Corporate Tax Alliance

Newsletter
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Corporate Tax Alliance
PO Box 17111
2502 CC The Hague

www.corptax.org
info@corptax.org

Intro talk

Dear all,

It is that time! As promised, the revival of our CTA Network Newsletter.

In this edition of the Newsletter, we have contributions regarding developments and explanations in:

- *Spain by Victor Manzanares Sainz;*
- *Austria by Robert Schneider;*
- *Hong Kong by Sue Cuthbertson;*
- *United Kingdom by Robert Newey.*

We hope you have been enjoying the summer holidays. Let's keep that momentum going and reactivate not only our quarterly Newsletter, but also short and to the point quarterly Webinars.

The ultimate goal, of course, is to reactivate our annual physical CTA meeting to talk about tax, have a drink (or two) and laugh together.

It would be great if you all can share pro-actively short articles and/ or ideas for our Newsletter/ Webinars and updates on your resume for the website. Hereby please consider what *you can do* within CTA. Alone we can do so little, together we can do so much.

Stay Healthy, Stay Sane,
Jan, Guido & Nico

INDEX

Abuse of Parent-Subsidiary Directive? Spanish High Court places burden of proof on tax authorities

By Victor Manzanares Sainz, head of the Madrid office tax department at Monereo, Meyer, Abogados, S.L.P

Routing Spanish dividends to a non-EU shareholder via a Luxembourg holding company and thereby avoid Spanish withholding tax. Does that stand the anti-abuse test? On 25 May 2021 the Spanish National High Court (*Audiencia Nacional*) delivered its ruling on the application of the EU Parent Subsidiary to the distribution of dividends by a Spanish subsidiary to its Luxembourg shareholder, which was controlled by a non-EU resident Canadian pension fund.

This ruling constitutes an important pronouncement. It is a turning point in the case-law of the Spanish Supreme Court and the Spanish National Court on the interpretation of the anti-abuse provision contained in the Spanish implementation of the EU Parent Subsidiary Directive. Both courts had previously ruled that the taxpayer has the burden of proving the absence of abuse or fraud in cases where a Spanish company distributes dividends to an EU-resident parent entity controlled by third country residents.

The EU Parent Subsidiary Directive: principles, exceptions and safe-harbour provisions

It is well known that the EU Parent-Subsidiary Directive (90/435/EEC) provides for a 0% withholding tax on dividends paid between entities resident in EU Member States under certain conditions.

The EU Directive, as implemented by Spain, includes an anti-avoidance provision that excludes the withholding tax exemption on distributions made to direct EU shareholders when the majority of the voting rights of the EU parent company are directly or indirectly owned by non-EU residents. However, in such case, the 0% dividend withholding tax would still apply if one of the following conditions (the so-called safe harbours) is satisfied:

- The EU parent entity is in fact conducting a business directly linked to the Spanish subsidiary's business;
- The business purpose of the parent entity is the management of the subsidiary with the necessary organization of human and material resources; or
- Evidence can be given that the EU parent was incorporated on sound economic reasons and not only to benefit from withholding tax exemption.

Spanish Revenue denied refund to Luxembourg shareholder due to anti-avoidance provisions

In years 2009 and 2010, a Spanish company paid dividends to its Luxembourg parent company (LuxCo) applying a 15% dividend withholding tax. LuxCo is a holding company engaged in the purchase, sale and management of shareholdings carrying out material investments in different locations including Spain. LuxCo does not have employees and its 100 percent share capital is held directly by a non-EU resident Canadian pension fund.

Pursuant to the Directive, LuxCo requested from the Spanish Tax Authorities a full refund of the dividend withholding tax applied in Spain by the Spanish company in its dividend payments.

The Spanish tax administration denied the full refund to LuxCo, contending that the Directive's anti-avoidance provisions should apply.

According to the Spanish tax administration, the exemption could not be applied as 100 percent LuxCo share capital is held directly by a non-EU company; and LuxCo failed to prove it was incorporated for valid economic reasons.

"The fact that LuxCo is controlled by a non-EU resident Canadian pension fund is not enough to say the structure is abusive"

The Spanish National High Court followed the ECJ dividends, Eqiom and Enka, Deister Holding and Danish conduit cases, confirming that the Spanish tax authorities and not the taxpayer, should bear the burden of proof when determining whether the main purpose of the entity receiving dividends is to benefit from the Parent-Subsidiary exemption.

In view of the Spanish National High Court, the Spanish tax authorities had failed to prove that the LuxCo was not incorporated for valid economic reasons and the presumption that the incorporation of LuxCo was purely tax driven for the sheer fact that the parent LuxCo is a Canadian pension fund infringes the holdings of the referred ECJ case law.

In addition, the Spanish National High Court confirmed that EU holding companies can benefit from the Parent-Subsidiary exemption if they can show that, according to a set of objective and subjective elements, there is no abusive or fraudulent use of the provisions.

On the other hand, the Spanish National High Court understand that the fact that the LuxCo is controlled by a non-EU resident Canadian pension fund is not enough to regard the LuxCo as an instrumental vehicle.

To do: check investments in Spanish companies in view of criteria mentioned in court decision

The Spanish National High Court decision deserves a positive appreciation, to the extent that represents a change in approach in the burden of proof of abuse in the framework of the implemented Parent-Subsidiary Directive.

The Spanish National High Court now concluded that it is for the Spanish tax authorities to prove that all the elements of an abusive practice are present, and it prevented the tax authorities from transferring the burden of proof onto the taxpayer to demonstrate that an exception to the anti-abuse rule applies.

In our opinion, when advising non-resident taxpayers investing in Spanish entities through these types of corporate structures, the criteria stated by the Spanish National High Court through this new ruling must be taken into consideration.

Profit distribution versus equity repayment in Austria

By Robert Schneider, general partner of SchneideR'S Rechtsanwalts-KG, Vienna, Austria

When making a distribution to the shareholder, an Austrian company may have the possibility to choose how such distribution is treated and how it is taxed. The rules and timing constraints are of great importance. Following an Austrian Administrative Supreme Court Decision (*Erkenntnis des Verwaltungsgerichtshofes* dated 05.02.2021, Ro 2019/13/0027), this article explains the Austrian tax situation in relation to profit distributions on the one hand and equity repayments on the other hand.

Treating a distribution as capital repayment can save a lot of Austrian taxation

Profit distributions made by corporations are generally subject to a withholding tax at the rate of 27.5% if the recipient is a natural person. For most Austrian tax residents this withholding tax finally covers the tax liability on the dividend income. This is different if the individual shareholder applies for regular taxation of the dividend. Such application makes sense if the person's total taxable income is low so that his average income tax rate is less than 27.5%.

If the recipient is a corporation, the withholding tax rate is reduced to 25% (corresponding to the corporate tax rate), but in many cases exemptions apply either on basis of domestic provisions (participation exemption) or on basis of double tax treaties.[1]

Equity repayments, however, are never subject to withholding tax. It is hereby not relevant whether the recipient is a natural person or a corporation. The repayment of equity just reduces the acquisition costs and thus increases the tax basis in case of a later disposal of the participation.

When does a company have the option how to treat a distribution?

Until 2015, corporations were free to decide whether a payment to its shareholders shall be qualified as profit distribution or as equity repayment for tax purposes (provided that both kinds of payment were allowed under company law accounting rules).

In 2015, the Austrian income tax law was amended so that equity contributions should only be possible after all profit amounts were distributed. However, this amendment did not enter into force and was overruled by a subsequent amendment that restored the freedom of choice. However, such choice is only possible, if the company has sufficient equity amounts as well as sufficient profit amounts to be distributed. In case that there are no sufficient profit amounts, dividend payments must be qualified as equity

[1] It should be noted that dividends received by an Austrian corporation from another Austrian corporation are always exempt from corporate tax but might not be exempt from withholding tax; in this case withholding tax on dividends is refunded or treated as corporate tax prepayment.

repayments, whereas payments must be qualified as dividend distributions in case that there is not sufficient equity available to be repaid.

The available equity resulting from shareholder contributions and the available profit amount resulting from the company's business activities (the company's internal financing, in German "*Innenfinanzierung*") is calculated according to tax provisions on basis of the equity and profits shown in the financial statements and must be disclosed in a separate table as part of the corporate income tax return.

In case there is sufficient equity as well as sufficient profit available to cover the distribution, the choice of qualification has to be made ultimately at the end of the calendar year. Regularly the choice is made in the withholding tax return that must be filed within one week after the distribution. A qualification of (hidden) distributions as equity repayments after the end of the calendar year is not possible.

Court decides that deadline for choice must be read strictly

The decision of the Austrian Administrative Supreme Court mentioned at the beginning of this article confirmed this point of view pursuant to an appeal of the Austrian tax authority against a decision of the Austrian Federal Finance Court (*Bundesfinanzgericht* or *BFG*). In its decision, the *BFG* was of the opinion that the option for qualification of a (hidden) distribution as equity repayment can be executed without time limits. In the case at hand, a company sold shares in a participation, but part of the purchase price was not paid to the company but to its shareholder. This was discovered during a tax audit and withholding tax was charged retrospectively. This tax charge was contested by the company that missed-out on the payment, favouring its parent. This company argued that part of the payment made to the shareholder should be considered as equity repayment. The *BFG* followed this argument. The *VwGH* repealed this decision, however, arguing that the qualification as equity repayment must be exerted until the end of the calendar year in which the payment was made. As the hidden distribution in the case at hand was made in 2009 and the qualification as equity repayment was only brought forward in the appeal against the tax charge some years later, withholding tax had to be paid.

New legislation enacted in Hong Kong enabling a tax deduction for foreign taxes

By Sue Cuthbertson, Managing Director

Tax Advisors (International) Limited
BOUTIQUE HONG KONG & MAINLAND CHINA TAX FIRM

The aspirations of as Hong Kong an international hub for technology, innovation and the development of intellectual property are not perfectly matching the tax system of Hong Kong. Due to the principles of the Hong Kong tax system, there were no rules to allow for relief for foreign taxes on, for example, royalties and licence fees. Recently enacted legislation provide for a tax relief, also for countries that do not have a DTA with Hong Kong.

Hong Kong applies a territorial system of taxation whereby only income under specified heads of taxation is subject to Hong Kong Profits Tax ("Profits Tax") to the extent that it is arising in or derived from Hong Kong from a business that is carried on in Hong Kong.

Conversely a Profits Tax deduction for specified expense is only available to the extent that it is incurred in the production of profits chargeable to Profits Tax.

Given the territorial nature of the Profits Tax regime, prime facie, profits derived from outside Hong Kong would be outside the scope to taxation and any expenses incurred in connection with those profits would be non-deductible.

Foreign tax relief was not a big thing in Hong Kong, it entered into its first DTA only in 2004

However, in certain circumstances, income or profits arising in other jurisdictions that may have been taxed in that jurisdiction, for example, royalties, interest or service fees may be subject to Profits Tax in Hong Kong as a consequence of the interpretation of source in Hong Kong or the application of specific sections of the Inland Revenue Ordinance ("IRO").

Historically, Hong Kong did not have a comprehensive double tax treaty network, with its first Double Tax Agreement (“DTA”) with Belgium having entered into force on 7 October 2004.

Accordingly, taxpayers subject to Profits Tax on income or profits that had been taxed overseas relied on the deduction section of the IRO, Section 16, to claim a tax deduction for overseas taxes. In particular, reliance was placed on Section 16 (1) of the IRO to claim a deduction for foreign taxes paid on profits or income, including royalties, licensing fees and service income on the ground that these were expenses of a non-capital nature incurred in the production of chargeable income.

Section 16(1) (c) provided a deduction for foreign taxes paid on certain types of income, such as specified interest, interest from inter-company financing and gains on the redemption of taxable instruments, to the extent that the taxes were paid in a jurisdiction with which Hong Kong had not entered into a DTA. In the absence of a DTA network most overseas taxes of a similar nature to Profits Tax would be deductible under this section.

However, as the Hong Kong DTA network subsequently expanded exponentially, the Inland Revenue Department (“IRD”) introduced a new Section into the IRO, Section 16 (2J), and issued a revised Departmental Interpretation and Note (“DIPN”) No. 28 (Revised) concerning the Deduction of Foreign Taxes in July 2019.

Section 16 (2J) which was effective from the year of assessment 2018/19 restricted the deduction available under Section 16(1) (c) of the IRO if the overseas taxes were paid in a jurisdiction with which Hong Kong had entered into a DTA which provided for a tax resident of Hong Kong to claim a tax credit in accordance with Section 50 of the IRO.

Furthermore, the IRD clarified in DIPN No. 28 (Revised) that deductions for overseas taxes paid on profits or income such as royalties, licensing and service fees would not be deductible under Section 16 (1) of the IRO since tax on profits and income is an application of the profits and not an expense or outgoing incurred in the production of chargeable profits.

As a consequence, taxpayers in receipt of income such as royalties, licensing fees and service income which did not fall within the scope of Section 16 (1) (c) would not be able to claim a deduction for overseas taxes charged on such income if received from a jurisdiction which had not entered into a DTA with Hong Kong, resulting in double taxation. Of course, if a DTA was in place, a Hong Kong resident taxpayer would be able to claim an appropriate tax credit as provided for in the Articles of the DTA.

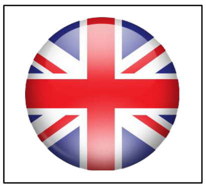
Bill 2021 introduces new provisions for claiming a tax deduction for overseas tax from non-DTA countries

As Hong Kong is actively promoting itself as a hub for technology, innovation and the development of intellectual property, the restriction of the tax deduction for overseas taxes paid on royalties and license fees may have severely impacted such development given that many payers of such fees may be located in developing nations which have not entered into DTAs with Hong Kong.

Accordingly, Hong Kong enacted the Inland Revenue (Amendment) (Miscellaneous Provisions) Bill 2021 (“Bill 2021”) which extends Section 16 (1) (c) to include royalties and licensing fees subject to the provisions of the revised Section 16 (2J) and Section 50 of the IRO. As a consequence, taxpayers paying overseas taxes in a jurisdiction with which Hong Kong has not entered a DTA will be able to claim a deduction for such overseas tax. If the overseas tax is paid in a DTA jurisdiction they will continue to be able to claim the appropriate tax credit under the terms of the DTA.

The Bill 2021 also added Section 16(1) (ca) which effectively provides that non-residents who are subject to Profits Tax and who pay “specified tax” may claim a deduction for that overseas tax in Hong Kong subject to the provisions of Section (16) (2J) and Section 50AA of the IRO. This provision will be particularly attractive to branches of foreign companies located in Hong Kong who are in receipt of income subject to specified tax from non-DTA jurisdictions.

Tax considerations when leaving the United Kingdom



By Robert Newey, Robert Newey & Co

It is possible to write a book about the tax aspects for individuals who emigrate from the United Kingdom (UK). This article is intended as ‘only’ a general overview of the UK tax implications for an individual leaving the UK to live abroad. To keep the length manageable, much detail is omitted. **For reasons of simplicity, this article assumes that:**

- the individual was resident in the UK for at least one of the 3 previous tax years;
- the individual does not work on board a vehicle, aircraft, or ship; and
- the individual does not die during the tax year of departure.

Note that a **tax year** runs from 6 April to the following 5 April. Usually, under UK tax law, residence status is for a complete tax year.

To be a UK tax resident or not, that is the question

The first question is whether or when the individual ceases to be resident in the UK for UK tax purposes. Since 2013 the UK has had a “statutory residence test,” which in fact consists of a hierarchy of tests.

1. An individual is resident in the UK for a tax year if the “automatic residence test” (see under 2-6) is met, or if the “sufficient ties test” (see under 7-8) is met. If the automatic residence test is met, it is not necessary to consider the sufficient ties test.

Automatic residence test

2. The automatic residence test in fact consists of several tests. There are 2 groups of these tests:
    a. the “automatic UK tests”; and
    b. the “automatic overseas tests”.
3. If any one or more of the automatic overseas tests is met, the individual is non-UK resident for the tax year concerned come what may.
4. For purposes of this article, there are 2 automatic overseas tests.
    a. The first of these tests applies where an individual spends less than 16 days in the UK during the tax year.
    b. The second test applies if during the tax year the individual works “sufficient hours overseas,” there are no “significant breaks” from overseas work, and certain other criteria are satisfied.
5. If none of the automatic overseas tests apply, then it is necessary to consider the automatic UK tests. If any of the automatic UK tests applies, then the individual is UK resident for the tax year concerned.
6. There are basically 3 automatic UK tests, covering:
    a. days spent by the individual in the UK;
    b. availability of a home to an individual in the UK; and
    c. hours worked by the individual in the UK.

Sufficient ties test

7. If none of the automatic overseas tests or automatic UK tests apply, it is necessary to consider the sufficient ties test.
8. Under the sufficient ties test, there is a sliding scale to the number of UK ties that is required for somebody to be regarded as UK resident, depending on the number of days spent by the individual in the UK in the tax year under consideration. The more days the individual spends in the tax year UK, fewer ties are needed for the individual to be regarded as UK resident.

    The **relevant ties** are:
    - a “family tie” – a member of the individual’s family (i.e. spouse or minor children) is UK resident;
    - an “accommodation tie” – the individual has accommodation in the UK available for his or her use;
    - a “work tie” – the individual performs more than 3 hours’ work in the UK on 40 or more days in the tax year;
    - a 90-day tie – the individual spent 91 or more midnights in the UK in one or both of the 2 previous tax years; and
    - a “country tie” – the individual spends more midnights in the UK in the tax year concerned than in any one other country.

Split tax year

9. As already noted, tax residence status is normally for a complete tax year (6 April to the following 5 April). In limited circumstances, however, it is possible to split a tax year in which an individual departs from the UK. Briefly these are:

   a. Case 1 – where the individual, having been UK resident in the previous tax year, starts work overseas and then stays in continuous work overseas for the remainder of the relevant tax year and the whole of the following tax year;

   b. Case 2 – where the individual is an accompanying spouse of someone who falls within Case one, who moves abroad to join him or her;

   c. Case 3: where
      i. the individual has no home in the UK in the overseas part of the year;
      ii. the individual spends fewer than 16 nights in the UK in the overseas part of the year; and
      iii. within 6 months of leaving, the individual becomes tax resident in another country or establishes his or her only home there.

   The overseas part of the year starts when the leaver first ceases to have a UK home.

10. Split year treatment does not mean that the individual is non-UK resident in the overseas part of the year for all purposes. It is necessary to check each charging provision individually to see whether split year treatment applies.

UK tax treatment of an individual who is not UK resident

UK tax legislation is, in general, subject to territorial limits. This means that either 'what is taxed' must have a UK source, or 'the person who is taxed' must be resident in the UK.

Someone who is not resident in the UK will generally remain taxable on income with a UK source.

Non-residents are generally not liable to capital gains tax ("CGT"), but:

- An individual who carries on a trade or profession in the UK through branch or agency is charged to CGT on gains arising on the disposal of assets in the UK used for the business or by the branch or agency. (TCGA 1992, section 1B.)
- A non-resident individual who disposes of UK property is liable to CGT. (TCGA 1992 section 1A.)
- An individual who emigrates but returns to the UK after a period of 5 or fewer tax years will be taxed on disposals made during his/her absence. (TCGA 1992, section 1M.)

Steps to be taken on departing from the UK

The simplest guidance is that someone leaving the UK should complete form P85 and submit it to HMRC. Depending on the detailed circumstances, this may well result in a tax refund. See https://www.gov.uk/government/publications/income-tax-leaving-the-uk-getting-your-tax-right-p85. It would be prudent, however, to seek professional advice before submitting this, especially because tax law and practice can change very fast. Such specific advice is likely to be essential to obtain before taking, or deciding not to take, any action.