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APPENDIX: Acquisition Finance, Debt Push-Down and Tax Abuse — An EU Perspective

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I. Introduction

In the fact pattern under examination, subsequent to the acquisition, it is intended to merge a host country acquisition vehicle (HC Acq) with a host country target (HC Target), allowing the operating cash flow of HC Target to be used to fund the interest payments on the financing received by HC Acq. The question arises whether such a merger would pass the test of the anti-abuse provision in the Merger Tax Directive[1] or, more generally or alternatively, that of the general anti-abuse rule (GAAR) introduced by the Anti-Tax Avoidance Directive (ATAD).[2] In the author's opinion, that may well be open to debate if the envisaged merger is (merely) aimed at effectively putting in place a debt push-down scenario.

II. Anti-Abuse Under the Merger Tax Directive

Under the anti-abuse provision of the Merger Tax Directive,[3] a Member State may refuse to apply or may withdraw the benefit of all or any part of the tax deferral regime provided for by the Merger Tax Directive where it appears that one of the operations covered by the Directive 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.[4]

In *Leur-Bloem*,[5] the seminal case on the interpretation and construction of this anti-abuse provision, the Court of Justice of the European Union (CJEU) held that the Member States must grant the tax advantages provided for by the Directive with respect to the operations covered by it, unless those operations have as their principal objective, or as one of their principal objectives, tax evasion or tax avoidance. In this regard, the Member States may stipulate that the fact that such operations were not carried out for valid commercial reasons — which is a concept involving more than the attainment of a purely fiscal advantage — constitutes a presumption of tax evasion or tax avoidance. It is for the Member States, observing the principle of proportionality, to determine the internal procedures necessary for this purpose. However, to determine whether the planned operation has an objective of tax evasion or tax avoidance, the competent national authorities cannot confine themselves to applying predetermined general criteria but must subject each particular case to a general examination. Such an examination must, moreover, be open to judicial review.

The examination may look at various factors (for example, the acquiring company not itself carrying on a business, the identity of the shareholder(s) and director(s) being the same before and after the operation, the involvement of a newly-created holding company, the restructuring of companies that already

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form a single entity from an economic and financial point of view, the creation of a specific structure for a limited period of time and not on a permanent basis), but none of those factors may be considered to be decisive on its own. On the other hand, the laying down of a general rule automatically excluding certain categories of operations from the tax advantage, whether or not there is actually tax evasion or tax avoidance, would go further than is necessary for preventing tax evasion or tax avoidance and would undermine the aim pursued by the Directive. This would also be the case if a rule of this kind were to be made subject to the mere possibility of the grant of a derogation, at the discretion of the administrative authority.

Kofoed[6] further elaborates on this case law by specifying that the anti-abuse provision in the Merger Tax Directive reflects the general EU law principle or principle of interpretation of EU law that abuse of EU law (or abuse of rights) is prohibited, thus suggesting that it must be interpreted in line with the contents and structural elements of that principle, as expressed in (*inter alia*) *Halifax*[7] and *Cadbury Schweppes*.[8] See also II., below.

In *Foggia*,[9] the CJEU reiterated its position that the concept of "valid economic reasons" involves more than the attainment of a purely fiscal advantage. Consequently, a merger operation based on a number of objectives, which may also include tax considerations, can have a valid commercial reason provided, however, that the tax considerations are not predominant in the context of the proposed transaction. Accordingly, where the merger operation has the sole aim of obtaining a tax advantage and is not carried out for valid commercial reasons, such a finding may constitute a presumption that the operation has tax evasion or avoidance as one of its principal objectives. The fact that, in the case of a merger operation between two companies of the same group, on the date of the merger operation, the acquired company does not carry out any activity, does not have any financial holdings and transfers to the acquiring company only substantial tax losses, even though that operation has a positive effect in terms of cost structure savings for that group (albeit marginal ones) may constitute a presumption that the operation has not been carried out for "valid commercial reasons."

Euro Park Service[10] concerned a French tax rule under which a cross-border merger cannot benefit from tax neutrality (as a domestic merger would) unless the French tax authorities deliver a prior approval (*agrément préalable*) subject to certain conditions. Specifically, prior approval was to be granted where, having regard to the assets transferred: (1) the operation was justified for commercial reasons, resulting, *inter alia*, in the exercise by the company receiving the transfer of an independent activity, in the improvement of structures or in an association between the parties; (2) the operation did not have as its principal objective or as one of its principal objectives tax evasion or tax avoidance; and (3) the manner in which the operation was carried out made it possible for the capital gains deferred for tax purposes to be taxed in the future. The prior approval procedure was introduced into French tax law as a way to implement Article 11 of Directive 90/434 (now Article 15 of the Merger Tax Directive). According to the CJEU, Article 11(1)(a) of Directive 90/434 (now Article 15(1)(a) of the Merger Tax Directive) authorizes Member States not to apply the provisions of Directive 90/434 under only one condition, namely that the operation covered by that directive "has as its principal objective or as one of its principal objectives tax evasion or tax avoidance." By requiring the above conditions (1) and (2) to be met, the French legislature derived two conditions from the single element laid down in Article 11(1)(a) of Directive 90/434 and, therefore, extended the scope of the reservation of competence beyond that laid down in that provision. Moreover, condition (3), which is also not provided for in Article 11(1)(a) of Directive 90/434, cannot be justified by the aim of combating tax evasion or tax avoidance, since that objective is already expressly covered by condition (2).

This is substantially different from the position in *Pelati*,[11] which also concerned the existence of a prior administrative procedure designed to assess eligibility for the advantages set out in Directive 90/434. In *Pelati*, the CJEU ruled that legislation such as that at issue "under which the grant of the tax advantages applicable to a division in accordance with that directive is subject to the condition that the application relating to that operation is submitted within a specified period" was not contrary to Directive 90/434 and left it to the referring court to ascertain whether the details, and more particularly the starting-point, of the time-limit for submitting the pending application complied with the principle of effectiveness. However, *Pelati* did not concern the substantive conditions set for obtaining prior approval (as was the case in *Euro Park Service*).

In addition, in *Euro Park Service*, the process of prior approval, by systematically and unconditionally requiring that evidence be provided that the operation at issue was justified for commercial reasons and did not have as its principal objective or as one of its principle objectives tax evasion or tax avoidance, without the tax authority being required to provide even *prima facie* evidence of the absence of valid commercial reasons or evidence of tax evasion or tax avoidance, constituted in essence a general presumption of tax evasion or tax avoidance. The introduction of such a presumption subjects, systematically and in advance, every cross-border merger to significant administrative constraints, even where there is no evidence whatsoever of tax evasion or tax avoidance. Such a presumption therefore goes against the objective of Directive 90/434, which, according to its first recital, seeks to reduce obstacles to mergers, divisions, transfers of assets and exchanges of shares involving companies of different Member States arising from the tax provisions of the Member States. This is in line with *Foggia*,[12] in which the CJEU held that, to determine whether the operation concerned pursues the objective of tax evasion or avoidance, the competent national authorities may not confine themselves to applying predetermined general criteria but must subject each particular case to a general examination of that operation, since the imposition of a general rule automatically excluding certain categories of operations from the tax advantage, without account being taken of whether there is actually tax evasion or avoidance, would go further than is necessary for prevent-

ing such tax evasion or avoidance and would undermine the objective pursued by the directive.[13]

CJEU case law has made two further clarifications in this area. First, as, according to settled case law, directives are unable by themselves to create obligations for individuals and cannot therefore be relied on *per se* by a Member State as against individuals,[14] each of the Member States to which a directive is addressed is obliged to adopt, within the framework of its national legal system, all the measures necessary to ensure that the directive is fully effective, in accordance with the objective that it pursues.[15] It follows that, if a Member State has not incorporated the Directive-based anti-abuse clause into its legal order, whether formally and specifically or by transposition achieved through a general legal context that does not go beyond the Directive-based anti-abuse rule as interpreted by the CJEU (so that a formal and express re-enactment of the provisions of the directive in specific national provisions is not necessary), that Member State cannot reduce the effect of the rest of the provisions of the Merger Tax Directive on that basis (and, hence, in such circumstances has to accord the benefits of the Directive).[16] Second, given that the Merger Tax Directive is designed to avoid certain fiscal obstacles (in the field of income tax) regarding cross-border reorganizations, and given that the anti-abuse provision in the Directive is a provision setting out an exception that is thus subject to strict interpretation, "tax evasion or avoidance" is to be understood to mean only the avoidance or evasion of income tax and not the evasion or avoidance of other taxes.[17]

II. The General Anti-Abuse Rule Under the Anti-Tax Avoidance Directive

The ATAD includes a general anti-abuse rule (GAAR) that, according to the Commission, is designed to reflect the "wholly artificial test" of the CJEU. However, the ATAD substitutes the term "non-genuine" for the term "wholly artificial."[18] Despite this change in terminology, it therefore remains useful (and even necessary) to put in perspective the (emergence and development of the) "wholly artificial test" in the case law of the CJEU, especially as it is more likely than not that the CJEU will construe the term "non-genuine" consistently with (and with reference to) the Court's (now settled) case law on "wholly artificial arrangements."

Imperial Chemicals Industries[19] contained an embryonic indication that abuse of EU law (*in casu*, the abuse of EU Treaty freedoms and, more specifically, the freedom of establishment) requires that there be "wholly artificial arrangements" that are intended to circumvent the tax legislation of a Member State. In *Marks & Spencer*,[20] the CJEU reiterated its position that Member States are free to adopt or maintain in force rules having the specific purpose of precluding from a tax benefit wholly artificial arrangements whose purpose is to circumvent or evade national tax law. In a second move, the two-pronged test for "abuse" with its objective and subjective elements, as developed by the CJEU in *Halifax* in the value added tax (VAT) area,[21] was expanded into the direct tax area by the ruling in *Cadbury Schweppes*,[22] albeit by tying it in with the "wholly artificial arrangements" concept that had been formulated in *ICI* and *Marks & Spencer*. According to the CJEU in *Cadbury Schweppes*, for it to be found that there is a "wholly artificial arrangement," 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 EU law, the objective pursued by (*in casu*) the freedom of establishment has not been achieved. However, for such an arrangement to exist, it is not enough that the taxpayer could have had the intention of saving tax. Nor does such an arrangement exist when a transaction responds to an "economic reality" that in turn corresponds to a "genuine economic activity in the host Member State" (the existence of "genuine economic activity" being assessed in terms of "premises, staff and equipment"). This case law was further elaborated on in, *inter alia*, *Eurowings*,[23] *Test Claimants in the Thin Cap Group Litigation*,[24] *Lammers*[25] and *SGI*.[26]

From this case law, it can be concluded that a wholly artificial arrangement can be found to exist when, by analyzing subjective and ascertainable evidence, the conclusion can be reached that a transaction lacks any economic reality and was not carried out for a valid commercial reason, but, rather, that the essential objective of the transaction was to obtain a tax advantage. Hence, the wholly artificial arrangement doctrine examines a transaction in accordance with a two-pronged conjunctive perspective involving an objective analysis of whether there is ascertainable evidence that the arrangement is not purely artificial (i.e., whether the form of the transaction differs from its substance and whether there is an economic reality underlying the transaction) and a subjective analysis of the taxpayer's purpose to determine whether the arrangement was made with a legitimate or valid business purpose other than to obtain a purely fiscal advantage.

As indicated above, under the ATAD the term "wholly artificial" has been replaced by the term "non-genuine." According to Article 6 of the ATAD, for purposes of calculating corporate tax liability, a Member State is to ignore an arrangement or a series of arrangements that, 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, is not genuine having regard to all the relevant facts and circumstances — an arrangement may comprise more than one step or part (Article 6(1)). For this purpose, an arrangement or a series of arrangements must be regarded as non-genuine to the extent it is not put into place for valid commercial reasons that reflect economic reality (Article 6(2)). Where an arrangement or a series of arrangements is so ignored, the (ensuing) tax liability must be calculated in accordance with national law (Article 6(3)).[27]

Finally, it is important to note that the GAAR is designed to cover gaps that may exist in a Member State's specific anti-abuse rules. Conversely, the GAAR does not affect *per se* the applicability of specific anti-abuse rules, such as Article 15(1)(a) of the Merger Tax Directive. This is logical as a specific anti-abuse rule is intended to deny or withdraw a (specific) tax benefit in certain circumstances, whereas the GAAR is aimed at

ignoring an arrangement that lacks valid commercial reasons reflecting economic reality.

NOTES

[1] On July 23, 1990, the Council adopted Directive 90/434/EEC 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. Council Directive 90/434/EEC has been substantially amended several times and, in the interests of clarity and rationality, was codified by Council Directive 2009/133/EC of Oct. 19, 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 (the "Merger Tax Directive"). Generally, the aim of the Merger Tax Directive is to create within the European Union conditions analogous to those of an internal market, and remove restrictions, disadvantages or distortions arising from the existing tax provisions of the Member States that disadvantage reorganizations of companies (such as mergers, divisions, partial divisions and other similar types of transactions) where companies of two or more Member States are involved. This objective is attained by the creation of a system that allows the taxation of income, profits and capital gains arising where businesses are reorganized to be deferred, provided certain conditions are fulfilled.

[2] Council Directive (EU) 2016/1164 of July 12, 2016, laying down rules against tax avoidance practices that directly affect the functioning of the internal market. The ATAD contains other provisions that may potentially affect the tax implications of the fact pattern under examination, namely the general interest limitation rule (i.e., the limitation of the deduction of excess borrowing costs to a maximum of 30% of the taxpayer's earnings before interest, tax, depreciation and amortization (EBITDA)) and the hybrid mismatches rules (which provide that, to the extent a hybrid mismatch (e.g., a profit participating loan that is treated as equity in one Member State but as debt in the other Member State) results in a double deduction, only the Member State in which the payment concerned has its source is allowed to give the deduction; on the other hand, to the extent a hybrid mismatch results in a deduction without inclusion, the Member State of the payer is to deny a deduction for the payment). The hybrid mismatch rules have been extended to mismatches involving third countries by Council Directive (EU) 2017/952 of May 29, 2017 amending Directive (EU) 2016/1164 as regards hybrid mismatches with third-countries ("ATAD 2")). However, these provisions or rules will not be further discussed in this paper.

[3] Certain authors have argued that the anti-abuse reservations in the Merger Tax Directive (as well as those in the Parent/Subsidiary and Interest and Royalty Directives) are redundant because, under the CJEU's case law, Member States have the right to deny the benefits of the Directive in cases of fraud or abuse and the national measures taken in this respect must observe the imperatives of EU law as further construed by the CJEU (see, Terra, B. and Wattel, P., European Tax Law, Kluwer Law International, 2005, p. 529, 571and 638).

[4] Merger Tax Directive, Art. 15(1)(a). Art. 15(1)(b) authorizes Member States to refuse to apply or to withdraw the benefit of the Directive where it appears that one of the operations results in a company, whether participating in the operation or not, no longer fulfilling the necessary conditions for the representation of employees on company organs according to the arrangements that were in force prior to that operation; this provision will apply as long as and to the extent that no EU law provisions containing equivalent rules on the representation of employees on company organs are applicable to companies covered by the Directive.

[5] Case C-28/95, *Leur-Bloem*.

[6] Case C-321/05, *Kofoed*.

[7] Case C-255/02, *Halifax*.

[8] Case C-196/04, *Cadbury Schweppes*.

[9] Case C-126/10, *Foggia*.

[10] Case C-14/16, *Euro Park Service*.

[11] Case C-603/10, *Pelati*.

[12] Case C-126/10, *Foggia*.

[13] A similar reasoning is followed by the CJEU with respect to the anti-abuse rule laid down in Parent/Subsidiary Directive, Art. 1(2)). In joined cases C-504/16 and C-613/16, *Deister Holding and Juhler Holding*, the CJEU held the former German anti-avoidance rule in German Income Tax Act, sec. 50d para 3 (applicable until 2011) to be incompatible with Art. 1(2) (and Treaty on the Functioning of the European Union (TFEU), Art. 49) as, without the tax authorities being required to provide *prima facie* evidence of the absence of economic reasons or of fraud or abuse, it entailed a general presumption of fraud or abuse.

[14] See, *inter alia*, Case 14/86 *Pretore di Salò*; Case 80/86 *Kolpinghuis Nijmegen*; Case C168/95 *Arcaro*; Joined Cases C-387/02, C391/02 and C403/02 *Berlusconi and Others*.

[15] See, *inter alia*, Case C-531/03 *Commission v. Germany*; Case C-456/03 *Commission v. Italy*.

[16] Case C-321/05, *Kofoed*.

[17] Case C-352/08, *Zwijnenburg* (at issue in that case was Dutch real property transfer tax).

[18] Member States are required, by Dec. 31, 2018, to adopt and publish the laws, regulations and administrative provisions necessary to comply with the GAAR set out in the ATAD and to apply those provisions from Jan. 1, 2019.

[19] Case C-264/96, *Imperial Chemical Industries*.

[20] Case C-446/03, *Marks & Spencer*.

[21] Case C-255/02, *Halifax*. Under the two-pronged test for "abuse," for it to be found that an abusive practice exists, it is necessary, first, that the transactions concerned, notwithstanding the formal application of the conditions laid down by the relevant provisions of the Sixth VAT Directive and the national legislation transposing it, result in the accrual of a tax advantage the granting of which would be contrary to the purpose of those provisions. It must also be apparent from a number of objective factors that the essential aim of the transactions concerned is to obtain a tax advantage. Where an abusive practice is found to exist, the transactions involved must be redefined so as to reestablish the situation that would have prevailed in the absence of the transactions constituting that abusive practice. However, the prohibition of abuse is not relevant where the economic activity carried out may have some explanation other than the mere attainment of tax advantages.

[22] Case 196/04, *Cadbury Schweppes*.

[23] Case C-294/97, *Eurowings*.

[24] Case C-524/04, *Test Claimants in the Thin Cap Group Litigation*.

[25] Case C-105/07, *Lammers*.

[26] Case C-311/08, *SGI* ("wholly artificial arrangements" are purely artificial arrangements, devoid of economic reality and created with the aim of escaping the tax normally due on the profits generated by activities carried out in national territory).

[27] Compare with the GAAR included in the Commission's Proposal for a Council Directive on a Common Corporate Tax Base (CCTB) of Oct. 25, 2016 (COM (2016) 685 final, 2016/0337 (CNS); see also Staff Working Documents \SWD(2016) 341\ and \SWD(2016) 342\): For purposes of calculating the CCTB, a Member State must disregard an arrangement or a series of arrangements that, having been put in place for the essential purpose of obtaining a tax advantage that defeats the object or purpose of the CCTB rules, is not genuine, having regard to all the relevant facts and circumstances. An arrangement may comprise more than one step or part. For this purpose, an arrangement or a series of arrangements will be regarded as non-genuine to the extent it is not put in place for valid commercial reasons that reflect economic reality. Arrangements or a series of arrangements that is disregarded under the GAAR must be treated, for purposes of calculating the tax base, by reference to their economic substance (CCTB Proposal, Art. 58). The CCTB GAAR, in referring to "essential purpose" rather than "main purpose or one of the main purposes," arguably has a narrower scope than the GAAR concept in the ATAD. Also, the CCTB GAAR refers to "economic substance" for purposes of calculating the tax base, whereas under the ATAD, the tax liability must be calculated by reference to "economic substance in accordance with national law."

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