Corporate Restructuring and Tax Arbitrage Strategies at International Level

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Abstract

From the analysis of the specialized literature in the fiscal field, I have noticed that there are conflicting opinions about the role of fiscal arbitrage in the efficiency of companies and the economic growth in the process of company restructuring. The main objective of any tax system is to collect revenues to the state budget. If this function is affected by international tax arbitrage, it can either reduce budget expenditures and thus lead to social and political difficulties, or to further increase tax pressure to obtain additional revenue. However, fiscal arbitrage opportunities will continue to exist, at least until international tax harmonization is reached. The questions I have been trying to find an answer through this paper are: "Are tax strategies important in a company's management decisions?", "Are there indeed real benefits through international tax arbitrage?", "If so, why do not more companies appeal to it?"

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1. Introduction

The concept of "corporate restructuring" is like a "broad umbrella" covering several aspects. James C. Van Horne defines corporate restructuring as "any change in the structure of capital, operations or owners, which is out of the ordinary course of business" (Van Horne, 2002).

Some authors view the international openness of companies and profit from tax benefits as a source of growth and economic growth in a broad context of corporate restraints, while others believe that tax arbitrage and different tax rates in some markets cause instability globally. Recently, there has been a growing tendency for multinationals to re-enter themselves into favourable jurisdictions to minimize the corporate burden (ie, "corporate inversion"). This change of residence does not bring significant changes to the transactions or activities of the company, but most of the times it comes with changing the structure of the company's shareholding. The first step in this process is the decision of the management and

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the shareholders of a company to incorporate a new company into a favourable jurisdiction or even a true tax haven (Clymer, 2009).

The second stage of the process can take two forms by exchanging shares and exchanging assets. The stock exchanges assume that the new company acquires all the shares of the original company, and the latter becomes a subsidiary of the company incorporated in the tax haven. In exchange for the shares they held at the first company, the shareholders received shares in the second, the proceeds of the sale of the shares being taxed. At the exchange of assets, the new company receives in return for its shares the assets of the initial company, which will then be liquidated, the shares of the new company being distributed to the shareholders of the original company.

Although the company changes its embedding country, its operations do not change. Inversion occurs only on paper.

Tax treatment is applicable if restructuring by mergers, acquisitions, disinvestments, divisions does not have as its main objective tax evasion or avoidance of tax payments. This "anti-abuse" clause was incorporated into Romanian domestic law "Directive 90/434 / EEC on the common system of taxation applicable to mergers, divisions, transfer of assets and exchanges of shares between companies of different Member States" 90/434 / EEC "). Therefore, to interpret the "anti-abuse" clause, the provisions of this directive should be taken into account.

More specifically, restructurings covered by the Directive should not have direct tax consequences on the companies undergoing restructuring or on the shareholders participating in the companies involved in the restructuring (Mitroi, 2009).

The purpose of Directive 90/434 / EEC is to abolish the tax obstacles to cross-border restructuring of EU companies. The Directive aims to ensure that Member States do not restrict cross-border restructuring that falls within its scope (mergers, total or partial divisions, share exchanges, etc.) by incurring disadvantages, constraints or fiscal distortions.

Thus, the restructurings covered by the Directive should not have the effect of direct tax consequences on the companies undergoing restructuring or on the shareholders participating in the companies involved in the restructuring. Potential value gains determined in connection with the restructuring of a company may be taxed only when they have actually been realized, i.e. the parties involved in the restructuring have capitalized the potential gains through subsequent restructuring transactions (Desai, 2003).

According to the ECJ and the European Commission, "avoidance of taxes" can be achieved when purely artificial structures are created without economic substance. If the arrangement has an economic substance at its base (legitimate commercial reasons and real economic activity) it cannot be considered as "purely artificial". Given that the actual circumstances may vary from one case to another, the ECJ strongly recommends that substance evaluation be made on a case-by-case basis.

If the objective of restructuring is to increase the market value of direct or indirect holdings in companies restructured by their shareholders, achieving that objective without suffering immediate tax consequences cannot be considered to be contrary to the purpose and objective of Directive 434/90 EEC and cannot, therefore, be based on the refusal of its benefits.

Therefore, a legitimate and legitimate economic reason for a restructuring can be sustained when, for example, the joint shareholders of the ceding company and of the splitting company involved in a partial division would, for economic reasons, rationalize and restructure the ownership the control of some economic activities so that the management and eventual subsequent sale of those holdings would result in an additional gain that could not have been obtained in the forms of organization and holding prior to the reorganization (Cummings, 2010).

However, Directive 90/434 / EEC states that tax benefits may be refused to restructuring operations if they have as their primary objective or as one of the main reasons tax evasion or avoidance of tax payments.

As the position of the Romanian legislation on the fiscal treatment of restructuring operations is influenced by the European legislation (eg regulations, directives) and the interpretations of the European Court of Justice in the various cases that have been presented to him over time, we have tried to prove the applicability its interpretations of cross-border reorganization in case of restructuring in Romania and various concepts such as "tax avoidance" or "purely artificial arrangements".

2. The case-law of the European Court of Justice

In analyzing the majority of the case law of the European Court of Justice (ECJ) regarding the interpretation of the provisions of Directive 90/434 / EEC, we consider the following aspects:

1. Applicability of ECJ interpretations on cross-border restructuring
2. Interpretation of the concept of 'tax avoidance' in Directive 90/434 / EEC by the ECJ
3. The interpretation by the ECJ of the concept of "purely artificial arrangements"
4. Interpretation of ECJ rulings by supreme courts of other Member States in relevant cases

2.1 Applicability of ECJ interpretations on cross-border restructuring

Interpretations and rulings of the European Court of Justice on Community law on cross-border restructuring also apply to national restructuring when Member States have introduced provisions inspired by Directive 90/434 / EEC, also applicable to national restructuring. This principle has been established and reiterated by various ECJ decisions.

Analysing the situation presented to the ECJ for determining the tax treatment of the reorganization of companies, namely the Leur-Bloem case, the ECJ interpretations and pronouncements also apply to national restructurings when

Member States have introduced provisions inspired by Directive 90/434 / EEC, valid and for national restructuring.

Case C-28/95 - Leur-Bloem v Inspecteur der Belastingdienst / Ondernemingen Amsterdam ('Leur-Bloem')

Ms Leur-Bloem, a Dutch citizen, was the sole shareholder and director of two Dutch companies. Ms Leur-Bloem wanted to obtain a stake in a Dutch holding company by way of share exchange. So it decided to change the shares held in the two joint stock companies in the third company. Following this transfer, Ms Leur-Bloem became the shareholder of the holding company and the latter, the sole shareholder of the two companies.

In order for the entire operation to be exempt from capital gains tax, Ms Leur-Bloem claimed that the transaction was a share-based merger and should therefore be fiscally neutral under the provisions of Directive 90/434 / EEC.

As the Dutch authorities, through Inspector Belastingdienst, decided that the transaction was not a merger under Dutch law, Mrs Leur-Bloem's case was referred to the European Court of Justice, which decided that when considering whether a reorganization is aimed at evasion or avoidance of tax payments, certain specific factors can not be newly established or restructuring of companies that already form an economically and financially united entity.

Surse: European Union Law, „Case C-28/95 Leur-Bloem vs Inspecteur der Belastingdienst/Ondernemingen Amsterdam”.

2.2 Interpretation of the concept of 'tax avoidance' in Directive 90/434 / EEC by the ECJ

According to the ECJ in the Leur-Bloem case, obtaining a purely tax advantage cannot be a valid economic reason for a restructuring and tax avoidance is presumed when the restructuring operation is not justified by a valid economic reason. The ECJ also sets out a number of elements to be taken into account to determine whether the restructuring operation has as its principal objective or as one of the main objectives tax evasion or avoidance of tax payments.

To this end, the competent national authorities must carry out a general examination and assessment of each case. Any such review should be subject to the review / judicial review process. It is the responsibility of each Member State to establish the necessary procedures for this purpose, but they must not infringe the principle of proportionality, not impose more than is necessary to achieve the proposed objective (Rosenbloom, 2000).

At the same time, the ECJ states in the Leur-Bloem judgment that when considering whether a restructuring is aimed at avoiding or avoiding taxes, certain specific factors cannot be considered as decisive factors, such as: (i) involvement in the reorganization of a newly-established holding companies; (ii) restructuring of companies already forming an economically and financially linked entity; (iii) creating a specific structure for a limited period of time and not on a permanent basis.

Thus, the national authorities cannot confine themselves to applying predetermined general criteria, but have to submit each case to a detailed examination.

In the same case, the ECJ has established that fiscal planning based on the exploitation of differences between the tax systems of the EU Member States is considered acceptable (Mackie – Mason, 1990).

In other relevant cases such as Eurowings, Imperial Chemical, Centros and Inspire Art, the ECJ has decided that the availability of a more favourable tax regime in another Member State cannot be a reason to deny a taxpayer the benefits of the EC Treaty.

2.3. The interpretation by the ECJ of the concept of "purely artificial arrangements"

According to ECJ jurisprudence, abuse of rights may exist when "purely artificial arrangements" have been made. Detecting purely artificial arrangements is an analysis of the substance's prevalence over form. " Thus, in the Cadbury Schweppes case, the ECJ noted that purely artificial arrangements must cumulatively meet the conditions of "subjective intent" and "objective circumstances" in order to be clarified as such, neither of which being sufficient in the absence of the other. Both the intention to obtain a purely fiscal advantage and the objective circumstances must be proven by the authorities.

At the same time, the ECJ has decided that a taxpayer should be given the opportunity, without being told of excessive administrative constraints, to produce evidence to deny the existence of a purely artificial arrangement made for tax purposes only.

The meaning of the concept of "objective circumstances" or "factors" is established in the light of the provisions of the EC Treaty on freedom of establishment. In the case of Cadbury Schweppes, the results of the investigation must be based on objective factors established by third parties that relate to the extent to which a company has actual physical existence in terms of space, employees and equipment. Only if, as a result of verification of these factors, that the company is a functional establishment which does not carry out any real economic activity on the territory of the host Member State, the creation of that company must be regarded as having the characteristics of a purely artificial arrangement.

Case C-196/04 - Cadbury Schweppes plc v Commissioners of Inland Revenue ('Cadbury Schweppes')

The Cadbury Schweppes Group had two subsidiaries in Ireland: Cadbury Schweppes Treasury International ("CSTI") and Cadbury Schweppes Treasury Services ("CSTS") whose role was to finance intra-group activities. In 1996, when the CSTI made a profit, and the CSTS loss, the Irish authorities asked Cadbury Schweppes to pay about 8 million pounds of tax corresponding to the profit earned by its CSTI subsidiary. Cadbury Schweppes has accused his right to freedom of establishment in the European Union and being discriminated against. If its CSTS

and CSTI subsidiaries were incorporated in the United Kingdom, then it would have been entitled to deduct from the profits of one subsidiary the loss of the other and otherwise the tax paid would have been lower. The European Court of Justice attributed it to the company, noting that the intention to obtain a purely fiscal advantage as well as the objective circumstances must be demonstrated by the authorities.
Source: European Union Law, Case C-196/04 Cadbury Schweppes plc v Commissioners of Inland Revenue.

2.4 Interpretation of ECJ rulings by the Supreme Courts of other Member States in relevant cases

Based on the interpretation of the ECJ in the Leur-Bloem case, the Amsterdam Court of Justice decided in a domestic case concerning the division of a Dutch holding company into two new type-holding companies that this operation must be tax-neutral even if the Dutch tax authorities considered it to be strictly tax-based, in contradiction with the taxpayer's claims.

Also, based on the same ECJ decision, i.e. Leur-Bloem, the Belgian Supreme Court decided in a case of internal reorganization that if the tax authorities claim that the motivation for the reorganization is only a pure tax advantage because the operation was not motivated by valid commercial reasons then it is the responsibility those authorities to demonstrate the absence of a valid commercial ground. As a result, the Belgian Supreme Court annulled the taxpayer's unfavourable decision previously handed down by a lower court.

From the cases analysed above, it follows that, according to the ECJ, "avoidance of tax payments" is present when it leads to the creation of purely artificial, non-economic structures. So if the arrangement has an economic substance at its base, legitimate commercial reasons and real economic activity, it cannot be considered as "purely artificial". Given that the circumstances may vary from one case to another, the ECJ strongly recommends that substance evaluation be made on a case-by-case basis (Boyle, 2005).

3. Tax restructuring and tax arbitrage model for Romanian companies - the factual situation

ABC SA ("ABC" or "The Company") is part of a group of companies active in various market segments, while holding shares in other Romanian companies.

ABC initiates and finalizes a partial divestment process through which ABC shares in RQS SA, a listed company, were transferred to XYZ S.A., a newly established company in Cyprus. We assume that on the date of the transfer of RQS S.A. the market value (ie. stock exchange) was close to the tax value.

The new direct shareholders, two resident companies in Cyprus, sold the XYZ S.A. to other Romanian legal entities, making a substantial capital gain.

In view of the above described situation, I will bring arguments to support the fiscal neutrality of the splitting operation. At the same time, I will emphasize the orientation of the case law of the European Court of Justice (ECJ) on the qualification of merger or division operations as fiscally neutral.

As well as the specific case of ABC, if the tax authorities were to deny the neutrality of the division of profits in which the Company was involved, it is for them to prove that the divestments did not have an economic reason or commercially valid from the point of view of the companies involved in the reorganization and rationalization of the activities: the ceding companies, the beneficiary companies and their operating companies. In addition, ABC and its shareholders must enjoy the right to produce justifications proving the commercial reasoning of the divisions.

One of the documents by which a society and its associates fundamentally divide is the splitting project. Then the economic substance could also be proven by detailing the transactions in which Alpha and the companies resulting from the division were involved.

However, in order to substantiate that the main purpose of the divisions was not to avoid the payment of taxes, the company and its shareholders must show that there were other legitimate commercial and economic reasons. To this end, the Company or its participants may provide authorities with documents such as: (i) a coherent management plan with regard to long-term objectives and strategies, including those relating to their direct and indirect participations in various companies; (ii) a medium-term management plan for Alpha's investment and disinvestment activities; (iii) an investment plan in all the activities of the Company, including, in particular, the sources of their financing, business plans, cash flows to support the functional independence and financial viability of divorced activities (eg individual business plans, on activities showing that the transferred activities were organizationally and functionally independent, both before and after division.

As we have seen, the ECJ case-law invalidates any possibility for the tax authorities to base their withdrawal on the benefits of the Directive on the grounds that Alpha shareholders, who became shareholders of the company resulting from the division, could benefit from the more favourable tax regime for capital gains of the shares acquired through the division, due to tax residence in another Member State (Van Horne, 2002).

The Romanian legislation makes no reference to the fact that the assets and liabilities transferred in a restructuring process must be part of an independent activity branch. Therefore, the Romanian tax authorities should not deny neutrality to reorganization by invoking this reason.

However, there is the possibility for Romanian tax authorities to establish that the division in which ABC was involved does not have an economic substance and therefore does not qualify for the benefit of tax neutrality. At that time, tax implications may arise in: (i) ABC as a transferring company; (ii) XYZ SA as a successor company; (iii) Non-resident companies, as participants in the transferring company and subsequently in the successor company.

Specifically, tax authorities may consider:

(i) the transfer of the shares held in RQS S.A. as a sale of assets;

(ii) the distribution of securities in XYZ SA to shareholders in Cyprus as a distribution of dividends.

(i) Sale of assets

At the ABC level, the taxable profit on the sale of shares will be determined as the difference between the market price of those shares at the time of the division and their tax value. This profit will be subject to a 16% tax.

Article 4 (1) (a) of Directive 434/90 / EEC states: "... the taxable amount is the amount on the basis of which any gains or losses were calculated for the purpose of taxation on the income, profits or capital gains of to the transferring company if those assets or liabilities were sold at the time of the merger, division or partial division but independent of it. "

In the case of ABC, a positive aspect may be that the market value at the date of the transfer (e.g. the RQS S.A. stock exchange quotation) is close to the tax value, so the gain is low. In determining this gain cannot be invoked the subsequent price at which the holdings in XYZ SA were capitalized because it could not have been obtained independently of the division.

At XYZ SA level, the tax value of RQS S.A. will be increased to market value.

(ii) Distribution of dividends

To determine the level of potential dividends distributed, tax authorities may consider the market value of shares in XYZ SA. Since, immediately after the division, the securities were sold to an independent party, this price could be considered as the market price of these securities.

The dividends thus determined will be subject to a 10% tax according to the double taxation treaty between Cyprus and Romania, insofar as there are valid taxable residence certificates of the shareholders of XYZ SA. Otherwise, these dividends will be taxed at 16% under tax law.

Following the transmission of the shares held by ABC SA in RQS SA to the Cypriot Cypriot company XYZ SA and then the sale of the new securities to non-affiliated Romanian legal entities, ABC SA and, implicitly, its shareholders obtained an exempt capital gain from tax (according to the legislation of Cyprus).

If the shares of RQS SA were sold directly to other legal entities, the transaction would have been subject to tax in Romania of 16%. As a result, ABC SA managed to obtain financial benefits by tax arbitrage by avoiding the payment of capital gains tax on the sale of the shares held in the Cypriot company XYZ SA.

4. Conclusions

The conclusion of the paper is that there are a number of tools available to Romanian companies to reorganize themselves in an efficient way and reduce their fiscal burden. At the same time, although there are no effective reorganization patterns to be followed by any company, an effective strategy and investing in favourable jurisdictions can achieve better financial results.

Regarding the above "Why do not Romanian companies focus on optimizing tax exposure?": probably due to lack of economic culture or lack of funds. For example, implementing a holding structure, although streamlining cash flows within a group of companies, is costly (e.g. consultant fees, costs of incorporation into other favourable legislation) and is only cost-effective if there are large amounts in the game. Also, an extensive international literature analyses how the benefits to managers determine their behaviour and company activity, especially in terms of tax planning. This is not the case for Romanian companies whose managers are mainly rewarded by bonuses to increase sales, and not for effective tax strategies.

Circumstances may vary from one case to another, and the reorganization assessment should be done on a case-by-case basis. If the arrangement has an economic substance at its base, legitimate commercial reasons and real economic activity, it cannot be considered as "purely artificial".

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