FC: Argentine Tax Court denies treaty benefits to companies without 'economic substance'

Jul 14, 2023

Empresa Distribuidora La Plata SA [TS-1054-FC-2022]

Conclusion

Brief facts

Empresa Distribuidora La Plata SA (‘**the taxpayer’**) is a tax resident of Argentina. The taxpayer is *interalia* owned by two Spanish holding companies, Inversora AES Holding and Zargas Participaciones SL. The shareholding of the said Spanish holding Companies is, in turn, owned by Uruguayan holding companies. The domestic tax laws of Argentina required participation in Argentine companies held by non-residents subject to an annual tax of a certain percentage on the net equity value of their shareholding. The Argentine tax authorities assessed that the taxpayer is required to pay tax to the extent of participation in the taxpayer by the non-resident shareholders.

Aggrieved by the order of the tax authorities, the taxpayer appealed before the National Tax Court of Argentina. The taxpayer argued that tax is not leviable on account of the following reasons:

- Article 22(4) of the double taxation avoidance agreement between Argentina and the Kingdom of Spain (**‘Argentina-Spain DTAA’**), as per which the signatory States have reserved to themselves, exclusively, the power of taxation on shares owned by their respective residents;
- The treaty provisions are fundamental pillars of public international law and, since the 1994 constitutional reform, have a higher rank than domestic laws;
- The tax authorities’ claim based on a general clause of Argentine domestic tax law, from which it derives the denial of a benefit provided for in the international treaty, implies a breach of the ‘Pacta Sunt Servanda’ rule, which governs the application of treaties and, therefore, a violation of good faith;
- The Spanish holding companies are legally incorporated and resident in Spain. The purpose of the acquisition of the shareholding by these companies was not to obtain the tax benefit but rather that this operation was carried out amid an investment process carried out by the group, which decided to concentrate the group’s investments through companies located in Spain, within a regular corporate structure. The holding companies are legally registered with the Spanish Tax Authority under the regime of entities holding foreign securities (**‘ETVE’**).

On the other hand, the tax authorities argued that the taxpayer is required to pay tax to the extent of participation in the taxpayer by the non-resident shareholders. The tax authorities based their view on the followings:

- The economic substance of the Spanish holding companies has not been established, and therefore, they can be interpreted as being merely interposed companies to obtain some benefit deriving from an international tax instrument;
- Neither the reason why the shares were given to two Spanish companies was demonstrated, nor was the risks assumed by them or any activity of any kind with the company based in Argentina indicated;
- Failure to demonstrate the true business purpose or the substance of the interposed company, with the result that the form or structure assumed does not coincide with the underlying economic reality;
- The case falls within the modality of ‘treaty shopping’, pointing out that the inclusion of the Spanish firms in the ETVE regime favoured tax evasion by the taxpayer, constituting one more element that allowed the abusive use of the provisions of the tax treaty, which led to avoiding taxation in both states, generating an undesired consequence in the treaties, which is double non-taxation.

The issue before the Court

Before the National Tax Court of Argentina, the issue was whether the benefit of Article 22(4) of Argentina-Spain DTAA was available to the Argentine entity, which was owned by two Spanish holding companies, whose shareholders were Uruguayan holding Companies?

The decision of the Court

The National Tax Court of Argentina observed and held as follows:

- International conventions dealing with tax matters must be interpreted in accordance with the general doctrine of hermeneutics in cases of treaties and tax rules. Likewise, due to the superior hierarchy that an international treaty enjoys over domestic law, the latter may be restricted or even invalidated if the conflict is irreconcilable by the commitments assumed by the Republic in an international agreement to avoid double taxation;
- The principle of reasonableness, however, expels from the legal system the abusive exercise of rights in all its variants. No international treaty in force can be invoked in an abusive manner, regardless of whether an anti-abusive clause is expressly enshrined in the text of that same treaty. The Court recognises good faith as a structural guide for the interpretation of international agreements and reasonableness as the standard of behaviour that repels interpretations that, under the pretext of invoking the clauses of a treaty, distort its nature, object or purpose;
- Based on the background information requested from the International Taxation Directorate of the Spanish Tax Agency and other elements collected by the audit, it appears as follows:

a) Inversora AES Americas Holding SL has AES Argentina Holdings SCA and AES Platense Investrnents Uruguay SCA, both Uruguayan companies, as partners;

b) Zargas Participaciones SL, has as its sole partner ISKARY SA, also a Uruguayan company;

c) The purpose of the former is the management and administration of securities representing the equity of companies and other entities, whether or not they are resident in Spanish territory, investment in companies and other entities, whether or not they are resident in the Spanish region, and it has only three employees (one administrative and two in charge of technical areas) and has opted for ETVE;

d) The second company, whose purpose is the management and administration of securities representing the equity of non-resident entities in Spanish territory, has had no employees on its payroll since its incorporation and has also opted for the ETVE regime;

e) Neither of the two companies is subject to taxation in their own country, similar to that in the present case;

f) According to the information provided by the Spanish Tax Agency, there is no record that it has any shareholdings in the share capital of other companies.

- The evidence and circumstances of the case show that the Spanish companies lack genuine economic substance, with the companies AES Argentina Holdings SCA and AES Platense Investments Uruguay SCA (both Uruguayan) holding the shares of Inversora AES Americas Holding SL and the company ISKARY SA (also Uruguayan) holding 100% of the shares of Zargas Participaciones SL.

In light of the above, the National Tax Court held that the Spanish entities could not prove with the evidence that they carried out a genuine economic activity and that they should not be treated as mere legal structures without economic substance. The Court further held that it is reasonable to conclude that the primary purpose of the incorporation of Spanish entities was to obtain the benefits granted by the tax treaties. Accordingly, it was held that the benefit of Article 22(4) of the Argentina-Spain DTAA is unavailable, and tax is payable.

Author's Comment

The above decision of the National Tax Court of Argentina is essential considering that the Court has permitted the denial of treaty benefits by invoking GAAR even though there was no anti-abuse clause (i.e., principal purpose test and beneficial ownership) in the tax treaty. In contrast to the Argentine National Tax Court decision, the Canadian Federal Court of Appeal in the case of Alta Energy Luxembourg SARL [TS-1109-FC-2021(CAN)] held that selection of a low tax jurisdiction may speak persuasively as evidence of a tax purpose for an alleged avoidance transaction, but the shopping or selection of a treaty to minimise tax on its own cannot be viewed as being abusive and accordingly denied invocation of GAAR to deny treaty benefits.

In the Indian context, section 95 of the Income-tax Act, 1961 ('Act') provides that treaty benefit may be denied in situations where the primary purpose of the arrangement is to obtain a tax benefit. The taxpayers who structure their transactions/holding companies purely to enjoy treaty benefits should take note of this Argentine National Tax Court decision while planning their tax affairs, as the tax authorities could draw guidance from this decision to deny treaty benefits by invoking GAAR in the event of double non-taxation, even if such treaties are not affected by Base Erosion Profit Shifting Action Plan 6. It is imperative to note that the said minimum standard mandates express intent in tax treaties to exclude opportunities for treaty abuse.:FC

Decision Summary

The case summary is prepared by CA Ashish Karundia.

Taxsutra Note

Convention between Argentina and the Kingdom of Spain (*Unofficial translation*)

Article 22 – Capital

1. Capital represented by immovable property referred to in Article 6, owned by a resident of a Contracting State and situated in the other Contracting State, may be taxed in that other State
2. Capital represented by movable property forming part of the business property of a permanent establishment which an enterprise of a Contracting State has in the other Contracting State or by movable property pertaining to a fixed base available to a resident of a Contracting State in the other Contracting State for the purpose of performing independent personal services may be taxed in that other State.
3. Capital represented by ships or aircraft operated in international traffic, and by movable property pertaining to the operation of such ships or aircraft shall be taxable only in the Contracting State in which the place of effective management of the enterprise is situated.
4. Capital represented by shares or participations in the capital or assets of a company shall be taxable only in the Contracting State of which the holder is a resident.
5. All elements of capital not dealt with in the foregoing paragraphs may be taxed in both States according to their domestic laws.

Case Law Information

Taxpayer Name

- Empresa Distribuidora La Plata SA

Judicial Level & Location

- Foreign Court

Date of Ruling

- 2022-09-28

Ruling in favour of

- Revenue