



## EU Anti-Discrimination Planning: Cyprus and Ireland

The focus of the EU Treaties is the creation of an internal market without borders. As part of this, the Treaty on the Functioning of the European Union (TFEU) guarantees a number of irrefutable freedoms for individuals and businesses undertaking cross-border activities within the EU: Freedom of Movement of Workers, Freedom of Establishment, Freedom to provide Services, and Freedom to employ Capital.

Despite this, some Member States have continued to keep in place domestic anti-avoidance tax provisions which infringe these Fundamental Freedoms. Since EU Law takes precedence over the domestic law of Member States, in theory planning can be undertaken which disregards offending domestic laws.

### Case Law of the ECJ

Domestic anti-avoidance measures have been considered at length by the ECJ in landmark cases such as *Cadbury-Schweppes*, *Marks & Spencer*, *Thin Cap GLO* et al.

The Court has developed the principle that arbitrary anti-avoidance provisions, as they affect intra-community trade, investment and employment are not compliant with EU law, unless they are restricted to wholly artificial arrangements. This is a very important concept. Domestic laws which restrict transactions purely on the basis of potential lost revenues, where those transactions are commercially driven, are not proportionate and cannot therefore stand under EU law.

The Court has also consistently found that companies taking up residence in another member state in order to avail of lower tax rates cannot be presumed to be undertaking tax avoidance. In the absence of harmonisation of direct taxation in the EU, it is the right of citizens and enterprises to choose a jurisdiction with more favourable tax rates providing they are not seeking to abuse EU law.

### CFC Laws

In *Cadbury-Schweppes*, the Court examined the UK CFC provisions. Cadbury, a UK-resident company, had established a subsidiary in Ireland for the purposes of managing IP, and to take advantage of the favourable 12.5% tax rate. The Court found that the UK could not operate CFC rules purely on the basis of a lower rate of taxation in another country: the rules had to consider the commercial realities and could only restrict wholly artificial arrangements.

Importantly, the Court put forward recommendations as to how commercial substance might be measured objectively. It focused on sufficiently qualified and experienced staff present in a local office where they can be said to be generating economic value.



### ***Exit Tax Laws***

The rulings in *De Lausterie* and *Case N* show without doubt that the ECJ does not consider exit taxes to be compliant with EU law, where an immediate tax charge is imposed on unrealised gains on change of tax residence. Nor does it accept the requirement for the provision of a guarantee in lieu of such an immediate tax charge.

The EU Commission has been very active in referring Member States to the ECJ in this area, as a result of which many states have abolished or changed their laws on such taxes for both individuals and companies.

### **Planning Opportunities**

There are significant tax planning opportunities in the EU on account of the ECJ's continued attack on over-zealous domestic anti-avoidance laws. The opportunities apply across the EU although we focus in this note on the benefits for UK resident companies.

Planning will almost always involve the utilisation of lower tax rates in other member states. The foremost jurisdictions in the EU for this planning are Cyprus and Ireland, with their corporation tax rates of 10% and 12.5% respectively.

### ***Migration***

The Commission has asked several member states including Ireland to amend their exit tax rules which seek to tax companies on unrealised gains on migrating to another member state.

In the light of this and recent case law, it is very unlikely that the UK would be able to justify an immediate exit charge on a migration to Cyprus or Ireland where there is sufficient commercial substance to the transaction. The opportunity presented, therefore, is reduction in corporation tax rates from 26% to 10% or 12.5% on moving the place of effective management of the UK company to Cyprus or Ireland.

It should be borne in mind that the ECJ in its judgements has generally upheld the right of a state to tax gains accrued during periods of residence in a state, but not on the basis of an up-front charge on unrealised gains. It is therefore likely that gains accrued up to exit would come into charge to UK tax, but not until the sale of the relevant investment (or, perhaps, on emigration outside the EU). Nevertheless, the 10%/12.5% income tax rate would be applicable from the moment of migration.

### ***Cyprus or Irish CFCs of UK-Headquartered Groups***

It may not always be desirable to migrate a UK headquarters or holding company overseas, for both operational and tax reasons. An alternative may be to carve out profitable UK activities which could easily be performed overseas and taxed at a lower rate. This might include active management of intellectual property.

Again, sufficient substance in Cyprus or Ireland would be very important, by means of an office and sufficiently competent staff to actively manage the business. With such arrangements in place, the UK CFC rules cannot bite as the arrangements are not wholly artificial.



### ***Individuals: Transfer of Assets Abroad***

The Commission has recently objected to the UK's "transfer of assets abroad" anti-avoidance rules for individuals by means of submission of a Reasoned Opinion.

Again, the alleged incompatibility of these rules with EU law presents a significant planning opportunity.

The rules have operated in a way which makes it very difficult for a UK resident to move assets into a non-UK resident company or trust where they (or a connected person) can at any point in the future benefit from income earned by that vehicle. As well as targeting artificial diversion of income from the charge to UK tax, the provisions have attacked the commercial funding of EU businesses and investment vehicles by attributing income directly back to the UK-resident individual.

### **Summary / How Verfides Can Help**

It is not yet clear how the UK will respond to the Commission but it appears likely that it will become possible for individuals to establish commercial structures in low tax EU jurisdictions such as Ireland and Cyprus without being taxed directly on income earned within that structure.

Verfides advises extensively on cross-border tax issues as they relate to both businesses and individuals. Our tax people are qualified in UK, EU, Irish and Cypriot tax planning.

Our Irish and Cyprus offices can assist businesses seeking to relocate by undertaking all necessary administrative and legal work. We can also help to provide substance by the provision of office accommodation, associated support services and professional Irish and Cyprus-resident directors.

*This document has been prepared as a general guide and it is based on the latest legislation and case law. Whilst every care has been taken in its preparation, Verfides cannot accept any responsibility for any person relying on this publication. Professional advice should be obtained before undertaking transactions and Verfides will be pleased to provide such advice where appropriate.*