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Tax Treaty Case Law around the Globe 2017

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Tax Treaty Case Law around the Globe 2017

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This book is a unique publication that gives a global overview of international tax disputes on double tax conventions, thereby filling a gap in the area of tax treaty case law. It covers the 41 most important tax treaty cases that were decided around the world in 2016. The systematic structure of each chapter allows for the easy and efficient study and comparison of the various methods adopted for applying and interpreting tax treaties in different cases.

With the continuously increasing importance of tax treaties, *Tax Treaty Case Law around the Globe 2017* is a valuable reference tool for anyone interested in tax treaty case law. This book is of interest to tax practitioners, multinational businesses, policymakers, tax administrators, judges and academics.

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Preface

Both the OECD Model Tax Convention on Income and Capital (OECD Model) and the United Nations Model Double Taxation Convention (UN Model) often serve as a basis for tax treaty negotiations between different jurisdictions worldwide. At the same time, however, and for a number of reasons, the interpretation of a particular tax treaty provision may still differ from country to country. Therefore, the risk of double or even multiple (non-) taxation is not fully eliminated. In order to promote a uniform interpretation of tax treaties worldwide and, hence, to reduce the risk of double or multiple (non-) taxation, basic knowledge is needed on how various tax treaty issues are solved in different jurisdictions. It is widely known that a unified approach to interpretation and application of international tax treaty rules can benefit not only the countries which are parties to the tax treaty in question but also their taxpayers, as well as international trade and investment in general. Therefore, this topic is of ongoing concern to many tax scholars, practitioners, representatives of international organizations and public officials.

On 27-29 April 2017, the conference "Tax Treaty Case Law around the Globe" was held at the WU (Vienna University of Economics and Business). This international conference took place for the seventh time (for the fourth time in Vienna) and was jointly organized by the Institute for Austrian and International Tax Law of the WU and the European Tax College of Tilburg University. The conference was dedicated to the analysis of the most important cases on international tax treaty law decided in different tax jurisdictions across the world in 2016. 42 cases were presented by outstanding tax experts from 28 countries. Each presentation was followed by an intensive and fruitful discussion. The participants in the conference compared interpretation approaches existing in both the OECD and non-OECD Member countries and came up with comprehensive conclusions and suggestions. The main scientific results of the conference are presented in this book.

Each report in this book is dedicated to a court case or a number of cases from 2016 on a particular article of the tax treaty at issue (often based on the OECD Model or UN Model) in a certain jurisdiction. Every report is structured in a similar way: facts of the case, the decision and reasoning of the court and the author's observations, including the possible impact of the decision on international tax law development in the respective country and in other jurisdictions. This clear and concise structure enables a solid and accessible overview of the 2016 case law on tax treaty application. The systematic structure of each report, allows for different tax treaty case law to be studied and compared in a simple and efficient way.

The editors believe that the reports presented in this book are of high value and, therefore, will be of particular interest for academics, tax consultants, judges, public officials and all those interested in international tax law. The fact that many domestic decisions are otherwise available only in the respective national languages makes the materials contained in this book even more valuable.

The editors would like to express their sincere gratitude to the Linde Publishing House for their cooperation and swift realization of this publishing project. Ms. Eleanor Campbell contributed greatly to the completion of this book by editing and polishing the texts for authors, for whom English is – for the most part – a foreign language. Furthermore, we are most grateful to Rita Julien and Selina Siller who helped with the preparation and realization of the conference and assisted in editing the book. Finally, special thanks go to Renée Pestuka who was responsible for the organization of the conference in Vienna and who also worked on the publication of this book.

Vienna, October 2017 The Editors

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Sample Content

Finland: Allocation of Subsidiary Share Related Loans to a PE[1]

Marjaana Helminen

1 FI: Supreme Administrative Court of Finland (KHO), 19 May 2016, KHO 2016/2147 (71) and KHO 2016/2146 (72).

1. Introduction

On 19 May 2016 the Supreme Administrative Court of Finland (KHO) delivered two judgments concerning the allocation of subsidiary shares and the loans related to the acquisition of the shares in a permanent establishment.[2] In order for the interest on such loan to be deductible in the taxation of the permanent establishment, the shares and the related loans have to be allocated to the permanent establishment.

However, it is not always clear as to when subsidiary shares and related loans should and can be allocated to a permanent establishment. The question of the proper allocation arises especially when the permanent establishment allocation means a considerable tax benefit to the company.

The proper allocation is primarily a question of general domestic tax law allocation rules and different anti-tax avoidance provisions. The impact of an applicable tax treaty depends on the impact of article 7 of the OECD Model concerning business profits and article 9 concerning associated enterprises and on how these tax treaty allocation provisions are interpreted.

2. Facts of the Cases

Both cases concerned a debt push-down arrangement in which a non-resident company had acquired an active subsidiary in the name of the non-resident company's permanent establishment situated in Finland. The non-resident company had allocated the subsidiary shares and the acquisition-related loans to the permanent establishment situated in Finland. The interest related to the loans had been deducted in the taxation of the permanent establishment.

In both cases the permanent establishment was able to cover the interest cost only with tax deductible group contributions received either from the acquired Finnish subsidiary or another Finnish group company engaged in active business. As a consequence of the combination of the group contributions and interest deductions no or very little taxes had been paid in Finland despite the active business in Finland.

In case KHO 2016/2147 (71) (hereinafter case 71) the arrangement took place in tax year 2006 and in case KHO 2016/2146 (72) (hereinafter case 72) in tax year 2008.

2 The two decisions have received a lot of attention from Finnish scholars. See e.g. Knuutinen, Reijo, Sivuliikkeiden korkovähennysten epääminen: normaalitulkintaa ja veron kiertämistä koskevan säännöksen soveltamista, Defensor Legis 5/2016, p. 799-818, Isomaa-Myllymäki, Anita, Tytäryhtiöosakkeiden ja niihin liittyvän hanintavelan kohdistaminen kiinteälle toimipaikalle, Verotus 4/2016, pp. 365-377, Penttilä Seppo, Korkojen vähennyskelpoisuus kiinteän toimipaikan verotuksessa – KHO:n ratkaisut 2016:71 ja 2016:72 ja niiden analyysi, www.edilex.fi/artikkelit/16631 and Nykänen, Pekka, Korkojen vähennyskelpoisuus verosuunnittelun välineenä ja mahdollisuudet puuttua ilmiöön, www.edilex.fi/artikkelit/16625.

3. The Court's Decisions

The KHO denied the allocation of the subsidiary shares, loans and interest to the permanent establishment and denied the interest deduction in both of the cases. The interesting difference between the cases was, that the decision in case 71 was based on the standard interpretation of general domestic tax law and tax treaty allocation provisions whereas the decision in case 72was based on the application of the general anti-avoidance rule in Finnish domestic law (section 28 of the GAAR; Act on Taxing Procedure (VML[3]).

In case 71 the court considered that in light of the OECD authorized approach the allocation of the shares, loans and interest to the permanent establishment would have been artificial. In case 72, however, the court considered that taken as a whole the series of arrangements was wholly artificial and therefore the GAAR was applied.

4. Comments on the Court's Reasoning

4.1. The Difference between the cases

The different approaches in the cases can be explained by the fact that in case 71 only very minor functions and few personnel were allocated to the permanent establishment. It was not shown that the permanent establishment had used the control power related to the subsidiary shares. The personnel of the permanent establishment did not engage in key personnel functions related to the ownership of the subsidiary shares. They did not have genuine control over the decisions concerning the ownership of the subsidiary shares. Moreover, the dividends received from the Finnish subsidiary had not effectively been allocated to the permanent establishment but had been transferred almost immediately from the permanent establishment to the foreign company. Under these circumstances the KHO considered that the subsidiary shares had not been used for the business of the permanent establishment and therefore could not be allocated to the permanent establishment.

In case 72 there was more substance to the permanent establishment. There were more functions and more personnel in the permanent establishment. It was still unclear whether the key shareholder functions were in the permanent establishment. The power to make strategic decisions concerning the acquisition or alienation of the subsidiary shares or strategic decisions concerning finance was not considered to be vested in the permanent establishment. Another relevant fact was that the series of arrangements took place very close to each other timewise, leading to major tax benefits without particularly relevant business reasons.

3 FI: *Laki verotusmenettelystä,* 18.12.1995/1558 (Act on Taxing Procedure).

In the end the court reached the conclusion that taken as a whole the series of arrangements were wholly artificial. It is however, important to note that the decision of the judges in case 72 was not unanimous. Three of the five judges considered that the permanent establishment was engaged in functions related to holding of the subsidiary shares and also that business risks could be allocated to the permanent establishment. Therefore, based on the standard interpretation the shares should be allocated to the permanent establishment. Only the application of section 28 of the GAAR of VML to the series of arrangements as a whole made it possible to deny the interest deduction. Three of the five judges considered that the GAAR had to be applied.

4.2. Relevance of the OECD Reports

In both of the cases the KHO referred to article 7(3) of the Nordic Tax Treaty (1996). According to article 7(3) of the Nordic tax treaty

> in determining the profits of a permanent establishment, there shall be allowed as deductions expenses which are incurred for the purposes of the permanent establishment, including executive and general administrative expenses so incurred, whether in the State in which the permanent establishment is situated or elsewhere.

Referring to article 7(3) of the Nordic tax treaty, the KHO considered that for tax treaty purposes it is also necessary to determine whether the subsidiary shares are assets of the permanent establishment.

In case 71 the court specifically mentioned that the OECD authorized approach (AOA) based on the OECD Report on the Attribution of Profits to Permanent Establishment (2008) (hereinafter the OECD Report 2008) must be followed in determining the proper allocation. The AOA could be followed even though the arrangement concerned had already taken place back in 2006. The court noted that, to the extent that the OECD Report 2008 introduced changes to the OECD Model it could not have any impact on the interpretation of the Nordic tax treaty in the case concerned. Instead, the OECD Report 2008 was relevant only to the extent that it was intended to provide guidance on how the version of the OECD Model that existed prior to the 2008 Report was to be interpreted.

The AOA advocates first determining the functions, assets and risks of the permanent establishment and then determining the intra-group transfers and their prices taking into account the functions, assets and risks.[4] Based on this analysis the KHO considered that the allocation of the subsidiary shares to the permanent establishment was artificial. The shares could have been allocated to the assets of the permanent establishment only if the allocation reflected the genuine division

4 See OECD Report on the Attribution of Profits to Permanent Establishment (OECD 2008) [hereinafter OECD Report 2008], Section D-2 and D-3.

of functions, assets and risks between the permanent establishment and other parts of the company.

In case 71 the court considered that on the basis of the domestic law general allocation provisions and article 7 of the Nordic tax treaty, interpreted in accordance with the AOA, the subsidiary shares were not assets of the permanent establishment. Under these circumstances the possible applicability of the Finnish GAAR (section 28 of the VML) was not relevant. The case could be solved based on normal interpretation of domestic law and tax treaty rules.

In case 72 the debt push-down arrangement including the allocation of subsidiary shares to the permanent establishment situated in Finland was a part of a series of intra-group arrangements that took place timewise very close to each other. In this case the KHO considered that the series of arrangements had to be considered as a whole. The majority of the judges considered that the legal form given to the series of arrangements was not considered to comply with the actual nature and purpose of the arrangement and that the purpose of the series of arrangements was to avoid taxes, thereby exploiting the combination of interest deduction and group contribution for no business reasons other than tax reasons. Therefore based on the Finnish domestic law GAAR, section 28 VML the shares could not be allocated to the permanent establishment and the interest was not deductible.

In addition, in case 72 the OECD AOA approach was mentioned. It was considered that allocation in accordance with the AOA approach would lead to the same outcome as the application of the domestic law GAAR: the subsidiary shares could not be allocated to the permanent establishment.

4.3. TFEU freedom of establishment

In both cases, the taxpayer asked the KHO to refer the case to the CJEU, because it considered that the denial of the deduction was contrary to the TFEU freedom of establishment provision. The taxpayers claimed that there was a conflict because in the case of a subsidiary the shares and the related loan could have been allocated to the subsidiary and the interest would have been deductible whereas this was not possible in the case of a permanent establishment. The KHO, however, considered that there was no need to refer the case for a preliminary ruling.

In case 71 the court stated that there was no freedom of establishment issue because an arrangement based on the use of a subsidiary in a debt push-down arrangement is not comparable to an arrangement based on the use of a permanent establishment and because the allocation of the shares to the permanent establishment in such an arrangement would be artificial. In case 71 the court, however, did not indicate that it considered that the allocation to the permanent establishment was wholly artificial unlike in case 72 where the court specifically stated that the allocation was wholly artificial and therefore no freedom of establishment issue existed.

The decision in case 71 was made based on the standard interpretation of tax law and not on the basis of the application of the GAAR to a wholly artificial arrangement. The court only mentioned that the allocation to the permanent establishment would have been artificial but not that the allocation would have been wholly artificial. In view of this difference between the cases, the author considers that the court in case 71 should have paid more attention to the EU law issue. As a consequence of this omission, the decision in case 71 may be in conflict with the TFEU freedom of establishment principle.

5. Conclusion

It can be concluded that the KHO considers that the two step allocation approach based on the OECD Report 2008 did not introduce such changes to the OECD Model that it could not be applied in the case of tax treaties dating from before the OECD Report 2008. Secondly, it can be concluded that the KHO considers that the OECD allocation approach is in line with the Finnish general tax law allocation provisions.

Despite these two important KHO decisions, it is not always clear as to when debt-push down arrangements are allowed in permanent establishment situations. It cannot be concluded that acquired subsidiary shares and the acquisition loan can never be allocated to a permanent establishment. Nor can it be concluded that covering interest deductions with group contributions will always be a problem. Allocation of subsidiary shares and the related loan to a permanent establishment should be allowed if in the light of the functions, assets and risks of the permanent establishment the subsidiary shares are part of the business of the permanent establishment.

The impact of the TFEU freedom of establishment is still unclear in relation to the case which was based on the standard interpretation of tax law and not on the application of the GAAR to a wholly artificial arrangement.

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