, be subject to withholding taxes, be it under existing bilateral treaties or under domestic law when tax treaties are not available. The relevance of a new anti-abuse rule under the Parent-Subsidiary Directive would be to prevent the use of artificial schemes that extend the application of the Directive to arrangements in which the legal and/or economic substance attributed to such intermediary holding entity would not be sufficiently robust to entitle such intermediary to the benefits of the Directive. The introduction of any such rule would be challenging in light of primary EU law, as it is postulated herein. The introduction of the rule as it stands, however, condones the use of functionally thin intermediary entities and holding companies, further reinforcing tax competition within the EU, and permitting the avoidance of withholding taxes (and corporate tax relief) in arrangements that if not ‘wholly artificial’ would still seem rather abusive.

Of note, the European Union applies a ‘subsidiarity rule’ meaning the taxing powers are reserved to the individual Member States except in very limited circumstances where the common interest applies such as the development of a common market, with a notorious exception being the harmonization of value-added tax (VAT). That is, the sovereign power to establish the tax base and the tax rate remains with each Member State. Member States, however, must legislate and enforce their tax jurisdiction and sovereignty consistently with (‘primary’) EU Law, and thus design and enforce

tax-triggering events in a manner that is compatible with community law. Such ‘primary’ law is embodied in the Treaty of Rome of 1958, as amended first by the Treaty of Maastricht of 1993 and ultimately reformed by the Treaty of Lisbon or ‘Treaty on the Functioning of the European Union’ (TFEU) which was signed in 2007 and entered into force in 2009. The ‘supremacy’ of EU Law as a *sui generis* form of Public International Law (which thus truly resembles Constitutional Law) was not expressly stated in the Treaty of Rome; nonetheless it was clearly enforced in the rulings of the European Court of Justice (ECJ),⁵ whilst the Treaty of Lisbon expressly warrants the direct applicability of EU Law within Member States.

In this sense, the EU Parliament and the EU Council can be viewed as the ‘legislative branch of the EU’, whereas the power to initiate legislation is reserved to the EU Commission.⁶ The Council, however, acts only by unanimous consent,⁷ which makes the political dynamics of EU legislative development quite complex and unique. The internal market is created and integration is primarily achieved through the ‘free movement of people, goods, services, capital and payments’ (henceforth referred to as the ‘Fundamental Freedoms’), fostered through the direct acts of the EU Council and EU Commission (‘positive integration’), which are particularly effected via the EU Directives, referred to as ‘secondary law’. Infringements to EU Law can only be ascertained by the ECJ, whose rulings foster integration through jurisprudential remedy that enables the enforcement of EU Law (‘negative integration’), and in particular of the broader and overriding fundamental principles of primary law.

Here, the EU Commission circulated a proposal 25 November 2013, indicating a goal to amend the Parent-Subsidiary Directive to apply a specific rule against hybrid entity mismatch, and a general anti-abuse rule.⁸ As noted, in general, the Parent-Subsidiary Directive operates as an exemption on withholding tax on dividends in the state of the subsidiary and applies to prevent the double economic taxation of intra-EU dividends. The Member State of the parent company has the option of using an exemption method on the inbound dividend or applying the credit method for the underlying corporate tax paid by the distributing corporation.⁹

The coordination of ‘national tax prerogatives’ of each Member State with the implementation of tax policies for the ‘European internal market’ has been the source of

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⁵ ECJ 5 Feb. 1963, 26/62, *Van Gend en Loos* [1963]; ECJ 15 Jul. 1964, 6/64, *Costa v. E.N.E.L.* [1964] ECR 585; ECJ 28 Jan. 1986, *Commission v. France* (‘*Avoir Fiscal*’) [1986] ECR 273.

⁶ Łikasz Adamczyk, *The Sources of EU Law Relevant for Direct Taxation* (Lang, Pistone, Schuh & Staringer, eds., 3d edn Linde 2014).

⁷ Consolidated Version of the Treaty Establishing the European Community, 29 Dec. 2006, Art. 93, 2006 O.J. (C 321E) 37.

⁸ 16918/13 FISC 237 – COM(2013) 814.

⁹ Mario Tenore, *The Parent Subsidiary Directive*, in *European Tax Law on Direct Taxation* (Lang, Pistone, Schuh & Staringer, eds. Linde 3rd edn, 2014); *See also*, Tumpel (2008) at 78.

much debate.¹⁰ With the issuance of the Amended Directive, the Member States are thereby directed by the EU Council to bring into force the laws, regulations as well as administrative provisions and practices necessary to comply with such Amended Directive at the latest by 31 December 2015. Thus, each of the Member States have approximately one year to design and implement a minimum anti-abuse rule sufficient to comply with the mandate.

The language of the amended directive contemplates several different elements in determining whether any arrangement is 'abusive'. The differing elements appear to be a comprehensive statement of an anti-abuse rule. Nonetheless, such elements are stated in the conjunctive, indicating that all of the factors must be met in order for the anti-abuse rule to apply: (i) a 'main purpose' must be to obtain a tax advantage; (ii) the arrangement must 'defeat the purpose of the directive'; (iii) the arrangement must be non-'genuine' meaning lacking economic substance or lacking business purpose. In addition, the 'step-transaction' doctrine may apply under item (iv), based on all the facts and circumstances. Each of these elements are discussed in further detail below.

The Amended Directive also specifically provides that it shall not interfere with other domestic laws or treaties: 'This Directive shall not preclude the application of domestic or agreement-based provisions required for the prevention of tax evasion, tax fraud or abuse.'¹¹ Thus, the minimum anti-abuse rule standard set forth in the Amended Directive is not intended to interfere with any more stringent anti-abuse rule that may already be in force in any Member State, or any tax treaty among the Member States which denies treaty benefits to abusive or fraudulent transactions. Thus, it is intended that tax treaty provisions between or among the Member States which contain a treaty anti-abuse provision are not overridden by the terms of the Amended Directive.¹² However, if an arrangement is not classified as 'abusive' under the minimum standards of the directive, yet, if it is deemed 'abusive' under the domestic laws of Member States, one can assume that primary EU law would be invoked for the ECJ to ascertain whether a more stringent rule would be an infringement of Fundamental Freedoms (as discussed hereunder), in which case it is expected that several arrangements and fact patterns that could be viewed as artificial might ultimately be deemed valid under EU Law.

Additionally, it should be noted that the countries that remain as members of the EEA and that, as such, have not relinquished their political rights to join the European Union (namely, Norway, Iceland, Liechtenstein, and Switzerland), are also bound to the creation of the internal market, and are thus subject to the terms of TFEU as it pertains to economic integration. Accordingly, the elimination of juridical and economic double taxation as prescribed in the EU Parent-Subsidiary Directive, is also extended to such EEA countries, which further exacerbates potential tax avoidance schemes (given that Switzerland and Liechtenstein have historically operated under low-tax and often opaque tax regimes).

2 TARGETED ABUSIVE STRUCTURE

The new anti-abuse rule in the amended directive appears to be designed to counter what is commonly referred to as 'directive shopping' within EU Member states, which is done in combination with 'treaty shopping' between one EU Member State and the home country of the parent multinational company. Perhaps notably, Pistone (2008) predicted the potential for abuse by the channelling of investment by non-EU taxpayers through intermediary companies.

Although one may argue that Member States in principle are free to go beyond the requirements of secondary Community law and impose on themselves more significant limitations on their national tax sovereignty, I submit that unilateral extension of the Parent-Subsidiary Directive may have a significant impact on other Member States' relations with third countries because non-EU taxpayers may channel their investments through intermediate companies located in Member States granting unilateral benefits. Thus, Member States not conferring unilateral benefits on third countries may lose third country investment.¹³

Such 'directive shopping' typically takes the form of the interposition of a holding company within an EU Member State (which is often Luxembourg or another low-tax jurisdiction that offers a favourable treaty with the home country of the parent company) above another EU subsidiary or permanent establishment within the legal

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¹⁰ Pasquale Pistone, *Taxation of Cross-Border Dividends in Europe: Building up Worldwide Tax Consistency*, 62 TAX L. REV. 67 (2008).

¹¹ Amended Directive at Art. 2(4).

¹² See generally, Michael Lang, *BEPS Action 6: Introducing an Antiabuse Rule in Tax Treaties*, 74 Tax Notes Int'l 7 (19 May 2014) at 655.

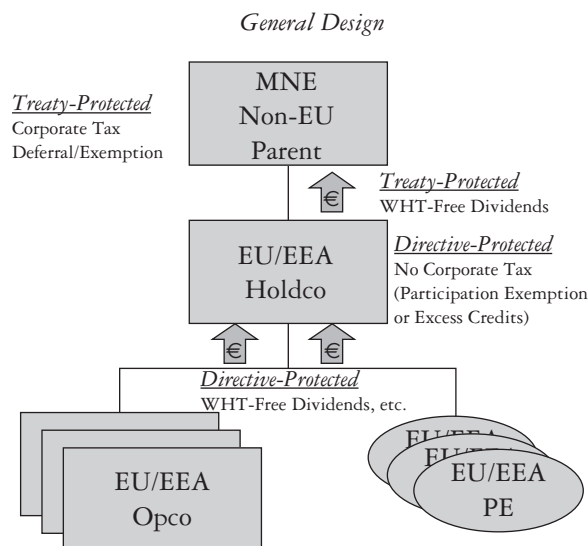
¹³ Pistone (2008) at 75.

entity structure.¹⁴ Notably, the abusive structure targeted by the Commission does not appear to be that of a mere permanent establishment in the role of such interposed EU holding, as Article 2(b) previously included a ‘subject-to-tax’ clause, similar to that observed in Article 3(a)(iii) of the Interest and Royalty Directive.¹⁵ It is arguable that such clause would further limit the tax avoidance strategies applied under the Parent-Subsidiary Directive,¹⁶ even though an exceedingly low rate of tax (if not tantamount to ‘state aid’ as per Article 107(1) of the TFEU) could satisfy such subject-to-tax threshold and still enable seemingly artificial arrangements.

The level of substance and the business purpose that can be observed in such intermediary holding arrangements can vary immensely, and therein resides the question of whether all arrangements that can be viewed as ‘artificial’ (i.e., lacking legal substance and/or lacking economic substance) would or should be qualified as ‘abusive’ under EU law.

The typical ‘directive shopping’ legal entity structures are presented below:

2.1 Illustration of ‘Treaty/Directive Shopping’ Legal Entity Structure



To better illustrate varying depths of substance in the general design above, consider the following hypothetical scenarios:

- Scenario 1: EU/EEA Holdco receives the shares of all EU/EEA Opcos via in-kind capital contribution, does not have any employees or exerts any functions or activities, does not occupy any physical space, and all dividends received from EU/EEA Opcos are immediately repaid to the Non-EU Parent (whilst there exists a legal obligation to repay all funds received as prescribed in arrangements that include the financial institutions which execute such cash transfers as agents of EU/EEA Holdco).
- Scenario 2: EU/EEA Holdco receives the shares of all EU/EEA Opcos via in-kind capital contribution and does not have any employees; however, it maintains a ‘board of directors’ that meets online every calendar-quarter and includes treasury managers from all EU Opcos. The ‘board’ nonetheless also includes (and is controlled by) treasury managers of the Non-EU Parent. Still, such ‘board’ formally approves the redeployment of funds across EU Opcos and/or the investment of such funds in financial market portfolios within the EU/EEA. All financial transactions, remittances, investments, and payments, are executed by agents (financial institutions) acting on behalf of the EU/EEA Holdco.
- Scenario 3: EU/EEA Holdco receives cash as direct investments in the form of capital contributions from its Non-EU Parent, and further contributes such cash to the capital of underlying EU/EEA Opcos. It has few employees that are not empowered to make decisions regarding the management of the funds, yet that facilitate banking operations and execute cash transfers without the use of financial institutions as ‘agents’. Such employees perform their activities under the direction of the members of the same ‘board of directors’ referred in Scenario 2 above. Again, such ‘board’ formally controls and approves the redeployment of funds or portfolio investments within the EU/EEA.
- Scenario 4: EU/EEA Holdco receives cash or shares of EU/EEA Opcos as capital contributions from its Non-EU Parent. It employs all treasury managers with decision-making authority in the EU/EEA and maintains a relevant physical infrastructure, commensurate with the treasury function it performs for the entire European group of operating companies, and it includes in its ‘board of directors’ all general managers of the EU/EEA Opcos, which legally control

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¹⁴ See, James Lasry, Peter Young & Anthony Jimenez, *Gib boom*, The Lawyer (18 Jul. 2011) (‘Consideration must be given to whether investments are made directly from Gibraltar or through another jurisdiction. A locally incorporated holding company can expect to obtain, at least from certain jurisdictions such as Luxembourg, the benefit of the EU’s Parent Subsidiary Directive and its Interest and Royalties Directive, which together eliminate many withholding taxes on returns from overseas European investments. Since the parent fund and the general partner directors would be Gibraltar-based, this makes it easier to establish substance in Gibraltar. Gibraltar has a wealth of EIF-licensed directors who specialise in differing sectors of industry and commerce, with experience gained in Gibraltar, the UK and elsewhere.’).

¹⁵ EU Interest and Royalty Directive of 1 Jan. 2004.

¹⁶ Amended Directive at Art. 2(b).

the decisions of the board and of all European operations.

In all scenarios above, whenever any dividends are paid from the EU subsidiary to the EU holding company, the Parent-Subsidiary directive is intended to apply, whilst further dividend repayments to the multinational home country would be exempt under the treaty or subject to a reduced rate of withholding not otherwise available if the Non-EU Parent invested directly in all EU/EEA Opcos.¹⁷ It seems apparent that Scenario 1 should be interpreted as ‘wholly artificial’ both from a legal substance perspective (i.e., as it can be argued that the interposed entity would not be a beneficial owner of the shares of the EU/EEA Opcos and not be minimally functional as an autonomous legal entity), as well as from an economic perspective (i.e., the interposed entity would not be an economic investor in the EU/EEA or a beneficial owner of the dividend payments received, and would not perform any function or activity commensurate with the income it would record); as such, Scenario 1 would be deemed ‘abusive’ under the new rule, and one would expect it to be deemed invalid, ineffective, or illegitimate under the laws of many Member States even prior to the proposed amendment to the Directive. Conversely, it seems apparent that Scenario 4 would be deemed substantive from a legal and economic perspective, and hence not abusive, both under the new standard of the Parent-Subsidiary Directive, as well as under the domestic laws of Member States (even though managerially and organizationally all decision-making in Europe might be subject to the direction and/or control of the Non-EU Parent).

The lingering concern, however, lies in the continuum of all scenarios that are situated between the two marginal cases. In our Scenario 2, for example, it would seem that the intermediary holding company would not be the ‘beneficial owner’ of shares received from the parent or dividends received from the operating entities. Nonetheless, it is an arrangement (or a vehicle) that is used to facilitate the re-investment of dividends across multiple countries of the EU/EEA, in such a manner that EU/EEA earnings are effectively ‘retained’ and not repatriated to the Non-EU Parent. In the more substantive (albeit still arguably artificial) Scenario 3, one might interpret that the intermediary holding company would instead be the ‘beneficial owner’ of shares and dividends (which is not entirely a given); nonetheless, the entity would be used a vehicle not only to facilitate reinvestment of earnings within the EU/EEA but also to channel foreign direct investments in cash into the EU/EEA – and it would have a few employees to make it minimally

functional as a legal entity (i.e., not relying on third-party agents to perform its activities), albeit under the managerial control of the Non-EU Parent. Yet, the substance and functionality evidenced in Scenario 3 would not be commensurate with the dividend income received by such intermediary holding company.

It would seem that Scenarios 2 and 3, even though ‘artificial’, would not be deemed ‘abusive’ under the terms and standards of the new rule, as we posit below. That being the case, this secondary EU Law that effects ‘positive integration’ would position such artificial arrangements as minimally acceptable in light of primary EU Law, and reinforce their stance under a systematic interpretation of EU Fundamental Freedoms as we further discuss below. Accordingly, if the country of residence of the intermediary holding company illustrated in Scenarios 2 or 3 above adopts such minimum standard and regards the existence of such entity as legitimate, compatible with EU Law, and not abusive (thereby applying the Directive to the receipt of dividends, providing relief from economic double taxation via the exemption or credit method), an inconsistent view of the stance of such holding company by the source states under which would deem it ‘abusive’ and hence subject intra-EU dividends to withholding taxation would certainly be challenged.

As discussed hereunder, Articles 63 et seq. of the TFEU on the *free movement of capital* would be invoked in all scenarios that involve investment or re-investment of funds into the EU/EEA (as this is the only freedom that also shelters situations involving third states) – and, moreover, in scenarios where the interposed entity is minimally functional, with employees and autonomous activities (i.e., no reliance on third party fiduciary agents) such challenge would also invoke Article 49 et seq. of the TFEU on the *freedom of establishment*, irrespective of whether such minimum economic substance and activities are commensurate with the benefits granted by the Parent-Subsidiary Directive.

3 DESIGN OF THE ANTI-ABUSE RULE IN THE EU PARENT-SUBSIDIARY DIRECTIVE

The Amended Directive contemplates in tax parlance a general anti-abuse rule (GAAR). The implementing language also specifically refers to a ‘genuine’ arrangement based on ‘economic reality’. Thus, the Amended Directive applies the anti-abuse principle *with* an ‘economic substance’ component making this particular GAAR a new species of anti-abuse rule within the tax world. There are several other known species of GAAR’s found in

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¹⁷ See generally: European Commission Memo/13/1040 (‘Why has the Commission proposed to amend it? While the Parent-Subsidiary Directive’s purpose is to avoid companies from suffering from double taxation on the Single Market, there are many cases where it is being abused by companies to avoid paying taxes in any Member State. The Commission therefore wants to close loopholes being used for a particular tax planning arrangement (hybrid loan arrangements) and to introduce a general anti-abuse rule [so] the Directive is not exploited by tax avoiders.’).

various statutory habitats worldwide. In comparison, the British GAAR is designed as a 'principles-based' GAAR and is therefore a lengthy statement of how the rule is intended to apply.¹⁸ The US version of a GAAR is a codified 'economic substance' doctrine.¹⁹ In general, the codified 'economic substance' doctrine is not considered a classic-'GAAR' as it can be viewed as self-limiting, whereas a true GAAR has a broader open-ended application typically rendering it more effective in the sense that the broader the terms, the greater the authority granted to the judicial authorities to interpret it, and the greater the insecurity introduced to situations that are unclear (i.e., the less room for manoeuvring and aggressive tax avoidance in light of greater uncertainty). Freedman (2014) understands, however, that a GAAR will not necessarily increase uncertainty, yet 'whether it does so depends on how much certainty exists in the relevant jurisdiction without a GAAR' and in fact a GAAR may even increase certainty²⁰ – for better or worse.

Here, the anti-abuse rule formulated by the EU Council may be described as a hybrid-GAAR because the fundamental basis for its application is 'economic substance' or 'reality' along with a statement of 'definitions' which frame the rule making it more specific and less general, and which effectively equate to guidelines. As explained by Freedman (2010, 2014), the GAAR should relate back to the underlying law²¹ – and in fact, would only operate properly if such underlying law is carefully drafted by policymakers with clearly stated 'principles' against which the alleged abuse would be tested. As discussed more fully below, the broad 'principles' that can be derived from EU primary law should systematically and coherently accommodate the interpretation of the 'definitions' introduced by the Amended Directive; as a result, such definitions will most likely increase certainty yet be used in artificial tax

avoidance structures that, albeit not 'wholly' artificial do seem to defeat the spirit of any such GAAR.

In addition to its characterization as a hybrid-GAAR, the Amended Directive also includes a provision against step-transaction tax avoidance planning. The Amended Directive provides in its pertinent part: 'For purposes of paragraph 2, an arrangement or series of arrangements shall be regarded as not genuine to the extent that they are not put into place for valid commercial reasons which reflect economic reality.'²² A provision implementing a step-transaction principle was also incorporated into the British GAAR enacted in 2013, and the US economic substance doctrine by IRS announcement during 2014.²³ Although Member States are required to enact domestic legislation to implement the directive that might take any form, the Amended Directive includes a similar non-override provision. The original version provided: 'This Directive shall not preclude the application of domestic or agreement-based provisions required for the prevention of fraud or abuse.'²⁴ However, the Amended Directive provides in slightly different wording: '...required for the prevention of tax evasion, tax fraud or abuse.'²⁵ Thus, the words 'tax evasion' and 'tax fraud' were added into the subsequent version, and used in the same context as 'abuse', also framing the interpretation of the new rule in a conceptually narrower manner.

3.1 A Comparison to the Council Directive on Hybrid-Entity Mismatches (i.e., a Specific Anti-abuse Rule, or 'SAAR')

The EU Council proceeded in a parallel fashion with regard to the recent amendments to the Parent-Subsidiary Directive with regard to hybrid loan mismatches.²⁶ The hybrid loan mismatch represents a familiar form of

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¹⁸ UK GAAR: s. 204(2)-(6) FB 2013 (2) ('Tax arrangements are "abusive" if they are arrangements the entering into or carrying out of which cannot reasonably be regarded as a reasonable course of action in relation to the relevant tax provisions, having regard to all the circumstances including – 18: (a) whether the substantive results of the arrangements are consistent with any principles on which those provisions are based (whether express or implied) and the policy objectives of those provisions, (b) whether the means of achieving those results involves one or more contrived or abnormal steps, and (c) whether the arrangements are intended to exploit any shortcomings in those provisions.').

¹⁹ US Economic Substance Doctrine: IRC §7701(o) Clarification of economic substance doctrine (1) Application of doctrine. In the case of any transaction to which the economic substance doctrine is relevant, such transaction shall be treated as having economic substance only if – (A) the transaction changes in a meaningful way (apart from Federal income tax effects) the taxpayer's economic position, and (B) the taxpayer has a substantial purpose (apart from Federal income tax effects) for entering into such transaction.... For purposes of paragraph (1)(B), achieving a financial accounting benefit shall not be taken into account as a purpose for entering into a transaction if the origin of such financial accounting benefit is a reduction of Federal income tax... (D) Transaction The term 'transaction' includes a series of transactions.).

²⁰ Judith Freeman, *Designing a General Anti-Abuse Rule: Striking a Balance* [2014] 20 (3) Asia-Pacific Tax Bulletin 167 (International Bureau of Fiscal Documentation), Oxford Legal Studies Research Paper No. 53/2014.

²¹ See: Judith Freedman, *Defining Taxpayer Responsibility: In Support of a General Anti-Avoidance Principle*, [2004] B.T.R. 332, 343; Judith Freedman, *Improving (not perfecting) Tax Legislation: Rules and Principles Revisited*, [2010] B.T.R. 718, 728 ('One of the major issues to be resolved with any general anti-avoidance provision, be it a rule or principle, is its relationship with the underlying law. That relationship would be made much easier if all the specific legislation were to be [principles-based legislation] and indeed one might not need a [GAAR] if all underlying legislation was drafted in a principles-based way, but since this is unlikely to occur for some time there is a case for this special kind of overarching [GAAR] for the time being.'). C. Latham, *A Tax Perspective on the Infrastructure of Regulatory Language and a Principled Response*, [2012] B.T.R. 65.

²² Amended Directive at Art. 2(3).

²³ IRS Notice 2014-58 (clarifying the definition of 'transaction' under the codified economic substance doctrine as a combined series of steps).

²⁴ Council Directive 2011/96/EU.

²⁵ Amended Directive at Art. 2(4).

²⁶ EU Council 11647/14 (8 Jul. 2014).

multinational tax planning where a hybrid instrument is used to create a payment which is treated as tax deductible interest in the payor EU Member State, but tax exempt profit distributions in the other recipient EU Member State.²⁷ Accordingly, in addition to the anti-abuse rule in the Amended Directive, a more specific amendment was also implemented relating specifically to such hybrid loan mismatches used as tax avoidance planning by multinationals. As such, the amendment in this regard is much more specific than the separate generalized GAAR. The SAAR as applied to hybrid-entity mismatches is more likely to have a deterrent effect on multinational tax planning to which it was directed.²⁸

Pistone (2008) also pointed out some time ago that some EU Member States do not extend the Parent-Subsidiary Directive to third-country situations which appears to be the primary source of abuse. Pistone (2008) explains as follows: ‘This conclusion likewise would apply to the national regimes of an EU Member State that formally do not extend the Parent-Subsidiary Directive to third country situations, but achieve equivalent results under domestic law.’²⁹ Therefore, one is left to wonder whether the EU Council does intend to curb the use of intermediary EU holding companies and, thus, to limit the application of benefits of the EU Parent-Subsidiary directive to non-EU taxpayers in situations other than ‘wholly artificial’ arrangements, and whether the economic policy is to foster integration through a veiled ‘most favoured nation’ approach to capital investment by third countries (i.e., wherein the most favourable tax treaty available to such third country would determine the ‘port-of-entry’ of capital into the EU/EEA which would from thereon function not only as a ‘single market’ but as a ‘single jurisdiction for capital’). If the aim is to curb wholly artificial arrangements only, a more explicit SAAR would be a more efficient and equally effective approach – perhaps a SAAR which includes a ‘beneficial ownership’ requirement would be a consistent solution, particularly as this standard is adopted under Article 1(4) et seq. of the Interest and Royalty Directive.³⁰

If, instead, the aim is to curb artificial transactions and directive shopping, and to preserve the tax jurisdiction and sovereignty of source states, the positive integration standard set under secondary law should be a stricter rule, wherein the benefits of the Parent-Subsidiary Directive

would have to be commensurate not only with the legal substance but with the functions and activities performed by the EU interposed ‘Parent’. In this sense, the benefits of the Parent-Subsidiary Directive would have to be ascertained in accordance with a refined arm’s length principle, wherein ‘excessive dividends’ (disproportionate in light of the economic value of the functions attributed to the interposed Parent) would not be sheltered by the rule.

3.2 Potential Harmful Effects of the New Anti-Abuse Rule: A Roadmap to EU Tax Avoidance

There are several potential harmful side-effects from the issuance of the anti-abuse rule in the form of a hybrid-GAAR, including an effective override of bilateral tax treaties executed by Member States within their sovereign tax jurisdiction, in respect to the withholding taxation of dividends owed to third-country beneficiaries. In general, the inclusion of broad platitudes in the form of guidelines in the anti-abuse rule allows interpreters to build structures designed to meet one or more of the anti-abuse thresholds. Many tax experts and commentators thus argue against such statements in a GAAR, as the reverse practical effect can occur that such statements are used in tax avoidance planning.³¹

Here, at least three possibilities are raised for future tax avoidance planning based on the specific language of the Amended Directive. The reference to the ‘main purpose’ or ‘one of the main purposes’ is particularly troubling to tax practitioners familiar with the US economic substance doctrine where cases grapple with the issue of whether or when avoidance of foreign or state tax constitutes ‘tax avoidance’ for legal purposes, and so forth.³² Furthermore, the doctrine of the ability to structure one’s affairs to minimize taxes is well-established under European law.³³ It is not at all clear how the Duke of Westminster doctrine would interact with the ‘main purpose’ test set forth in the Amended Directive. In this sense, if capital is invested or dividends re-invested, at values that dwarf the amount of the withholding tax savings, and if a ‘cash pooling’ arrangement is implemented through the structure (be it through the activities of a fiduciary agent, or through the

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²⁷ European Commission Memo/13/1040, *supra* n. 17.

²⁸ See: Yariv Brauner, *What the BEPS?* 16 Fla. Tax Rev. 55 (2014).

²⁹ Pistone (2008) at 75.

³⁰ EU Interest and Royalty Directive of 1 Jan. 2004.

³¹ See generally: OECD Comments, *BEPS Action 6: Preventing the Granting of Treaty Benefits in Inappropriate Circumstances* available at <http://www.oecd.org/tax/treaties/comments-action-6-prevent-treaty-abuse.pdf>.

³² See generally: Peter L. Faber, *Business Purpose and Economic Substance in State Taxation*, Tax Analysts (1 Feb. 2010) citing *United Parcel Service of America v. Comm’r*, 254 F.3d 1014 (11th Cir. 2001), *rev’g and remanding*, T.G. Memo 1999–268.

³³ *Inland Revenue Commissioners v. Duke of Westminster* (1936) AC 1, [1935] All ER Rep 259, 51 TLR 467, 19 Tax Case 490 (the ‘Duke of Westminster Rule’).

activities of personnel employed by the interposed holding company), such facts would arguably defuse the view of tax avoidance as a ‘main purpose’ of the overall arrangement.

Another provision of the Amended Directive references the specific intent of the EU Council in the general statement, ‘defeats the purpose of the directive’.³⁴ It is not clear how such a requirement adds anything to the anti-abuse rule. Indeed, the ‘purpose’ of the Parent-Subsidiary Directive is primarily to achieve capital efficiencies within the EU/EEA through the elimination of juridical double-taxation (as it eliminates intra-EU dividend withholding taxation), and also through the elimination of economic double taxation (as it provides for relief of underlying corporate taxation via exemption or credit at the recipient); thus such provision could be interpreted to be aimed at a Member State seeking to levy tax in spite of the Directive, rather than at multinationals attempting to achieve double non-taxation.³⁵ Accordingly, the greater purpose seems to be the creation of a single internal (capital) market, and the application of the relief would, therefore, only be denied in situations where the tax relief does not occur in tandem with capital investments within the EU/EEA. As such, in all scenarios of foreign direct investments, or earnings reinvestments, one could argue that the non-imposition of withholding taxes by source states (even in respect to functionally thin interposed entities that are not ‘wholly artificial’) would be aligned with the purpose of the directive.

Last but not least, the language specifying a ‘non-genuine’ arrangement referencing ‘economic reality’ appears to introduce an ‘economic substance’ standard or doctrine in EU tax law. However, several tax avoidance techniques are commonly used, tried and tested by multinationals that arrange their affairs in accordance with similar economic substance doctrines in multiple countries around the world (as it is the case with US MNEs), and such ‘substance’ requirements might be insufficient to curb ‘abuse’ in the seemingly disproportionate utilization

of the Parent-Subsidiary Directive. All of the examples illustrated in Scenarios 2 and 3 above could be argued as ‘genuine’, to the extent that ‘genuine’ (or actual) capital investments are made into Europe through the scheme, and/or ‘genuine’ treasury benefits can be attained from the pooling of interests and of cash for all of Europe through the arrangement, and ultimately, as depicted in Scenario 3, a functionally autonomous legal entity with a few employees and office infrastructure is ‘genuine’ as such. Sheppard (2014) argues that the additional ‘substance’ typically required by the GAAR would not have any meaningful impact to curb tax avoidance, given the sophistication of techniques employed by multinationals and the amounts involved, which from a practical point of view is a rather sensible assertion.³⁶

4 AN ANTI-ABUSE RULE IN THE EU PARENT-SUBSIDIARY DIRECTIVE AND EU PRIMARY LAW: NEGATIVE INTEGRATION AND TAX COMPETITION

It is worthwhile to consider the already existing aspects of European law that otherwise deal with harmful or abusive tax arrangements.³⁷ First, although the ECJ has not issued any previous case law interpreting the former Article 1(2) of the Parent-Subsidiary Directive,³⁸ a minimum degree of economic substance was required based on the ECJ’s rulings with regard to other Council Directives, such as the Merger Directive.³⁹ Tenore (2013) argues that the principles of ECJ case law over what may constitute an ‘abuse’ of law should apply to the EU Fundamental Freedoms, as well as secondary law, and such an interpretation may represent a more coherent approach to EU law.⁴⁰

Many tax practitioners view the numerous tax rulings of the European Court of Justice (ECJ) as the origin of a common law on taxation for EU purposes.⁴¹ Indeed, the *WT Ramsay v. Inland Revenue Commissioners* (1982) holding

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³⁴ Amended Directive at Art. 2(2).

³⁵ See: Steven A. Bank, *The Globalization of Corporate Tax Reform*, 40 Pepp. L. Rev. 1307 (2013) at 1313–1314 (‘This same principle was applied in the EU’s so-called Parent/Subsidiary Directive, which focused on outlawing the double taxation of dividends paid by a subsidiary of one member state to its parent company located in another member state.’).

³⁶ Lee A. Sheppard, *Twilight of the International Consensus: How Multinationals Squandered Their Privileges*, 44 Wash. U. J.L. & Pol’y 61, 71 (2014) (‘The Europeans think requiring substance in CFCs will solve the problem. It will not. Requiring substance will mean income shifting is more expensive, and requires more bodies to be thrown at tax avoidance plans; but when billions of dollars are at stake, a few boots on the ground in a pleasant European tax haven becomes a bearable cost. And the result may still be objectionable to the multinational’s home country.’).

³⁷ See, Ana Paula Dourado, *Aggressive Tax Planning in EU Law and in the Light of BEPS: The EC Recommendation on Aggressive Tax Planning and BEPS Actions 2 and 6*, 43 Intertax (2015).

³⁸ Tenore at 148.

³⁹ Tenore at 148 (‘There are no valid reasons to apply different standards for interpreting abuse under primary and secondary law. If this is true, one has to come to the conclusion that abuse should be given an autonomous meaning, i.e., regardless of whether the taxpayer intends to abuse a fundamental freedom, secondary legislation or a Member State’s domestic law’).

⁴⁰ Pistone (2008) at 74 (‘Secondary law being instrumental to achieving the goals set by primary law, one may thus wonder whether this option still makes sense within an internal market, or whether by contrast it could in fact conflict with the level playing field among different taxpayers.’).

⁴¹ Bank, at 1314 (‘Indeed, the ECJ had “decided more than a hundred cases involving Member States’ income tax systems” as of 2007. As a result, Michael Graetz and Alvin Warren concluded that “the Court has become deeply enmeshed in fashioning the Member States’ income tax policies.”).

of the ECJ established a principle limiting the Duke of Westminster holding to arrangements which it considered 'artificial'.⁴² From this precedent it appears the ECJ has been developing a judicial standard for anti-abuse in conformity with primary EU law that should continue to evolve⁴³ and not be limited by secondary law.⁴⁴ The fact that a low standard is expressly adopted in the Amended Directive, however, cannot be taken lightly, and will exert influence in the ultimate definition of 'abuse' under European tax law.⁴⁵

At its current state, the anti-abuse doctrine of the ECJ allows Member States to disregard arrangements that are 'wholly artificial constructions that are used by the taxpayer to circumvent the national legislation or to improperly or fraudulently take advantage of provisions of the TFEU'.⁴⁶ Thus, arrangements that are not exclusively tax-motivated, that are not wholly artificial constructs which have absolutely no ramifications or implications other than the tax effect sought by the taxpayer, and that are not achieved through fraud, cannot be disregarded by Member States.⁴⁷ Accordingly, under the current standards of the ECJ, all scenarios of direct capital investment or dividend reinvestment across EU countries would most likely be protected under Article 63 et seq. of the TFEU, on the *free movement of capital*. Note, again, that the rule dictates that 'all restrictions on the movement of capital and payments between Member States and between Member States and third countries are prohibited'.⁴⁸ It would seem therefore that the creation of the internal market requires capital investment from within the EU and from third countries, and that such object and purpose is as fundamental in terms of EU law in this specific context as is nationality in the context of all other Fundamental Freedoms and rights. It is a cornerstone of EU law.

Therefore, there would be strong arguments to invoke this fundamental freedom in all scenarios above except that one which is entirely artificial (i.e., no capital inflows into the EU/EEA, no reinvestment of EU dividends, no

employees or infrastructure, use of fiduciary agents to receive and immediately repay dividends). In Scenario 2, wherein the 'beneficial ownership' standard would not be clearly demonstrated, however, wherein the intermediary entity would serve as a re-investment vehicle, this standard would not necessarily limit this fundamental freedom, in the sense that it applies to third countries.

That is, even if the third country is deemed a beneficial owner of capital, the payment of cash dividends within the EU conditioned to the re-investment of such cash across and within the EU would also be protected by this fundamental rule, particularly if the country wherein the intermediary holding company is formed acknowledges its stance as a resident taxpayer, and if the third country also regards the existence of such intermediary holding company. The veiled truth would be the assertion that the creation of a single 'internal market' funded with foreign direct investment is a 'greater good' that justifies an override of underlying withholding taxes on intra-EU dividends, and that the EU-wide dividend tax is eliminated (or deferred) under the terms of the bilateral treaty executed by the non-resident investor with EU country that serves as a 'port-of-entry' (akin to an implicit 'most favoured nation' clause).

To make matters even more complex, if we assume that the interposed holding company is minimally functional yet sufficiently autonomous as a legal entity, in the sense that it would not rely on third-party fiduciary agents or contractors to perform its activities (i.e., arguably a beneficial owner yet with disproportionate dividend income vis-à-vis its economic functions), it would stand as a legal entity with EU employees. This is in essence what is demonstrated in Scenario 3 above. It is arguable that in this case the intermediary holding company would most likely be entitled to a 'right of establishment' (freedom of establishment), a fundamental right which is reserved to EU individuals and that also applies to EU companies, granting them the right to set up agencies, branches or subsidiaries in another Member State.⁴⁹

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⁴² *WT Ramsay v. Inland Revenue Commissioners* (1982), [1981] 1 All ER 865, [1982] AC 300, [1981] UKHL 1, [1981] STC 174.

⁴³ See, Dourado, *supra* n. 37.

⁴⁴ See: Chris White & Clotilde Briquet, *Under Commission*, THE LAWYER (6 Nov. 2006) ('The ECJ went on to say that any advantage resulting from low tax to which a subsidiary company established in a member state, other than that to which the parent company's was incorporated, cannot of itself authorise the parent company's member state to offset that advantage by less favourable tax treatment of the parent company. The court qualified its views by stating that such less favourable tax treatment could nevertheless be justified when the company's tax arrangements are "artificial" and aimed at avoiding the effects of national legislation. Even then the less favourable treatment must be proportionate and not go beyond what is strictly needed to achieve the overriding policy purpose of avoiding tax forum shopping. The court did not go on to elucidate on what sort of arrangements it would consider "artificial". It simply points to the extent to which the company in question has a physical presence in the favourable tax jurisdiction and carries on genuine economic activities there.').

⁴⁵ See: Pasquale Pistone, *Il divieto di abuso come principio del diritto tributario comunitario e la sua influenza sulla giurisprudenza tributaria nazionale*, In: G. Maisto, *Elusione ed abuso del diritto tributario*, in *Quaderni della Rivista di diritto tributario*, ISBN: 88-14-14558-X, Giuffrè, Milan, pp. 281–308, and *L'elusione fiscale come abuso del diritto: certezza giuridica oltre le imprecisioni terminologiche della Corte di Giustizia Europea in tema di IVA*, in *Rivista di diritto tributario*, 2007/1, IV, pp. 17–26.

⁴⁶ Vanessa E. Englmair, *The Relevance of the Fundamental Freedoms for Direct Taxation*, in *European Tax Law on Direct Taxation* (Lang, Pistone, Schuh & Staringer, eds, 3d edn Linde, 2014).

⁴⁷ ECJ 21 Nov. 2002, C-346/00, *X and Y* [2002] ECR I-10829; ECJ 12 Sep. 2006, C-196/04, *Cadbury Schweppes* [2006] ECR I-7995.

⁴⁸ See n. 44.

⁴⁹ Vanessa E. Englmair, *The Relevance of the Fundamental Freedoms for Direct Taxation*, in *European Tax Law on Direct Taxation* (Lang, Pistone, Schuh & Staringer, eds, 3d edn, Linde 2014).

Therefore, the matter is not as much the behaviour of MNE tax avoiders which exploit the current state of EU law, as it is about the constitution or ‘functioning’ of the European Union itself. Can the intermediary country recognize the legitimacy of a functionally thin (or downright artificial) intermediary entity? The ECOFIN Council of the EU also incorporates a Code of Conduct for Business Taxation that may have been applicable to harmful tax competition in the form of extending the benefits of the Parent-Subsidiary to non-EU taxpayers, thereby eroding the tax base of another EU Member State.⁵⁰ However, the Code of Conduct is not binding; that is, Member States have retained their sovereignty in the matter. As such, only if the potentially harmful tax competition equates to ‘state aid’ (which is also quite a formulary construct and as such quite avoidable) under the terms of Article 107(1) of the TFEU could the arrangement be recast, and the structure result subject to tax. The EU Council most likely considered that the anti-abuse rule would be practicable because of its binding effect, even though the rule is of limited reach, as discussed. The Code of Conduct also incorporated an idea of ‘transparency’ that include an inquiry into whether a non-resident company without any real economic activity was able to garner tax advantages in the Member State.⁵¹ It can be assumed, however, that even if structures are fully transparent, the matter of conformity to Fundamental Freedoms would remain as an obstacle to the application of stricter anti-abuse rules in fact patterns where capital is invested or dividends re-invested, and furthermore where the right of establishment is also at stake.

Finally, it is also worthy of note the proposed Directive on the Common Consolidated Corporate Tax Base (CCCTB) which included a potential anti-abuse rule. However, as Lang (2014) points out precisely the same issue arises as to whether if a CCCTB Directive were issued how such would apply to non-EU taxpayers.⁵² In particular, the prospect of ‘CCCTB shopping’ must

therefore be contemplated and the potential for a future CCCTB anti-abuse rule in that arena as well.

5 POTENTIAL INTERACTION OF EU PARENT-SUBSIDIARY DIRECTIVE WITH BEPS

In setting forth recommendations under the OECD/G20 Base Erosion and Profit Shifting (BEPS) Project, Action 6 (*Preventing the Granting of Treaty Benefits in Inappropriate Circumstances*), the OECD introduces a ‘three-pronged approach’ which would mean significant alterations to the tax treaties currently in force,⁵³ to the Model Convention, and hence to future bilateral treaties. The approach would include:

- First: a change to the title and preamble of the treaties to emphasize that the Contracting States enter into a treaty intend to avoid creating opportunities for ‘double non-taxation’ or ‘reduced taxation through tax evasion or avoidance’, including through ‘treaty shopping arrangements’;
- Second: introduction of a specific anti-abuse rule (SAAR) in the treaties based on the ‘limitation-on-benefits’ (LOB) provision that is used by the United States in its tax treaties;
- Third: a more general anti-abuse rule (GAAR), which would also limit situations that could escape the LOB SAAR, namely a ‘principal purposes test’ (PPT).

It seems that the OECD acknowledges and understands ‘treaty abuse’ and ‘treaty shopping’ in a fairly precise manner, as it systematically advances a concerted effort through multiple initiatives (and under multiple Actions of the BEPS Project) to curb legal structures that absolutely lack economic substance and ‘functionality’. Wholly artificial or empty ‘cash boxes’, ‘IP boxes’, and other forms of ‘PO Box’ entities are simply no longer acceptable (irrespective of their financial capital and legal

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⁵⁰ Tracy A. Kaye, *Europe's Balancing Act: Trends in Taxation*, 62 TAX L. REV. 193, 197 (2008) (‘ECOFIN established the Code of Conduct for Business Taxation based on a recommendation from the European Commission with regard to the elimination of harmful tax competition. Although the Code is not binding on the Member States, those adopting it agree to reduce any existing tax measures that constitute harmful competition and to refrain from instituting any similar measures in the future. Despite the fact that it is not legally binding, the Code carries great political influence within the Community and has worked as an effective tool for minimizing harmful competition.’).

⁵¹ Kaye (2008) at 198 (‘In addition to these affirmative steps that must be taken by the Member States, signatories to the Code must inform other signatories of tax policies that fall within the purview of the Code of Conduct. This secondary requirement, known as “transparency,” is meant to strengthen the internal market by making tax regimes clear and visible to all affected parties. The Code sets forth the following considerations for evaluating whether a new or existing tax regime constitutes harmful tax competition: Are advantages granted to a nonresident company without any real economic activity or presence in the regulating Member State?’).

⁵² Michael Lang, *The Principle of Territoriality and Its Implementation in the Proposal for a Council Directive on a Common Consolidated Corporate Tax Base (CCCTB)*, 13 Fla. Tax Rev. 305, 314 (2012) (‘Concededly, Article 2 of the Parent-Subsidiary Directive and Article 3 of the Interest and Royalties Directive are based on a similar concept, although the CCCTB proposal has its own terminology. As a result of the two existing Directives, the absence of treaty benefits turns into an advantage for purposes of the Directive. Ultimately, the Directive's scope of application depends on the content of the concluded DTCs and can hence be different in each Member State. This can only be due to the fact that, as a result of the company's residence outside the European Union for purposes of the DTC, the company can be taxed in the EU Member State only in respect of income from sources in the Member State, hence resembling more a nonresident than a resident. For both the existing Directives and the CCCTB proposal, the question now is whether it is worth accepting that the scope of the Directive not only varies from Member State to Member State, but also, on the other [*315] hand, depends on in which third country the company is still resident. Should these companies generally be regarded as being resident in the EU, it would be useful to adopt in the Directive the wording of the tie-breaker rule laid out in Art. 4(3) OECD-MC.’).

⁵³ The immediate changes would be introduced via multilateral instrument which would amend bilateral tax treaties currently in force, as proposed under Action 15 (see, OECD, OECD/G20 BEPS Project – Action 15: A Mandate for the Development of a Multilateral Instrument on Tax Treaty Measures to Tackle BEPS).

stance) – if they have ever been. Treaty entitlement would be conditioned to economic functionality (e.g., activities that contribute to value creation, active trade or business, etc.). Accordingly, the OECD clearly understands that *‘No or low taxation is not per se a cause of concern, but it becomes so when it is associated with practices that artificially segregate taxable income from the activities that generate it.’* Companies should not be seen to be abusing Treaty benefits where a genuine business is set up (perhaps specifically attracted by benefits, enacted for the express purpose of attracting business), one of the implications of which is a preferable Treaty being available; nonetheless treaty entitlement should be proportionate to and commensurate with the activities that justify value creation. The solutions drafted by the OECD under Action 6, however, do not advance this understanding⁵⁴ and instead re-heat ideas that historically have proven to be less than effective and that, instead, can simply lead to inconsistent application and protracted controversy.

In the EU context, a SAAR in the form of an LOB could face similar challenges under the Fundamental Freedoms as discussed hereinabove, even though, as noted by Dourado (2015) the ECJ has declared them compatible with EU Law, albeit with unsatisfactory arguments.⁵⁵ Particularly in light of the potential incompatibility between bilateral treaties of the third country with the ‘interposed state’ versus the ultimate source states.

As such, if the Parent-Subsidiary Directive (or the Member States) were to adopt as an anti-abuse rule the standards presented above, the same obstacles and limitations under the fundamental rights that arise from the *free movement of capital* and *right of establishment* would remain. Some believe that the inclusion of a ‘subject-to-tax’ clause in the treaties or under domestic law would curb the targeted abusive transaction.⁵⁶ At this point, this is the road not taken by the EU Council and by the OECD, and quite understandably so. In the subject-to-tax standard, particularly in the EU framework, *any tax rate imposed at the intermediary country*, would serve as an indicator of validity of the arrangement. As such, in an environment of tax sovereignty and of tax competition within the EU/EEA and worldwide,

intermediary countries could simply impose very low, single-digit tax rates (or even rates below 1%) on dividend income received by artificial holding companies, and pass the anti-abuse test. As it seems, the Amended Directive embraces the simulacrum of a ‘principal purposes test’ yet it condones minimal substance deeming it compatible with primary EU law, in essence ‘locking’ the definition of abuse at the current ECJ standard of ‘wholly artificial arrangements’. As such, the Amended Directive can legitimate the use of highly (but not wholly) artificial arrangements within the EU.

6 CONCLUSION

The new anti-abuse rule of the amended Parent-Subsidiary Directive significantly affects the analysis under EU law of ‘holding company structures’ used by third-country investors. For the reasons set forth above, tax avoidance becomes perhaps more certain (*not less certain*) with framed anti-abuse provisions, such as those provided by the EU Council in the Amended Directive in its present form.

Intermediary EU/EEA countries and MNEs that engage in ‘directive shopping’ now have clearer guidelines and standards with fairly specific terms that define ‘abuse’ in a manner that is quite narrow. As such, the EU hybrid-GAAR in its current form most likely only prohibits wholly artificial arrangements and therefore validates tax avoidance through other artificial arrangements. As a result, it lowers the bar for tax competition within Europe.

Under the jurisprudence of the ECJ, wholly artificial constructs were already considered abusive, and thus illegitimate. In the context of an anti-abuse rule under the Parent-Subsidiary Directive, a beneficial ownership test or subject-to-tax requirement could have been adopted (albeit with limited effectiveness). However, it is arguable that the application of the Fundamental Freedoms enshrined in primary EU Law would limit the imposition of any stricter anti-abuse standards by Member States; and in light of the new minimum standard adopted by the European Commission in the Amended Directive, such interpretation is further reinforced.

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⁵⁴ See Romero J.S. Tavares, *The ‘Active Trade or Business’ Exception of the Limitation on Benefits Clause*, in *Base Erosion and Profit Shifting: The Proposals to Revise the OECD Model Convention* (Michael Lang ed., IBFD, forthcoming, 2015).

⁵⁵ See Dourado [2015], *supra* n. 37: ‘Regarding LOBs, the ECJ has declared them compatible with EU law in the *ACT GLO* case. However, the arguments used by the ECJ are far from satisfactory. The nature of LOB clauses was not analysed: are they entitlement rules, allocation of taxing rights rules or anti-abuse rules containing un rebuttable presumptions? Instead, the ECJ decision was based on the argument that tax treaties are negotiated bilaterally on a give-and-take basis, which is basically true for all treaties. Moreover, the decision was in contradiction to previous case law involving the analysis of the compatibility between bilateral treaties concluded by at least one Member State and another State.’.

⁵⁶ Sheppard [2014] at 74 ‘But the OECD accepts that treaties can be abused. The OECD will draft an anti-abuse provision for treaties. In this context, abuse refers to the use of third countries to gain unwarranted treaty benefits. The provision will clarify that treaties are not meant to facilitate double non-taxation – something the OECD has never done before in its great service to multinationals The best way to address this problem is to put a subject-to-tax clause in a treaty or in domestic law. Sadly, the OECD appears headed in the direction of the American limitation on benefits clauses, which, in their more complicated versions, do not restrain public companies.’.

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