The Graduate Tax Program Presents:

COMPARATIVE TAX LAW:
France and ATAD Versus the Economic Substance Doctrine

Join students from the NYLS LL.M. in Taxation Program and the Université de Rennes 1 LL.M. in Taxation in our annual comparative discussion of major U.S. and French tax concepts. This year’s discussion will address the U.S. economic substance doctrine, its partial codification, and its French and European equivalents—the “abuse of law” concept.

Date: Tuesday, April 30, 2019
Time: 12:30 p.m.–2:00 p.m.
(Light lunch will be served at 12:15 p.m.)
Location: Auditorium
185 West Broadway, New York, NY 10013
RSVP: www.nyls.edu/TaxRSVP
CLE: 1.5 credits in Areas of Professional Practice (NY transitional and nontransitional)
Contact: ashley.oliver@nyls.edu • 212.431.2147
The economic substance and the step transaction doctrines: a French perspective
Introduction

- Principle of freedom of management

- One of the limit to this principle : Abuse of Law doctrine

- Two provisions can be used to characterize an abuse of law:
  - The traditional French concept - Art L. 64 of FTC (Exclusive Purpose Test)
    - 80% or 40% penalties
  - January 2019: A new concept (close to PPT) coming from the ATAD - Art 205 A FTC (Principal Purpose Test)
    - No automatic penalty (tax base rule)
I/ THE NOTION OF «ABUSE OF LAW»
A) The traditional abuse of law concept in French tax law (1/2)

Exclusive tax purpose

- French tax law literally requires the scheme to look for an exclusive tax purpose

- Garnier Choiseul case, FASC, 17 July 2013:
  - Step 1: Company A purchased company B that no longer carried out an activity
  - Step 2: Company B distributes dividends to company A
  - Consequences:
    - Deduction from the tax base of impairment on securities and dividends tax exempt
    - Cash advantage due to dividends received

Even if the tax advantage was not the sole purpose of the transaction, it qualifies as an exclusive tax purpose because the cash advantage is insignificant compared to the tax benefit.
A) The traditional abuse of law concept in French tax law (2/2)

Taxpayer looks for a literal application of provisions or decisions against the initial objective sought by their authors

- Before, the judges were clearly characterizing these elements

- Evolutions: this condition is testified by the artificiality of the arrangement

  - SCI PH R Investissement case - FASC, 8 February 2019
B) The implementation of the ATAD (1/2)

- ATAD stands for anti-tax avoidance directive
  - It is an EU Directive implementing into EU law the BEPS project

- The Finance Act for 2019 transposes the ATAD general anti-abuse rule

- 3 cumulative conditions:
  - existence of an arrangement which is not genuine
  - having for principal purpose or one of the principal purpose the obtainment of a tax advantage
  - that defeats the object or purpose of the applicable tax law
B) The implementation of the ATAD (2/2)

- **The requirement of non-genuine arrangement**
  - Introduction of this notion in the French Tax Code
  - Interpretation of the notion of “artificial arrangement” : X-GmbH case - ECJ, 2019

- **The pursuit of a principal tax purpose**
  - “Principal tax purpose” replaces “exclusive tax purpose”
  - Notion not new to European Union : Halifax case - ECJ, 2006

- **The third condition is common to Article L64 FTCP (EPT)**
II/ IMPLEMENTATION OF THE NOTION OF «ABUSE OF LAW»
CASE STUDY
- USA
- Luxembourg
- France

- Withholding tax: 5% Luxembourg/USA DTT
- Withholding tax: 5% France/USA DTT
- Withholding tax: Exempt by EU law
A) The traditional abuse of law concept (the EPT) (1/2)

Literal application of provisions against the initial objective sought by the author / Non-genuine arrangements

- Much easier to focus on the artificiality of the arrangement

- Material criteria:
  - Absence of employees
  - Absence of mean of production
  - Absence of ordinary general meeting

- Economic criteria:
  - No operational activity
  - Absence of risk borne by the company
A) The traditional abuse of law concept (the EPT) (2/2)

**Exclusive purpose test / Principal purpose test**

Even if the literal application criteria is no longer mandatory for an act to be regarded as an abuse of law, it remains necessary to demonstrate that the arrangement has a tax purpose.

- “An arrangement may not be qualified as an abuse of law if it does not provide any tax advantage” – Pharmacie des Chalonges case, FASC, 5 March 2007

- In our situation, the abuse of law within the meaning of article L 64 of the French Tax Procedure Code may not be claimed by the French Tax Authorities because there is no tax advantage.
B) Abuse of law under the implementation of the ATAD (the PPT) (1/3)

New concept: lack of guidelines in French case law

Very important recent case: Danish case, 26 February 2019

- Characterization of an abuse of law requires 2 conditions:
  - Purposes of the provision not achieved
  - The intention to obtain a tax advantage by artificial arrangement
B) Abuse of law under the implementation of the ATAD (the PPT) (2/3)

Assessment of artificiality

- Necessary substance has to give economic and commercial justification

- Indications which may lead to the characterization of artificiality:
  - Indictions based on the use of income
  - Indications of the existence of a relay company
  - Temporal proximity between operations and the entry into force of new tax laws

- It is no longer possible to avoid the characterization of an abusive situation if no economic element is proven

- Material & legal substances may not be sufficient
B) Abuse of law under the implementation of the ATAD (the PPT) (3/3)

Assessment of a tax advantage in the arrangement

It may no longer be necessary to characterize a tax advantage

- Case refers to “the intention to obtain an advantage”

- It would be possible to characterize abuse even if the tax treatment of the flow is not improved by the implementation of this arrangement

- The assessment of an abuse of law under PPT covers a broader scope than the assessment of an abuse of law under EPT
To conclude
US Anti-Tax Avoidance: The Economic Substance Doctrine

Presented by:
- Lionel Kuate Talom; Lynne Summers; Anne Maly; Elliot Kelly; and Hannah Daniels
Overview

• Brief Introduction to Economic Substance
• The Doctrine before Codification
• What Led to Codification
• The Application of § 7701(o)
• Examples
• Penalty Structure
• Brief Comparison “abus de droit” in France
• Conclusion
Objective

At the end of this presentation, you will be able to:

• Describe the basic principles of the codification of economic substance ("COES") doctrine
• Identify situations where COES is likely applicable
• Identify key differences between COES and "abuse de droit" doctrine in France
• Be aware that the ATAD Directive adopted in 2016 in implementation of BEPS Action 15 invites EU member States to provide comments to the EU Commission on implementing the anti tax abuse practices.
What is the economic substance doctrine? Cases Establishing the Law Prior to 2010

• A judicial doctrine commonly cited as originating in *Gregory v. Helvering*, that has been used to disallow the tax benefits generated by transactions that literally satisfy the requirements of the code but lack practical economic significance apart from the tax benefits.

• Tax avoidance is not permitted to be the taxpayer’s only motive for entering the transaction. *Gregory v. Helvering*.

• The economic-substance doctrine provides “a transaction is not entitled to tax respect if it lacks economic effects or substance other than the generation of tax benefits, or if the transaction serves no business purpose.” *Winn-Dixie Stores, Inc. v. Comm’r*
Economic Substance Doctrine Prior to Codification

- On a case-by-case basis, federal courts developed and applied the economic substance doctrine to deny tax benefits flowing from transactions lacking any “purpose, substance, or utility” apart from their tax consequences. The taxpayer bears the burden of proving that a disputed transaction possesses economic substance.
- Economic substance (objective): Transaction changes taxpayer’s economic position in a meaningful way apart from federal tax effects.
- Business Purpose (subjective): Taxpayer has substantial purpose for engaging in transaction apart from federal tax effects.
- Legislation introduced beginning in 1999 to codify economic substance; bills proposed each Congress thereafter.
What Led to Codification

• Lack of Uniformity
  – Three different approaches used to apply the law

• Viability of the Economic Substance Doctrine
  – The Court of Federal Claims concluded application of the doctrine would violate the separation of powers

• Projected Tax Revenue
  – The effect of a stricter penalty scheme and uniformity were estimated to bring in additional $4.5 billion tax revenue in 10 year window
What Led to Codification

Geographic Boundaries
of United States Courts of Appeals and United States District Courts
Coltec Industries v. United States

• “Under our time-tested system of separation of powers, it is Congress, not the court, that should determine how the federal tax laws should be used to promote economic welfare.”

• “[T]he use of the ‘economic substance’ doctrine to trump ‘mere compliance with the Code’ would violate the separation of powers.”
The Joint Committee on Taxation estimated that codification of economic substance doctrine and the associated penalties for its violation would increase tax revenue by $4.545 billion.
March 30, 2010, section 7701(o) “Clarification of Economic Substance Doctrine” and related strict liability penalty provisions took effect.
Economic Substance Doctrine Now

Under Section 7701(o), a taxpayer must establish the presence of both economic substance/effects and business purpose:

Objective Test
– Change in the Taxpayer’s Economic Position in a Meaningful way

Subjective Test
– Substantial Purpose for entering into transaction (apart from Federal income tax effects)
Open Issues

• Uniformity
  – Whether a conjunctive test actually changed judicial scrutiny of transactions
  – Courts may apply principles of statutory interpretation differently
    ▪ “Substantial”
    ▪ “Meaningful”

• Constraining Judicial Discretion
  – IRS Regulatory Authority could trump judicial precedent
  – Penalty Structure
Examples


– Plaintiff sold his business and was set to receive $45 million in capital gains
– Employed KPMG to provide tax advice
– After a convoluted series of transactions, using foreign entities, options and swap deals, created a loss of $45 million, which plaintiff utilized to offset their capital gains
– Court found that the transaction lacked economic substance
  ▪ Prearranged steps designed to create losses
  ▪ Plaintiff was not an investor
  ▪ Loss had no economic reality
Examples continued


- Purchased currencies, and sold options
- Created a net loss
- Court said the transaction lacked economic substance
  - No real dollars changed hands
  - Notably, it did not violate Federal Tax laws
Codification of Economic Substance
Possible Application to
Facts of Prior Historic Cases

• Cottage Savings v. United States, 499 U.S. 554 (1991)

• Dover Industries Inc. v. Commissioner, 122 T.C. 324 (2004)
Planning: P owns a portfolio of mortgage securities which have declined in value. P swaps securities for a portfolio of similar securities and claims a loss on the exchange.
Step 1: CFC-2 elects to be classified as a disregarded entity --- a liquidation.

Step 2: CFC-1 sells interest in CFC-2 which is now a disregarded entity.

Liquidation converts CFC-2 to a branch resulting in asset versus stock sale avoiding Subpart F inclusion.
Penalty – I.R.C. § 6662

(a) Imposition of penalty.--If this section applies to any portion of an underpayment of tax required to be shown on a return, there shall be added to the tax an amount equal to 20 percent of the portion of the underpayment to which this section applies.

(b) Portion of underpayment to which section applies.--This section shall apply to the portion of any underpayment which is attributable to 1 or more of the following:

(6) Any disallowance of claimed tax benefits by reason of a transaction lacking economic substance (within the meaning of section 7701(o)) or failing to meet the requirements of any similar rule of law

(i) Increase in penalty in case of nondisclosed noneconomic substance transactions.--

(1) In general.--In the case of any portion of an underpayment which is attributable to one or more nondisclosed noneconomic substance transactions, subsection (a) shall be applied with respect to such portion by substituting “40 percent” for “20 percent”.

* Subsection (2) → defines “nondisclosed noneconomic substance transaction”
* Subsection (3) → restrictions on amendments or supplements to a return
Penalty Structure

• In Favor of Strict Liability
  – Deterrence
  – Complexity → reducing disadvantages to the IRS in enforcing penalties

• Against Strict Liability
  – Fairness
  – Adverse Effects on Taxpayer Behavior
  – Enforcement Issues
  – Motivation → Revenue

• Economic substance penalty vs. Current penalties applicable to tax shelters
Brief comparison to “abus de droit” in France

Similarities
• U.S. and French tax systems adopt a “controlled declaration approach”. Return is audited after it is submitted to tax authorities.
• Similar tests to inquire into the business purpose of the transactions
• Determining whether transactions have tax saving purposes
• Essentially, transactions need to have enough economic substance

Differences
• Possible to obtain advance rulings in France (Article L64 B of Livre des Procédures Fiscales) but not in the U.S.
• Higher sanction in France. Abus de droit penalty is 80% of any portion of an underpayment of tax that would otherwise be due in France. Note however that the penalty can lowered 40% if the Tax Administration fails to prove that the taxpayer was the principal instigator or beneficiary of the abuse (Article L195 A of Livre des Procedures Fiscales). The penalty rate is 20% in the U.S. or 40% if information has not been adequately disclosed on the return (i.e., statements, footnotes...).
Brief comparison to “abus de droit”/ ATAD (Cont’d)

Differences (Cont’d)

• The IRS will not issue PLRs regarding whether the doctrine is relevant.

• Also, the IRS indicated on numerous occasions that it does not intend to issue general administrative guidance regarding the types of transactions to which the economic substance doctrine either applies or does not apply.

• Taxpayers can generally rely on guidance published by French Tax Authorities without risk of whipsaw if the guidance is strictly complied with.

• Adequate disclosure to mitigate penalty from 40% to 20% in the U.S. but not in France.
Concluding Remarks

• Any transaction involving tax planning must have both a business purpose and economic substance.

• Need to document analysis and adequately disclose the position on the return to alleviate potential penalties.
Questions?
Resources and Citations

§ 7701(o)
Winn-Dixie Stores, Inc. v. Comm’r, 254 F.3d 1313

J. COMM. ON TAXATION, GENERAL EXPLANATION OF TAX LEGISLATION ENACTED IN THE 111TH CONGRESS
JCS-2-11, at 369—82 (Mar. 2011).
REBECCA ROSENBERG, Codification of the Economic Substance Doctrine: Substantive Impact and


§ 6662
KATHLEEN DELANEY THOMAS, The Case Against a Strict Liability Economic Substance Reality, 13 U. PA.

Article L64 B of Livre des Procedures Fiscales
Article L195 A of Livre des Procedures Fiscales
Biographies: Program Moderators
Professor Alan I. Appel

Professor Alan I. Appel specializes in international and domestic tax planning. He is on the Board of Advisors for the Journal of International Taxation and the Journal of Taxation and Regulation of Financial Institutions. He was formerly Council Director for the International Tax Committees as well as the Chair of the U.S. Activities of Foreigners and Tax Treaties Committee of the American Bar Association Section of Taxation. Professor Appel holds a J.D. from New York Law School and an L.L.M. from New York University. At New York Law School, he is the Director of the International Tax Program. He teaches courses in International Tax, Corporate Tax, and Federal Income Tax. Prior to joining New York Law School, he spent 13 years in the New York office of Bryan Cave Leighton Paisner LLP (formerly Bryan Cave LLP).
Emmanuel Raingeard de la Blétière
Associate Professor, Partner at PwC Société d'avocats

Summary
N/A

Experience

Partner
July 2016 - Present
In charge of the EU tax practice
Dealing mostly with EU and international tax law issues
Member of:
- the Technical Committee of PwC Société d'avocats
- the EU DTG Technical Committee of PwC
- the SAWG (State Aid Working Group) of PwC

Associate Professor of Tax law (with tenure) / Maître de conférences
September 2011 - Present
Lecturing French Tax law, International tax law, European tax law

Lecturing in several universities in France (e.g. University Paris-Dauphine IX) and in Europe (e.g. Leiden)

Author of numerous articles in international tax law and EU tax law (see below) and speaker in several tax conferences in France and within the EU

Of Counsel at PwC Société d'avocats
September 2011 - Present
In charge of the EU tax practice
Dealing mostly with EU and international tax law issues
Member of:
- the Technical Committee of Landwell & Associés
- the EU DTG Technical Committee of PwC (EU level)
- the SAWG (State Aid Working Group) of PwC (EU level)

International tax expert
January 2014 - Present
Expert witness in a Court case in Thailand
Training in international tax law

Director
January 2008 - August 2011 (3 years 8 months)

Tax at ArcelorMittal
April 2002 - July 2007 (5 years 4 months)
  - Arcelor Mittal Group: “Regional Tax Director Asia-Pacific & Middle East”

Education
University of Paris I: Panthéon-Sorbonne
Ph. D, Tax law, 2001 - 2008
Queen Mary University of London
LLM, Tax, 2000 - 2001
Université Paris Dauphine
DESS 211, Tax, 1999 - 2000
Université Panthéon Assas (Paris II)
Law, 1995 - 1999
Student Presenters

From University de Rennes- Law School, France:
Erwan Cherfaoui
Louis Fournier
Niels Liberti
Laura Renouf
Pierre Vasseur

From New York Law School, U.S.:
Hannah Daniels, J.D. 2020 (candidate)
Elliot Kelly ’17, LL.M. in Taxation 2020 (candidate)
Anne Maly ’18, LL.M. in Taxation 2019 (candidate)
Lynne Summers, LL.M. in Taxation 2019 (candidate)
Lionel Kuate Talom, LL.M. in Taxation 2019 (candidate)