# EU experience in administering GAARs
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**EU experience of administering GAAR**

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## 1. Introduction

Statutory General Anti-Avoidance Rules (GAARs) respond through the enactment of their primary and secondary tests. As well, they are delimited by the tax system they serve. Limitations to the scope of action of a GAAR can also be found outside their wording. For instance, they exist in the meaning to be given to the terminology used in the provision, and remain deeply connected with the connotation of abuse of law.

Having a clear conscience of the elements in the GAAR and considering that the provision serves for the purposes of a given tax system enables the interpreter to determine how to use it in practical experiences. An example of the former, is provided by the GAARs to be used by member states of the European Union (EU). Where every country is entitled to use domestic, supranational and international anti-tax abuse provisions. Understanding the context in which each GAAR is embedded will provide the interpreter with instructions on how to administer it.

Bear in mind that anti-abuse measures can be implemented simultaneously if required. In doing so member states shall respect the international and supranational commitments. This is to say that every country within the EU is enabled to develop domestic GAARs and SAARs, which cannot contravene EU Community laws[1] or international ones. In order to reduce the possible conflicts that may arise when interpreting anti-abuse provisions conjointly, the EU

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[1] EU Community laws in this context refers to all primary or secondary laws determined by the European Union Commission, the European Union Council or the European Union Court of Justice. As explained by Marjaana Helminen in Chapter 1: Concepts and Basic Principles of EU Tax Law in EU Tax Law – Direct Taxation 2017 (IBFD Books) *"Each EU Member State has its own national tax system. EU tax law, the tax treaties concluded by each Member State and the national tax laws of each Member State are parts of the national tax laws of the Member States. In accordance with the principle of autonomy, EU tax law, tax treaties and national tax law of each Member State are separate legal systems belonging to the national legal system of the Member State concerned. These different parts of tax law, however, are in a strong interaction with each other. For example, EU law has a substantial impact on the national tax laws of the Member States."* As well, primary law is refered to the founding treaties and the accession treaties, as well as the principles of EU law. The treaties have been consolidated in the Treaty of the Functioning of the European Union -TFEU and the Treaty on Eurepean Union – TEU, both work as international treaties signed by the EU member states and aquire the same status of a constitution. The principles can be founded in the TEU and TFEU or constructed as common legal principles derived from the national legal systems of the EU member states or by the decisions of the European Court of Justice having an effect on EU tax law. Quoting Marjaana Helminen *"Secondary EU law includes the provisions given by the EU organs on the basis of the authorization of the founding treaties. With regard to direct taxation, these provisions include the directives on direct taxes issued in accordance with article 115 of the TFEU. Unlike in relation to direct taxes, with regard to indirect taxes regulations are also possible. The authorization to issue directives included in article 115 of the TFEU instead is the only express measure available for the positive harmonization of direct taxes."*

Commission and EU Court of Justice (ECJ) have worked to consolidate a common objective when combating fraud and tax evasion.

Concretely this chapter deals with the administration of GAARs to be adopted by member states of the EU considering that legislative and judicial efforts have been made to include GAARs within secondary legislation[2] and adopting the principle of *prohibition of abuse of law*. Likewise, attention will be given to the adoption of the Principal Purpose Test (PPT) [3] as one of the most extensively used GAAR in the international sphere, after being included in the Multilateral Instrument (MLI)[4] and 2017 model tax convention of the Organization for Cooperation and Economic Development (OECD). The international GAAR will be briefly studied in order to address the commentaries provided by the OECD in regard to the possible conflicts arising from enacting domestic anti-abuse measures jointly with the PPT.

The paper comprises six sections: the first one deals with general comments about the administration of a GAAR. Following, the importance to be given to the tax advantage that is being guarded by the GAAR will be explained. Afterwards, remarks about the PPT and its conflicting status with other anti-avoidance provisions shall be made. Subsequently, the evolution of the principle of prohibition of abuse of law in the EU will be laid out, moving on to explain the particularities of the GAARs introduced in secondary EU law. Finally, remarks will be made in regard to the administration of GAARs to be used by EU member states.

## 2. Administering a GAAR

GAARs understood as clauses used to disallow the granting of benefits to a certain taxpayer in given situations work as catch all provisions regarding abuse of law. Comprehensively a GAAR can be used to secure the due application of norms regarding tax matters, but also any other branch of law, or at least, any other positive legislation concerning matters sufficiently connected with the structure being analyzed with the GAAR.

The former does not mean that the GAAR is, by its own, allowed to defend all possible regulatory breaches. However, in its enactment provides the given tax authority with a way to look into the operative part of an arrangement with the intention to disallow specific tax benefits. Once the analysis provides for the latter result, other issues might be worked out in different instances or by different actors towards securing the correct application of any other norm being abused of.

[2] Ibid; Marjaana Helminen, Concepts and Basic Principles of EU Tax Law in EU Tax Law. p.11 See also Terra and Wattel's European Tax Law (2012). Also worthy of mentioning are Easson's Taxation in the European Community (1993) and Gormley's EU Taxation Law (2005).

[3] Some of the main articles on the principal purpose test are: V. Chand, "The principal purpose test in the Multilateral Convention. An in-depth analysis". 46 Intertax Issue 1 (2018) pp. 18-44; D. Duff, "Tax Treaty Abuse and the Principal Purpose Test" Part I. Canadian Tax Journal (2018) pp. 619-677 and "Tax Treaty Abuse and the Principal Purpose Test" Part. II; B. Kuźniacki, "The Principal Purpose Test (PPT) in BEPS Action 6 and the MLI", World Tax Journal, Vol. 10. No. 2. (2018); I.J. Mosquera Valderrama, "Output Legitimacy Deficits and the Inclusive Framework of the OECD/G20 Base Erosion and Profit Shifting Initiative", Bulletin for International Taxation 72(3). (2018); P. Piantavigna, "The Role of the Subjective Element in Tax Abuse and Aggressive Tax Planning", World Tax Journal, Vol. 10 No. 2 (2018); D. Weber, "The Reasonableness Test of the Principal Purpose Test Rule in OECD BEPS Action 6 (Tax Treaty Abuse) versus the EU Principle of Legal Certainty and the EU Abuse of Law Case Law", Erasmus Law Review, 1, (2017) pp. 48-59 and S. van Weeghel, A Deconstruction of the Principal Purpose Test, World Tax Journal, Vol. 11 No. 1. (2019).

[4] The MLI is outside the scope of this contribution. See for a discussion on MLI: García Antón, R. (2016) The 21st Century Multilateralism in International Taxation: The Emperor's New Clothes? 8 World Tax Journal, Journals IBFD; Bravo, N. (2016) The Multilateral Tax Instrument and Its Relationship with Tax Treaties. Vol. 8. No. 3. World Tax Journal. Journals IBFD; Grinberg, I. (2016) The New International Tax Diplomacy. 104 Georgetown Law Journal, pp. 1137-1196.

The same holds true when the presumed abuse situation involves a national GAAR and is being analyzed by European Court of Justice (ECJ), in as much, the Court's ruling relies on matters concerning the union's interests, which in the tax arena are not entirely harmonized between Member States (MS). Thus, the Court identifies the fundamental freedom[5] being harmed by the enactment of the GAAR and later on will inquire for the purpose of the anti-abuse rule.

The inquiry on the purpose of the GAAR in such case is directed into knowing if the restriction of the fundamental freedom is justified, resulting in the implementation of necessary and proportionate measures. This feature, entails one of the principal differences of administering a GAAR in the EU in comparison to a GAAR of any given jurisdiction not contingent on a supranational order. To a certain extent, the ample nature of GAARs is restricted by the guidelines provided in order to comply with EU commitments, in this case protecting the exercise of the fundamental freedoms.

The use of any GAAR must be restricted in order to secure a balance between the power assigned to the provision's operator vis-à-vis taxpayers' rights. The call for a tactful application might come from the judgement of an external body (i.e. Courts) or be included directly in the wording of the GAAR. According to Paolo Rosenblatt, statutory GAARs are an example of internationally transplanted measures[6]. Hence, they include similar features among them, covering particularly two tests, as well as primary and secondary elements[7].

Two tests are needed in order to accomplish both aspects of a sound analysis. Namely an ***objective test*** addressing the neutrally observable circumstances, such as the economic reality supporting the arrangement. And a ***subjective test*** looking after the taxpayer's intention in effecting the structure, whether it was exclusively or mainly carried out for obtaining the tax benefit or not. Other adjacent elements might complement the components of these tests.

For example, the legislator might clarify that the objective test needs to start with from verifying a variation in the tax burden assumed by the tax payer, calling for a comparison between the commonly achieved result and the one effectively obtained. The subjective test might be

[5] The fundamental freedoms are included in the TFEU and TEU and form the bedrock of EU's single market. There are five economic fundamental freedoms, namely the free movement of goods (articles 26 and 28-37 of the TFEU), services (articles 26 and 56 to 62 of the TFEU), workers (articles 3 (2) of the TEU and articles 4(2) (a), 20, 26 and 45 to 48 of the TFEU), capital (articles 63 to 66 of the TFEU) and establishment (articles 26 and 49 to 55 of the TFEU). All freedoms concern the members states and are equally extended to the European Economic Area – EEA. Member states should not infringe fundamental freedoms when imposing tax measures to cross-border trade within the EU or the EEA. The only freedom that get to be enjoyed even in cross-border trade implying third countries is the freedom of capital. See also The internal market: general principles, Facts Sheets on the European Union, European Parliament, available at: https://www.europarl.europa.eu/factsheets/en/sheet/33/the-internal-market-general-principles last consulted on 26 March, 2020.

[6] Rosenblatt, Paolo. General Anti-Avoidance Rules for Major Developing Countries. Chapter 2: Similar features shared by statutory GAARs from Diverse Jurisdictions. Wolters Kluwer, 2015, p. 3; More recently this analysis of GAARs as legal transplants has been addressed in P. Rosenblatt & M.E. Tron, *General Report Anti-avoidance measures of a general nature and scope – GAAR and other rules*, IFA, *Cahiers de droit fiscal international* vol. 103a (SDU 2018), Books IBFD. Likewise, the topic of tax transplants was discussed in by I.J. Mosquera, Valderrama at the European Association of Tax Law Professors (EATLP) Academic meeting in June 2019. *See* slide presentation available at https://globtaxgov.weblog.leidenuniv.nl/files/2019/06/Mosquera-tax-competition-and-legal-transplants.pdf . In regards to practical examples of GAARs transplantation one can find a recent analysis of the UK GAAR in J. Freedman, *The UK General Anti-Avoidance Rule: Transplants and Lessons* , 73 Bull. Intl. Taxn. 6/7 (2019), Journal Articles & Papers IBFD. And a well, an example of Leasing transplants in Colombia, France and the Netherlands the PhD Cumlaude Thesis of Mosquera, Valderrama "Leasing and Legal Culture – Towards consistent behaviour in tax treatment in civil law and common law jurisdictions", ISBN 9789036729895, Rijksuniversiteit Groningen.

[7] Ibid; Rosenblatt, Chapter 3, p.34

accompanied with a genuine economic feature based on objective factors, as a way to reduce the subjectivity of the tax authorities when determining the intentions of the taxpayer[8].

Additionally, the essence of the GAAR will be displayed in the primary and secondary elements. The first ones are comprehended by the meaning to be given to the words 1) transaction, arrangement or scheme; 2) benefit or tax advantage; and 3) the guidance on how to determine the purpose or intent of the taxpayer.[9] The latter will rely on principles or guidelines settled after case law or directly through ground norms. Between these primary elements all five key questions to solve a problem can be found.

| Primary element / Question | Who | What | When | Where | Why |
|---|---|---|---|---|---|
| Definition for transaction, arrangement or scheme | X | | X | X | |
| Definition for benefit or tax advantage | | X | | | |
| How to determine the purpose or intent of the taxpayer | | | | | X |

A background scoping study guides the tax authority to determine taxpayers involved and which of them should be audited. As well, enables the authorities determining the taxable periods in which the structure was in place, and which jurisdictions are covered. The possibility to identify the benefit or tax advantage within the transaction enables the tax authority to select the GAAR to be used or, if proven to be more suitable, applying a Specific Anti-Avoidance Rule (SAAR) or general principle. A further analysis on this item can be found in the following section.

One of the most difficult aspect to prove in the GAAR is the determination of the intent sought by the taxpayer with the given transaction. This comprehends the motivation for entering into a given arrangement. Secondary elements serve in this case to delineate the factors to be looked at when determining the reasons why a taxpayer operates in a given manner. Despite this difficulty, several other concepts or sub-tests can be introduced into the GAAR securing the existence of commonly agreed aspects to look at as to avoid legal certainty breaches or authority abuses.

Requirements towards genuine activity and observable actions taken by the taxpayers contribute to secure the correct interpretation of the intentions of a taxpayer. It must be noted that the presence of a genuine test within a GAAR does not imply establishing immovable criteria to presume substance in a given operation. In fact, providing minimum requirements within the legislation might steer taxpayers to incorporate those features avoiding audits. The real nature of the search for economic reasoning behind the taxpayer's actions resides on

[8] See Weber, Denis. The reasonableness Test of the Principal Purpose Test Rule in OECD BEPS Action 6 (Tax Treaty Abuse) versus the EU Principle of Legal Certainty and EU Abuse of Law Case Law. Erasmus Law Review, Eleven International, No. 1 – doi: 10.5553 / 000081 August 2017, p.56. Danon, Robert J. Treaty Abuse in the Post-BEPS World: Analysis of the Policy Shift and Impact of the Principal Purpose Test for MNE Groups. IBFD, Bulletin for International Taxation, January 2018, p.36

[9] Op. Cit, Rosenblatt, Chapter 3, p.34

identifying the logic behind the operation and the hallmarks that support the version of the facts provided by the taxpayer. Reviewing each case separately contributes to this aim.

Other tests that could help for finding the ulterior purpose of a transaction are the reasonableness test or appropriateness test, which aim at comparing the behavior of the taxpayer with that to be perceived in a reasonable person facing the same circumstances.[10] The simile landmarks are not odd for tax lawyers as most of them guide the transfer pricing practice, where the comparison is settled with regards to specific criteria that will be commonly present in any given operation.

All these elements guide the practice and enable courts to address the extent to which the GAAR should operate in a given case. In Rosenblatt's opinion the legislator should strike a balance between a broad delimitation on the GAAR's elements and an excessively fixed/narrow list of contents. It is desirable to keep the flexibility of the GAAR, so its scope of action does not resemble a more targeted rule (e.g. SAAR) depleting it from its wide range of action.

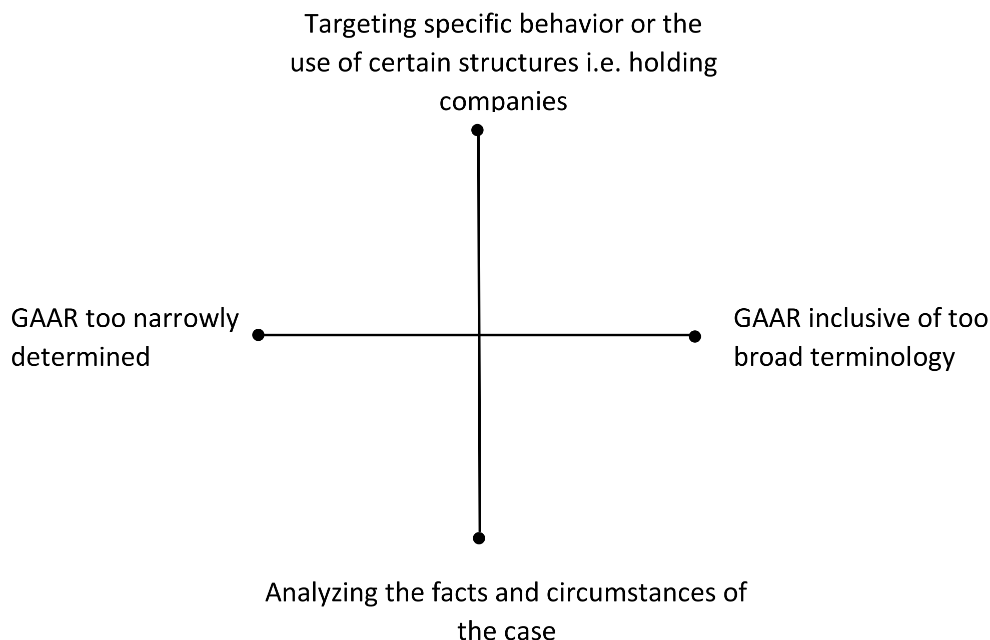
If so achieved, the tax administration will benefit from a clause that can be applied to situations where there are no concrete measures and despite formal compliance there are strong reasons to believe that a case of abuse of tax law is present. It should be noted that a GAAR in any case serves the purpose of defending a benefit granted in light of the object and purpose of a given legislation. And in this regard, an equilibrium should be observed when drafting the provision and making a prima facie identification of cases falling under the GAAR's examination.

Defending a tax benefit in this context means to allow the tax advantage to be enjoyed only by taxpayers effectively complying with formal and substantial requirements. Therefore, the GAAR will be used to disallow a tax advantage to taxpayers obtaining it unrightfully. In so doing the general anti-abuse measure enables the tax authority to enforce the object and purpose of the tax legislation describing the tax benefit. The restructuring character of a GAAR rests on reestablishing the true nature of the affaires and their effects, which ultimately will lead to repeal the tax benefits in those situations where they do not correspond.

The following figure depicts a two by two diagram which determines the specific balance to be achieved when drafting and applying a GAAR. The provision will have to be presented in a wording flexible enough to be interpreted by the tax authorities. Too narrow constructions will restrict the tax authorities' judgement and prove to be non-applicable in practice, as they elicit mock compliance. Conversely too broad terms might serve for selective auditing on the side of the tax administration and derive into taxpayer's rights breach.

The vertical axis shows the attitude with which the tax authorities should read the GAAR. As explained before the authorities should not target specific actions as to be considered abusive, unless those actions prove to be so in the context of each case.

[10] Ibid; Rosenblatt, Chapter 3, p.34-35




## 3. Identifying the tax advantage recognizing the GAAR to be applied

As stated before GAARs are created in accordance with the principles and *fundamental norms*[11] of the tax system in which they will be applied. Such system will determine how to interpret and use the objective and subjective tests within the provision. However, it could be argued that emphasizing on the inter dependence of the norms and the system is a matter that could be applicable to any written law.

Still, in the case of statutory GAARs, the relevance of the system increases as it will determine the enabling factors and the semantic nature of the provision. Without the tax system it would be hard for local authorities to understand: When is it possible to use the GAAR? Who can enact it? And which are the guidelines to interpret the principles and wording of the norm?

The influence is decisive if it is considered that GAARs serves the purpose of a given order. It can be local (i.e. a GAAR settled for dealing with abuses against national rules), international (i.e. the GAAR introduced via the Multilateral Instrument (MLI) amending bilateral treaties around the world) or supranational (i.e. a GAAR included in a Directives at EU law level). In light of the former a GAAR will defend the object and purpose of a legislation that protects international, supranational or local interests.

In each one of these strata the GAAR will be destined to protect a given benefit. Among those the taxpayer could be enjoying a tax exemption, a reduction on the nominal rate of a certain tax, a corrective measure to ensure neutrality or even a fundamental freedom. Regardless, of the specific target of the regulation providing for the benefit, it will be protected by the GAAR.

[11] Referring to norms that settle the basic notions of any tax system or identify it in a particular way from any other. As an example of this one could talk about the participation-exemption rules in the Netherlands. Or in Kelsen's Pure Theory of Law as if they were Grundnorms.

The role of the GAAR will be to guarantee the allocation of the right upon the rightful taxpayer. At the same time, the rule will hinder the assignation of the right if the taxpayer does not comply with the parameters established in the provision to be protected (i.e. formal requirements of a rule that provides for no withholding taxes on certain transactions); or even when complying with formal requisites fails in fulfilling a substantial element needed to allot the right.

A final step will always be needed, if aside from formal and substantial compliance, the tax system requests the GAAR to be read in accordance with the object and purpose of the provision or body of norms granting the benefit. This can also happen if the wording of the GAAR provides for a caveat on the anti-abuse rule itself. For example, if the legislator gave room for the tax authority to grant the benefits to an abusive taxpayer, if in so doing the object and purpose of the regulation will not be defeated. Cases in this category should point out that the legislation providing the benefit needs to be amended in order to curb abusive situations.

Knowing the former, allows the GAAR interpreter to correctly apply the general wording of the GAAR to concrete cases. It must be mentioned that anti-abuse measures are not mutually excluding. Therefore, the interpreter will deal with cases in which two anti-abuse measures of different orders can be applied. Whether those measures are compatible or not will ultimately be determined by the benefit they are protecting, as well as by the object and purpose of the legislation in which the benefit is described.

The following two sections will address international and supranational GAARs and their interplay with domestic anti-abuse measures. The first section corresponds to the introduction of the Principal Purpose Test as a GAAR in the MLI and the OECD 2017 model tax convention and its relation with domestic anti-abuse measures. The second, will deal with the construction of the general principle of *prohibition of abuse of law* in the EU and the landmarks established to distinguish the between tax abusive cases and legitimate ones. The third section will address the semantic meaning to be given to the GAARs introduced in EU directives, considering they are influenced by the wording and definitions used by the ECJ in its case law.

It will be pointed out that there is a synergy between the international, supranational and national approximations towards tax law abuses. Some remarks will be given towards explaining how these measures could contrast and the reasons why it could be considered that a clash is hardly possible.

### 3.1. Using GAARs to protect tax benefits at an international level after 2017

Acknowledging the former implies that the tax authority must define the GAAR to be used in order to solve the case. The level in which that GAAR operates will provide for the guidelines on how to work with the provision. When the tax benefit being protected is a reduction in a given rate in a cross-border operation the formal requirements will be addressed in lieu with the provision offering the benefit, as well the object and purpose of such provision[12].

Following this line of thinking, if the benefit is conferred under a Bilateral Double Tax Treaty (DTT), signed between two countries which consider the benefit to be provided by the treaty itself[13]; the references for delimiting such benefit, acknowledging the transaction and guiding

[12] Applicable when included as a key element of the GAAR. As well in those cases where a carve out is possible under discretion of the tax authorities, this means granting a tax benefit in cases where despite the absence of some formal requirement or in uncommon situation granting the benefit does not go against the object and purpose of the legislation granting the benefit.

[13] This means that the countries rely on a GAAR at a treaty level instead of assuming that a domestic GAAR should be used. The latter is clarified because there are some countries that conceive the benefit to be given by the

the investigation (taxpayer's intention) will follow after the plain wording of the DTT. Only when allowed by the DTT local definitions shall be consulted.[14]

This approach establishes already a legal order to be followed, distancing the DTT from the domestic regulations, considering that the GAAR can be enacted as it constitutes a remedy of international law. Moreover, if the DTT was elaborated based on a model tax convention provided by the Organization for Economic Cooperation and Development (OECD) or the United Nations (UN) the commentaries made to these models will help as criteria of interpretation as long as acknowledged by the tax system of each country. The weight to be given to those commentaries as well as the restrictions in time for their application[15] shall be guided by the country's positions towards the implementation.

For example, if the GAAR being enacted is comprised in a DTT which has been amended by the Multilateral Instrument (MLI) or adopted using as a reference the 2017 OECD MC, it must be understood that such clause will contain the features of the Principal Purpose Test (PPT). Bear in mind, that additional guidance is provided for administering the PPT, considered as a GAAR that can be used jointly with other SAARs and the MC preamble or separately to protect tax treaties from "treaty shopping" practices[16].

The PPT indeed entails an objective and subjective test, where the latter is limited on the grounds of all relevant facts and circumstances and a reasonableness test to restrict the discretion with which the evidence should be examined. The same care for restraining the subjectivity of anti-abuse remedies was early included in the commentaries 9.4 and 9.5 under article 1 of the 2003 OECD MC[17]; where it was clarified that States were not obliged to grant benefits under a DTT to arrangements entered into with the intention to abuse a provision.

Correspondingly, the examination of the situations could not derive into light assumptions on the conduct of the taxpayer. And in order to avoid misinterpretations the guiding principle was proposed:

*"A **guiding principle** is that the benefits of a double taxations conventions should not be available where a main purpose for entering into certain transactions or arrangements was to secure a more favourable position and obtaining that more favourable treatment in these circumstances would be contrary to the object and purpose of the relevant provisions."*[18]

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domestic legislation directly, as the DTT is limited to distribute taxing powers that were actually created at a local level.

[14] In the terms of article 3 (2) of the Organization for Economic Cooperation and Development (OECD) model tax convention of 2017.

[15] In regards to static/ambulatory vs dynamic approach please refer to Linderfalk, Ulf; and Hilling, Maria. The Use of OECD Commentaries as Interpretative Aids – The Static/Ambulatory – Approaches Debate Considered from the Perspective of international Law. Nordic Tax Journal, March 15 of 2015, DOI 10.1515/ntaxj-2015-0003, p. 34-59 available at: https://www.degruyter.com/downloadpdf/j/ntaxj.2015.2015.issue-1/ntaxj-2015-0003/ntaxj-2015-0003.pdf

[16] See also Cubillos González, Juliana. Is the OECD principal purpose test a threat to EU consolidated approach towards abuse? Master Thesis, University of Amsterdam-IBFD, Chapter I, p. 7 – 26.

[17] Both comments included in the 2003 OECD MC and left unaltered until the 2014 OECD MC. In the 2017 OECD MC these comments were transcribed into commentaries 60 and 61.

[18] The principle distinguishes two elements: a) the willingness to *"secure a more favorable position",* and b) obtaining such advantage in the case circumstances is "contrary to the object and purpose of the relevant provisions". Where the first characteristic introduces a main purpose test.

This principle was the core initiative that guided the existence of the PPT[19]. In parallel, the *EU principle of prohibition of abuse of law* takes a similar status in order to interpret the GAARs introduced in secondary legislation and can take prevalence upon them when acknowledged as a general principle of EU law[20]. Although, the interaction of these principles with treaty GAARs and as well that of treaty GAARs with anti-abuse measures arising from different regulatory layers (i.e. national notions, as *fraus legis*, reality doctrine, etc.) should be addressed respecting the prevalence of certain rules and principles upon the others.

An example of this is provided by paragraphs 68 to 80 of the commentary on article 1 of the 2017 OECD MC, where it is clarified that normally anti-abuse measures can be used in order to assist the implementation of a GAAR. However, they would not be accepted in those cases were their usage restricts the effectiveness of the DTT GAAR, in consideration of enabling the other Contracting State to terminate or suspend the DTT, for the breach of the *pacta sunt servanda*[21] principle.

The commentary also acknowledges that using domestic specific rules provides more certainty, nonetheless, such rules should not restrict the range for applying treaty provisions[22]. The same regard needs to be taken when developing judicial doctrines, which are known for changing over time[23], feature that might entail clashes between the legislative provisions and more recent interpretations of the same rules.

Whilst in cases of no conflict[24] between treaty provisions and local regulations, tests such as "substance-over-form", "economic substance", "reality doctrine" and others can be accepted. The former, since treaty provisions should be interpreted in accordance with articles 31 to 33 of the Vienna Convention on the Law of Treaties (VCLT), which *"do*[es] *not prevent the application of similar judicial doctrines and principles to the interpretation of the provisions of tax treaties"*.[25]

In order to fully understand what is meant to be a conflict, paragraph 75 of article 1 of the 2017 OECD MC provides an example:

*"(…) where a domestic law rule that State A adopted to prevent temporary changes of residence for tax purposes would provide for the taxation of an individual who is a resident of State B on gains from the alienation of property situated in a third State if that individual was a resident of State A when the property was acquired and was a resident of State A for at least*

[19] One of the arguments that strongly defends this position is the recommendation stated in paragraph 21.4 of the commentary on article 1 of the 2003 OECD MC, which suggest including a paragraph on articles 10 to 12 and 21 (other income), stating that the benefits of such provisions will not be granted when the *main purpose* was to *"take advantage of [the articles] by means of [a] creation or assignment*".

[20] De la Feria, Rita. EU General Anti-(Tax) Avoidance Mechanism: From GAAP to GAAR. In G Loutzenhiser and R de la Feria (eds), The Dynamic of Taxation, Oxford, Hart Publishing, 2020.

[21] Recognized in article 26 of the Vienna Convention on the Law of Treaties, this principle emphasize that treaty provisions should prevail upon domestic provisions or judicial doctrines in case of conflict, as recognized in public international law.

[22] Paragraph 74 and 75 of the commentary on article 1 of the 2017 OECD MC. Specifically paragraph 75 mentions that *"Domestic specific anti-abuse rules, however, are often drafted with reference to objective facts, such as the existence of a certain level of shareholding or a certain debt-equity ratio. Whilst this facilitates their application and provides greater certainty, it may sometimes result in the application of such a rule in a case where the rule conflicts with a provision of the Convention and where paragraph 9 of Article 29 does not apply to deny the benefits of that provision (and where the principles of paragraphs 60 and 61 above also do not apply). In such a case, the Convention will not allow the application of the domestic rule to the extent of the conflict."*

[23] Paragraph 78 of the commentary on article 1 of the 2017 OECD MC.

[24] Paragraph 75 of the commentary on article 1 of the 2017 OECD MC identifies that *"(…) there will be no conflict with the treaty provisions if the benefits of the treaty are denied under both paragraph 9 of Article 29 (or the principles in paragraphs 60 and 61 above) and the relevant domestic specific anti-abuse rules."*

[25] Ibid; commentary on article 1 of the 2017 OECD MC.

*seven of the 10 years preceding the alienation. In such a case,* ***to the extent that paragraph 5 of Article 13 would prevent the taxation of that individual by State A upon the alienation of the property, the Convention would prevent the application of that domestic rule unless the benefits of paragraph 5 of Article 13 could be denied, in that specific case, under paragraph 9 of Article 29 or the principles in paragraphs 60 and 61 above.****"* (bold type added)

Accordingly, a clash takes place when the domestic specific provision disallows a treaty benefit that would not be banned under the guiding principle or the PPT. In essence the same discrepancy could be observed between a local GAAR, SAAR or principles providing for a dual test and the treaty anti-abuse rules. Contrastingly, imposing a narrow rule for avoiding abuse affecting the granting of treaty benefits shall be disallowed if the PPT provides for a different result.

Based on the commentary and the interplay that the PPT is expected to have with: a) the 2017 OECD MC preamble, b) specific SAARs included in the distributive rules (e.g. Limitation of Benefit Clauses requesting for a Beneficial Owner), and c) other anti-abuse rules or principles outside the treaties; it can be assumed that this GAAR[26] provides an ample spectrum of action serving not only to protect the benefits of the treaty from being abused, but protects them from being disallowed in situations where the domestic specific measures restrict their application.

### 3.2. Evolution of the principle of *prohibition of abuse of law* in the EU

As indicated before, this section explains step by step the evolution of the general EU principle of *prohibition of abuse of law* in regards to taxation. It must be mentioned that the notion of abuse is not limited to tax law cases. Therefore, the analysis by the ECJ of tax cases in light of the principle was required by member states[27]. This initiative allowed the ECJ to construct a given line of reasoning to be applied to tax matters.

Moreover, as academics point out the first-time abuse of tax law was presented was in regards to a VAT case named *Halifax*. Later on, the concept was extended to cover direct taxation matters. The former is key to understand why the secondary law GAARs include language as "absence of commercial reasons" or "wholly artificial arrangements". It will be argued that these wording comes from the case law dealing with the consolidation of the principle of *prohibition of abuse of law.*

#### 3.2.1. First cases considering the principle of *prohibition of abuse of law* in matters other than tax law

One of the first cases that recognized the existence of abuses against national laws within the EU was *Van Binsbergen*[28]. The case was about a Dutch lawyer, who intended to appear before

[26] Namely as a catch all provision that allows the competent authorities to repeal DTT benefits in cases where treaty shopping considers to be proven. The latter based on a reasonableness test that aims for objective factors that would be present in the acting of other taxpayer in the same situation, making the affirmations of the tax authorities reasonable to arrive into the conclusion that the GAAR can be enacted for hindering the benefits. For a thorough analysis on the PPT ample nature please refer to: Cubillos González, Juliana. Is the OECD principal purpose test a threat to EU consolidated approach towards abuse? Master Thesis, University of Amsterdam-IBFD, Chapters I and IV.

[27] The interaction between courts and member states is however not the only way in which a principle acquires its status as general principle of EU law. As rightly pointed out by Rita de la Feria "*Realization of the process of creation of a new principle of EU law is at point unavoidable, with cognizance being not necessarily triggered internally within the CJEU itself, but often externally, either by national courts or legal commentators – or both.*" Op. Cit; De la Feria, R. EU General Anti-(Tax) Avoidance Mechanisms, p.26

[28] Case 33/74, ECLI:EU:C:1974:131

Dutch courts while his new place of residence was Belgium. The Dutch law prevented him from acting as a Dutch lawyer in the member state considering that professional rules were being unattended. And as well, that such situation was willingly caused by the lawyer, since he had moved to the neighboring member state so the regulations were not anymore applicable to him. In this context, the ECJ concluded that member states could implement measures to prevent national rules from being avoided. Paragraph 13 of the ruling expressly stated:

*"Likewise, as Member State cannot be denied the right to take measures to prevent the exercise by a person providing services whose activity is entirely or principally directed towards its territory of the freedom guaranteed by article [49] for the purpose of avoiding the professional rules of conduct which would be applicable to him if he were established within that state; such a situation may be subject to judicial control under the provisions of the chapter relating to the right of establishment and not of that on the provision of services."*[29]

The express allowance for member states to take preventive measures was reiterated in the cases following this ruling. Between 1991 and 1994 three cases dealing with the provision of broadcasting services were decided by the ECJ[30]. In these rulings the Court reflected about the interpretation to be given to the Television Without Frontiers Directive and the free movement of services vis-à-vis restrictive measures applied by member states to stop businesses from implementing circumventing transactions for the provision of broadcasting services.

The Court ruled that measures taken by the member states were a restriction on the free movement of broadcasting services. However, such restriction was justified in the light of what the Court had considered so far to be an abusive practice. Moreover, as Rita de la Feria argues the Opinion of Advocate General Lenz in case *TV10*[31] introduced two of the key elements of the principle of *prohibition of abuse of law*. She summarizes her views in the following paragraph:

*"(a) the view expressed in the Opinion that an activity, even if abusive, should be regarded as falling within the scope of the free movement provisions, with the abuse principle seen as "an exception" to those provisions, could arguably be regarded as the theoretical framework behind the Centros line of case law; (b) the reference in the Opinion to the need for the establishment of criteria for the determination of the existence of abuse, and in particular to the possible use of objective and/or subjective criteria, could arguably be regarded as the origin of the abuse test, set out some years later in Emsland-Stärke."*[32]

Indeed, *Centros*[33] was the first case in which the ECJ established a minimum level of adequacy for an anti-abusive practice to be accepted as a justifiable restriction on the freedom of establishment. The facts of this case concerned the failed registration of a branch by a company originally incorporated in the United Kingdom. The former, under the grounds that such registration was a circumventing maneuver implemented by two Danish citizens, which acted as sole owners of the corporation. Their actions were perceived as to avoid Danish rules on minimum capital.

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[29] Ibid; Van Binsbergen, paragraph 13
[30] Recognized as the Broadcasting Cases: C-211/91, Commission v. Belgium, ECLI:EU:C:1992:526; Veronica, ECLI:EU:C:1993:45; C-23/93, TV10, ECLI:EU:C:1994:362.
[31] C-23/93, ECLI:EU:C:1994:251
[32] Op. Cit; Rita de la Feria, p. 7
[33] C-212/97, ECLI:EU:C:1999:126

The Court established as base line that the mere action to establish a branch in a different member state could never be understood as an abusive practice *per se*. Additionally, paragraph 34 of the case explained in detail which were the criteria to be follow in order to impose an anti-abusive measure:

*"It should be observed, first, that the reasons put forward do not fall within the ambit of Article 56 of the Treaty. Next, it should be borne in mind that, according to the Court's case-law, national measures liable to hinder or make less attractive the exercise of fundamental freedoms guaranteed by the Treaty must fulfil four conditions:* ***they must be applied in a non-discriminatory manner; they must be justified by imperative requirements in the general interest; they must be suitable for securing the attainment of the objective which they pursue; and they must not go beyond what is necessary in order to attain it."***

Under these assumptions, the Court rule in favor of Centros Ltd. contending that the criteria were not fulfilled. The Danish administration argued that the denial in the inscription was implemented in order to protect Centros Ltd. creditors from being deceived. According to the authority, Centros Ltd. had no business in the place of incorporation and getting registered abroad could lead to future abuses. On the contrary, the ECJ considered that there could be measures which were less restrictive in order to protect such creditors, therefore no direct link was to be found between the attempt of protecting creditors and the absence of a business activity in the United Kingdom.

With this contribution the principle of *prohibition of abuse of law* demonstrated its dual character. On one side, it could be used for confirming the existence of abuses that constituted justifiable restrictions to the fundamental freedoms, but at the same time protect the freedoms or any other community law from being repealed based on criteria that disregard their object or purpose. In essence, the protection of the fundamental freedoms was of such importance that its sole existence allowed for abusive and non-abusive cases to fall under their scope. Feature that enabled the ECJ on reviewing the correct application of even local GAARs.

An example of the former is present in the ruling of *Kefalas and Others*[34] where the state decided to implement a domestic GAAR in order to disallow undertakings to rely on a secondary law provision. In this case, the Greek State raised an objection of abuse of rights against the shareholders of a company named Athinaiki Khartopiia AE. Said shareholders had filed a request for dismissal on the decision of increasing the company's capital. The decision had been taken by the Organization for the Restructuring of Undertakings and approved by the Ministry for Industry without discussing it in a general meeting. For this reason, the shareholders called on the violation of article 25 (1) of the Second Directive 77/9, according to which the increase in capital had to be decided in a general meeting.[35]

As a response on this action the Greek State decided to open a proceeding for abuse of rights under article 281 of the Greek Civil Code, which provided that *"the exercise of a right is prohibited where it manifestly exceeds the bounds of good faith, morality or the economic or social purpose of that right"*. In the member state's opinion, the shareholders should use the preference right to acquire the new shares instead of disputing the decision taken.[36]

[34] C-367/96, ECLI:EU:C:1998:222

[35] Ibid; *Kefalas*, Paragraph 11 "*In the plaintiffs' view, the increase in capital decided upon by the OAE is contrary to Article 25(1) of the Second Directive, which provides that `Any increase in capital must be decided upon by the general meeting'. Consequently, they brought an action before the Polimeles Protodikio (Court of First Instance), Athens, which dismissed their application."*

[36] Ibid; Kefalas, paragraph 10

Contrary to the position of the member state the ECJ advised that both the Greek State and the shareholders could rely on the existing rules in order to defend their interests. The first, was enabled to apply provisions of national law to stop abusive situations and the former could still rely on Community law rights, even when choosing to dismiss the usage of other rights. Comprehensively the Court ruled against the Greek State affirming the following:

*"However, Community law does not preclude a national court, on the basis of sufficient telling evidence, from examining whether, by bringing an action under Article 25(1) of the Second Directive for a declaration that an increase in capital is invalid, a shareholder is seeking to derive, to the detriment of the company, an improper advantage, manifestly contrary to the objective of that provision, which is to ensure, for the benefit of shareholders, that a decision increasing the capital of the company and, consequently, affecting the share of equity held by them, is not taken without their participation in the exercise of the decision-making powers of the company.*

*In the light of the foregoing, the reply to the questions referred must be that Community law does not preclude national courts from applying a provision of national law in order to assess whether a right arising from a provision of Community law is being exercised abusively. However, where such an assessment is made, a shareholder relying on Article 25(1) of the Second Directive cannot be deemed to be abusing the right arising from that provision merely because the increase in capital contested by him has resolved the financial difficulties threatening the existence of the company concerned and has clearly ensured to his economic benefit, or because he has not exercised his preferential right under Article 29(1) of the Second Directive to acquire new shares issued on the increase in capital at issue."*

The previous cases established the background for abusive situations to be countered. The ECJ had provided a lower limit based on the exercise of the fundamental freedoms and an upper limit relying on the application of local regulations or measures in order to disallow rights on undertakings when incurring into abusive transactions. However, so far, no case was to be found to be abusive as to disallow the application of the rights. This changed with *Emsland-Stärke*.

This case, concerned a German company which requested an export refund on food commodities that were transported to Switzerland and immediately after their clearance in the said country, were transported back to Germany. The export refund was granted under Regulation 2730/79 covering incentives for agricultural products. Such regulation provided for a series of formal requirements in order to grant the benefit (in this case the refund). All those requirements were met by Emsland-Stärke GmbH. The regulation did not include a GAAR or any other rule that could disallow the granting of the export subsidy or even demand its repayment by the German corporation.

Thus, the Federal Finance Court (Bundesfinanzhof) requested the ECJ to rule upon the possibility of using the principle of *prohibition of abuse of law* to prevent the local company to access the benefits of Regulation 2730/79. The Court responded in the following terms:

*"However, in the light of the specific circumstances of the operation at issue in the main proceedings, which might suggest an abuse, that is to say, a purely formal dispatch from Community territory with the sole purpose of benefiting from export refunds, it must be examined whether Regulation No 2730/79 precludes an obligation to repay a refund once granted.*

*In that regard, it is clear from the case-law of the Court that the scope of Community regulations must in no case be extended to cover abuses on the part of a trader (Cremer, cited above, paragraph 21). The Court has also held that the fact that importation and re-exportation operations were not realized as bona fide commercial transactions but only in order wrongfully*

*to benefit from the grant of monetary compensatory amounts, may preclude the application of positive monetary compensatory amounts (General Milk Products, cited above, paragraph 21)."*[37]

Additionally, in order to clarify when the national court should call for the existence of abuse, the ECJ provided some guidance specifying objective and subjective criteria:

*"A finding of an abuse requires, first, a combination of objective circumstances in which, despite formal observance of the conditions laid down by the Community rules, the purpose of those rules has not been achieved.*

*It requires, second, a subjective element consisting in the intention to obtain an advantage from the Community rules by creating artificially the conditions laid down for obtaining it. The existence of that subjective element can be established, inter alia, by evidence of collusion between the Community exporter receiving the refunds and the importer of the goods in the non-member country."*[38]

As it can be noticed, this dual construction includes the objective and subjective tests to be found in a GAAR. This resemblance contributes to create a feedback cycle between the principle and the GAARs to be established locally or at the Community level. At this point in time, however, the local jurisdictions relied on the principle for matters other than taxes. In this regard, the efforts for prohibiting abuses were direct to matters that could be connected with Community's own resources (e.g. agricultural products incentives).[39]

It must be remembered that value added tax (VAT) was to be considered a Community resource since 1977[40]. Therefore, it was arguable that the principle of *prohibition of abuse of law* could as well be extensible to VAT cases. In spite the likelihood of extending the principle to the tax field on harmonized taxes, this shift was only achieved thirty years later with the ruling in *Halifax*[41].

#### 3.2.2. Cases on the application of the principle of *prohibition of abuse of law* for indirect taxation

Halifax plc was a banking company, whose services were mainly exempted from VAT, reducing its right for crediting against input VAT. In total the corporation was able to recover only 5% of the total VAT paid in the acquisition goods and services for running its own business. Considering the former and in an attempt to increase such percentage, Halifax plc entered in a series of transactions making sure that the VAT could be recovered.

The transactions were conducted to provide construction works to its related companies. However, the tax authorities of the United Kingdom rejected the application for repayment of input VAT claiming that the company had entered in the transactions with the sole aim of obtaining a tax advantage. Without such intention, Halifax plc would have not provided the construction services as those were outside of its business purpose.

The domestic court requested the ECJ to reflect on this case under the lenses of the principle considering the landmarks already established in *Emsland-Stärke*. In response to the request, the Court confirmed the applicability of the principle to VAT cases. However, the weight given

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[37] C-110/99, ECLI:EU:C:2000:695, paragraphs 50 and 51
[38] Ibid; Emsland-Stärke, paragraphs 52 and 53
[39] This might explain the introduction of a new provision in the Charter of Fundamental Rights of the European Union, under the title "Prohibition of abuse of rights". Op.Cit; Rita de la Feria, P.
[40] With the adoption of the Sixth Directive 77/388/EEC, Articles 2 -3.
[41] C-255/02, ECLI:EU:C:2006:121

to subjective criteria was lessened. A clear preference for observable and circumstantial evidence was remarked. As well as, a keen interest for conferring a right only when the undertakings were based on the compliance of the objective criteria established in the Sixth VAT Directive and aligned with its purpose.

In order to guide the national court to distinguish the legitimate from the abusive VAT arrangements the Court provided once a gain some guidance:

*"In view of the foregoing considerations, it would appear that, in the sphere of VAT, and abusive practice can be found to exist only if, first, the transactions concerned, notwithstanding formal application of the conditions laid down by the relevant provisions of the Sixth Directive and the national legislation transposing it, result in the accrual of a tax advantage the grant of which would be contrary to the purpose of those provisions.*

*Second, it must also be apparent from a number of objective factors that the essential aim of the transactions concerned is to obtain a tax advantage. As the Advocate General observed in point 89 of his Opinion, the prohibition of abuse is not relevant where the economic activity carried out may have some explanation other than the mere attainment of tax advantages."*

In order to clarify the second requirement, the Court advised the local courts to determine the real substance of the transactions concerned. And in order to do so suggested to consider the *"purely artificial nature of those transactions and the links of a legal, economic and/or personal nature between the operators involved in the scheme for reduction of the tax burden (see, to that effect, Emsland Stärke, paragraph 58)."*[42]

A second case implying VAT matters that continued the exercise of refining the scope of the principle in the tax field was *Part Service*[43]. The facts of the case concerned a company named Part Service Srl, which according to the Italian tax authority had entered into a leasing agreement with other two companies in regards to the future acquisition of a vehicle.

In the authority's opinion the transaction corresponded to a sole contract that had been divided into multiple ones in order to leverage from the benefits of the Sixth VAT Directive. In the ruling the ECJ confirmed that obtaining a tax advantage did not had to be the sole purpose of a transaction rather it could be seen as the principal purpose to fall within the scope of abuse of law. This affirmation broadened the outreach of the principle when applied to VAT cases.

Some academics[44] considered that a test that covered not only sole abusive purposes but also main abusive purposes was in strict sense broader than the test introduced in *Emsland-Stärke*. In order to explain this difference, the academics pointed out that both cases referred to purely internal situations in which the interpretation of a Community regulation was in line with its local transposed rule. Hence, it was advisable to provide the national courts with a margin of appreciation. Also, that the VAT fraud was contesting a common enemy which were the VAT carousels. Where series of transactions held together for the singular purpose of defrauding the system.

Such broad affirmation of the test to be used in regards to abuses of tax law lasted only for VAT purposes. In cases of direct taxation, the implementation of the principle gained strength

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[42] Ibid; Halifax; paragraph 81

[43] C-425/06, ECLI:EU:C:2008:108

[44] See F. Vanistendael, in R. de la Feria and S. Vogenauer (eds.), Prohibition of Abuse of Law: A New General Principle of EU Law, P.423; and, K. Lenaerts, The concept of abuse of law in the case law of the European Court of justice on direct taxation, Leuven University, 2015, p. 22

with the decision made by the ECJ regarding *Cadbury Schweppes*[45]. In such decision, the elements of the abuse of law test were redefined, providing it with a narrower scope focused on the existence of purely artificial arrangements.

### 3.2.3. Cases on the application of the principle of *prohibition of abuse of law* for direct taxation

The approach taken by the ECJ regarding the application of the principle of *prohibition of abuse of law* differs between tax law cases. On one side the VAT cases call for the application of less restrict tests. While cases concerning direct taxes enforce a narrower approach. One feature that explains this difference is the fact that VAT has been harmonized at the Community level. While direct taxation remains un-harmonized and gets limited by directives, which regulate specific matters influencing direct taxation.

This constitutes a key difference, since member states operate in a standardized way for indirect taxation. Thus, avoiding conflicts arising from differences in treatment between jurisdictions in regards to taxpayers. This is to say that in VAT cases the struggle against abuse is normally presented at a national level. Jurisdictions agreed in a treatment for certain transactions depending on the nature of the operation and the jurisdictions implied in it.

More often than not, VAT abuses are related with organized sham operations. Making easier for member states to identify the mechanisms implicit in those fraudulent activities. For example, it is known that EU fights fraud operations and VAT carrousels. Hence, when the abusive situations take place member states can rely on the measures and investigations conducted by other jurisdictions while enacting the same common laws.

On the other side, direct taxation cases have to face abuse issues, while not being able to rely in a legislative set of rules applicable to all member states. Each state can define its own policies in regards to direct taxes, however remain bound to comply with Community law and respect the considerations instructed by the ECJ. The present implies for each member state to enact new regulations that could be effectively used by local tax authorities without breaching Community law. Although, directives guide member states in certain matters, they lack of specific regulatory legislation explaining the proper enactment of more general norms.

In this regard, member states resort to the ECJ rulings on abuse of tax law for determining their own anti-tax avoidance practices. Bear in mind that at the EU level tax avoidance was first contested by applying the principle of *prohibition of abuse of law*. Then after, more specific measures were taken against abuse of law through secondary legislation (i.e. introduction of GAARs in some directives and consolidation of a GAAR in the Anti-Tax Avoidance Directive).

In order to understand the scope of the principle the next sub-sections will highlight some of the hints voiced by the Court. Each section presents different cases that can be grouped based on the type of measure being used to counter tax abuse. The first one engages with domestic SAARs (i.e. limitation of benefits rules). The second, reflects on cases where the enactment of the domestic SAARs was allowed by the Parent Subsidiary Directive. And the final section reviews some of the last cases presented for judgment before the ECJ requesting a ruling on which should be the legal basis to be used in order to counter artificial group structures that result in tax law abuse.

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[45] C-196/04; ECLI:EU:C: 2006:544

### 3.2.4. Cases where abuse of law was tried to be stopped by enacting domestic SAARs

One of the most representative judgements in regards to tax abuse in direct taxation is *Cadbury Schweppes.* The case concerned a group of companies established in Ireland and the United Kingdom. The parent company was incorporated in the territory of the member state, while its subsidiaries were within the International Financial Services Center in Dublin. Being part of the Center allowed them to enjoy a 10% nominal rate for corporate income tax. The main activity of these companies was to serve as financial providers for the rest of the group.

Considering that the activity performed by the subsidiaries was not essential or significant for the group. Rather perceived as an excuse for leveraging a "lower level of taxation". The United Kingdom tax authorities applied the Controlled Foreign Corporation (CFC) regime in order to tax at the level of the partner undistributed profits made by the subsidiaries. Although the CFC regime provided for exemptions to its application, none of those were admitted in the main proceedings.

The ECJ determined that the CFC regime constituted a restriction on the freedom of establishment, as it would serve as a discouraging measure for United Kingdom resident companies to establish themselves in other member states. Specially, when those jurisdictions offered the taxpayer a *"lower level of taxation". To this consideration the United Kingdom tax authority argued that the CFC regime was intended to prevent tax avoidance, "given its objective to prevent the reduction or diversion of profits liable to the United Kingdom tax"[46].*

Such justification was accepted inasmuch the measure was able to "thwart practices which have no purpose other than to escape the tax normally due on the profits generated by activities carried on in a national territory"[47]. Notwithstanding, the Court explained that the scope in which the CFC regime should be applied was restricted for combating wholly artificial arrangement. Which occur when no economic reality motivates the enactment of the transactions, deriving into a purely artificial construction.

In the ruling the Court emphasized in paragraphs 60 and 71 that the ultimate aim of testing for wholly artificial arrangements was to find if the taxpayer actions reflected economic reality. In order to do so the taxpayer should be enabled to produced evidence confirming that its actions pursue a genuine economic activity.

The wholly artificial arrangements element was already been discussed in other cases before it was developed in Cadbury Schweppes.[48] Nevertheless, it had never been linked with the test offered in *Halifax*, rather had been described in lieu with exercising a freedom. It had so far been clear that mere presumptions of abuse, based on general factors, were not desirable as they could prevent the reliance on the fundamental freedoms.

In Cadbury Schweppes it was clarified that in absence of economic reality there was no freedom to be protected. Clearly in this case, no balance should be looked for in the enactment of the anti-abuse measure. In fact, its application would revert the situation to what it should

[46] Ibid; paragraph 27
[47] Ibid; paragraph 59
[48] Ibid; paragraph 51. See also C-264/96 *ICI*, paragraph 26; Case C-324/00 *Lankhorst-Hohorst* [2002] ECR I-11779, paragraph 37; *De Lasteyrie du Saillant*, paragraph 50; and *Marks & Spencer*, paragraph 57.

be. Enabling the tax system to be strengthened, as it would be applied in accordance with the general rules.

The only curfew on the application of the anti-abuse measure consisted into avoiding too general provisions. Meaning provisions that could be applied to any type of arrangement, regardless of the factual circumstances surrounding the activity. Basically, the concern was placed on not scoping within the anti-abuse rule so it could catch genuine and non-genuine arrangements.

In the ruling this was pointed out in paragraph 72 when the Court said: *"the motive test, as defined by the legislation on CFCs, lends itself to an interpretation which enables the taxation provided for by that legislation to be restricted to wholly artificial arrangements or whether, on the contrary, the criteria on which that test is based mean that, where none of the exceptions laid down by that legislation applies and the intention to obtain a reduction in United Kingdom tax is central to the reasons for incorporating the CFC, the resident parent company comes within the scope of application of that legislation, despite the absence of objective evidence such as to indicate the existence of an arrangement of that nature."*

Following cases such as *Lankhorst-Hohorst*[49] and *Test Claimants in the Thin Cap Group Litigation*[50] (Thin Cap) recalled the importance of delimitating the anti-abuse provisions to target only wholly artificial arrangements. Both cases referred to thin capitalization rules, which are used to avoid the deduction of interest payments connected with debts that exceed in a given ratio the amount of equity of the company in a taxable year. The first of these cases included a measure targeting companies in reference to its place of incorporation. Scope that was not approved by the ECJ as sufficiently limited to be admissible in restriction of the freedom of establishment.

In the second, the scoping conditions of the thin capitalization provision were not as wide. In such regulation, interest paid between entities of the same group could be held as distributions. This to the extent that those interest were considered excessive in comparison with interest to be paid between the payer and the payee in arm's length conditions or by any of the parties and a third entity. The inconvenience of the rule resided in the fact that it was not supposed to apply when both companies were subject to tax in the United Kingdom.

In the Court's opinion, such situation defeated the suitability of the rule for complying with Community law. The thin capitalization rule differentiated between companies established in other member states providing loans to United Kingdom residents and those located within the jurisdiction despite both developed the same operation. Hence, the rule constituted a restriction on the freedom of establishment. Moreover, it was not admissible that the place of incorporation of a company could be a landmark for defining the existence of an abusive situation[51].

Nonetheless, the measure had to be tested in regards to its necessity and proportionality. To do so the Court focused on the interest in excess being the definitive component for implementing a re-characterization. This element was accepted as an objective factor that could be reviewed by the national court. As well, if the interest was exceeding that which normally would had been paid, it could be connected with wholly artificial arrangements. In any

[49] C-324/00; ECLI:EU:C:2002:749 Lankhorst-Hohorst
[50] C-524/04; ECLI:EU:C:2007:161, Test Claimants in the Thin Cap Group Litigation.
[51] Ibid; paragraphs 79 and 73.

case, the existence of artificiality must be proven by the tax authority and the taxpayer should be able to provide evidence countering the tax authority's findings.

#### 3.2.5. Cases where abuse of law was tried to be stopped by enacting domestic SAARs as permitted by the Parent Subsidiary Directive

In, 2011 the Parent Subsidiary Directive included in article 1 (2), indicating that the directive *"shall not preclude the application of domestic or agreement-based provisions in order to prevent fraud or abuse".* This provision was amended in 2015 in order to include a GAAR within the directive's wording. However, for several years, member states enacted their domestic anti-avoidance provisions in accordance with the first version of article 1 (2).

As an example, *Equiom*[52] and *Juhler*[53] concerned the application of domestic GAARs in order to disallow the exemption of withholding taxes upon the distribution of dividends between a subsidiary and its parent company. Such benefit was granted under article 5 of the Directive[54], and could allegedly be repealed claiming article 1 (2) of the same legislation. For the French and German administrations this implied the possibility to resort to domestic GAARs and SAARs for disallowing the enjoyment of the benefit in non-compliant cases.

For the French and German tax authorities the non-compliant cases where those listed within the SAARs included in the legislation transposing the Parent Subsidiary Directive. In both cases, the SAAR went beyond the formal requirements instructed by the directive. In *Equiom* the taxpayer receiving the dividends needed to comply with several requirements, among those proving to be the beneficiary of the repatriated profits.[55] While in *Juhler* the requirements were targeted to prevent the use of conduct companies for accessing the directive's benefits. The local regulation required to provide a business motive to engage with the specific subsidiary.

In the rulings the Court contested the adequacy of the SAARs in regards to the ordinary meaning to be given to article 1(2). As well addressed the domestic measures for their suitability to respect the object and purpose of the Parent Subsidiary Directive. Secondly, the Court reviewed if the local regulations could be accepted as to restrict the freedom of establishment. Meaning that the measures were justifiable and proven to be necessary and proportional as to attain the desired objective.

The first consideration uttered by the Court referred to the limited scope of article 1 (2) of the Parent Subsidiary Directive. Even when exhorting members states to use local anti-abuse provisions the rule did not consent for local targeted rules not in accordance with the object and purpose of the directive. Basically, the provision allowed for using rules exclusively drafted for preventing fraudulent or abusive situations within the constraints of wholly artificial arrangements.[56]

In this regard, the French and German targeted rules were aiming at catching every situation that could avail from the use of holding companies or simply repatriation of profits via dividends distribution. Being not only burdensome for the tax authorities to control these factual scenarios in every possible circumstance, the measures could restrict the application of the Parent

[52] C-6/16 ECLI:EU:C:2017:641 Equiom and Enka
[53] C-504/16 ECLI:EU:C:2017:1009 Deister Holding and Juhler Holding
[54] Article 5 of the Directive instructed the following: *"Profits which a subsidiary distributes to its parent company shall be exempt from withholding tax."*
[55] Ibid; Equiom, par. 7; Juhler, par. 14
[56] Op.Cit; Equiom, par. 30; Juhler, par. 60

Subsidiary Directive in cases where no fraud was being committed. Therefore, the SAARs were based on general presumptions of fraud and abuse, allowing the tax authorities to disallow benefits on taxpayers without having to provide even prima facie evidence of tax abuse.[57]

As well, the SAARs were not suited for restricting the freedom of establishment, as the restrictions were applicable only to foreign shareholders. The subsidiaries located in France and Germany where supposed to provide evidence in order to access the directive's benefits. Such practice might discourage foreign shareholders from investing in any of those jurisdictions. To arrive at this conclusion, the ECJ acknowledged that a comparison between domestic and foreign shareholders could be made inasmuch the French and German governments decided to extend their tax jurisdiction over the profits distributed by resident entities to companies in other member states. With such extension the position of local and foreign subsidiaries distributing dividends could be comparable.

It must be highlighted that despite the conscious analysis made by the Court on the merits of the SAARs regarding secondary and primary law, respectively; as a whole, EU community laws are aimed at the same objective in regards to combating tax evasion and avoidance. So was written in each one of the cases:

**Equiom:** *"However, it must be noted that the objective of combating fraud and tax evasion, whether it is relied on under Article 1(2) of the Parent-Subsidiary Directive or as justification for an exception to primary law, has the same scope. Therefore, the findings set out in paragraphs 30 to 36 of the present judgment also apply with regard to that freedom"*.[58]

**Juhler:** "*However, it must be noted that the objective of combating tax evasion and avoidance, whether it is relied on under Article 1(2) of the Parent and Subsidiaries Directive or as justification for an exception to primary law, has the same scope (judgment of 7 September 2017, Eqiom and Enka, C-6/16, EU:C:2017:641, paragraph 64). Therefore, the findings set out in paragraphs 60 to 74 above also apply with regard to that freedom"*.[59]

#### 3.2.6. Cases in which there is an active search for finding a legal basis for combating abuses of tax law.

The most recent cases concerning the principle of *prohibition of abuse of law* were issued in the year 2016 for consideration of the ECJ. Popularly these cases have been named "The Danish Beneficial Ownership Cases" and concerned the repatriation of profits of six subsidiaries located in Denmark to their respective parent companies located in diverse EU members states. Two of the cases referred to repatriation through dividends payment[60] and the remaining four concerned interests paid in regards to royalty agreements[61].

In the opinion of the Danish tax authority the ultimate beneficial owner of these payments was not the entity receiving them, rather the benefit was supposed to arrive at the level of the ultimate parent incorporated outside the EU.[62] This background implied that the passive

[57] Ibid; Equiom, pars.31 and 32; Juhler, pars. 61 and 62
[58] Ibid; Equiom, paragraph 64
[59] Op.Cit; Juhler, paragraph 97
[60] Skatteministeriet v. T Danmark – C-116/16 and Skatteministeriet v. Y. Denmark – C-117/16
[61] N Luxembourg 1 and Others v. Skatteministeriet – C115/16, X Denmark A/S v. Skatteministeriet – C-118/16, C Denmark I v. Skatteministeriet – C 119/16, and Z Denmark v. Skatteminiesteriet – C-299/16. ECLI:EU:C: 2019:134
[62] For a detailed description of the facts see S.H. Baerentzen, Cross-Border Dividend and Interest Payments and Holding Companies – An Analysis of Advocate General Kokott's Opinions in the Danish Beneficial Ownership Cases. 58 European Taxation 8, 2018. See also S.H. Baerentzen, European Union/International – Danish Cases

income payments between corporations located within the EU had to be covered by the Parent Subsidiary Directive and the Interest and Royalties Directive. Hence, the payments were not subject to withholding taxes at the level of the payer.

The questions raised to the ECJ contemplated the possibility to apply local doctrines, supranational GAARs or even international anti-avoidance provisions for repealing the ban on applying withholding taxes to the contested payments. To these questions the Court provided an interpretation of beneficial ownership in the Interest and Royalties Directive context[63] and decided to make remarks in light of the principle of *prohibition of abuse of law.* The Directives general anti-avoidance measures were not addressed in the cases as they were not successfully transposed by the Danish legislator.[64]

As a baseline for defining the notion of beneficial ownership within the Interest and Royalties Directive the Court mentioned in paragraph 88 of the ruling on *N Luxembourg 1 and Others* [65]that:

*"The concept of 'beneficial owner of the interest', within the meaning of Directive 2003/49, must therefore be interpreted as designating an entity which actually benefits from the interest that is paid to it. Article 1(4) of the directive confirms that reference to economic reality by stating that a company of a Member State is to be treated as the beneficial owner of interest or royalties only if it receives those payments for its own benefit and not as an intermediary, such as an agent, trustee or authorized signatory, for some other person."*

This initial approximation was enhanced by including two specific considerations:

- Remembering that the Commentaries on article 11 of the 1996 OECD model tax convention[66] applied a narrow interpretation to the concept of beneficial ownership, which disregarded "conduit companies" from the concept.

  Having regard to this explanation, the ECJ clarified that the mere presence of such conduit companies was not the issue to be observed, rather considerations should be given to the establishment of such company *"it should be understood in its context and in light of the object and purposes of the Convention, including avoiding double taxation and the prevention of fiscal evasion and avoidance*".[67]

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on the Usage of Holding Companies for Cross-Border Dividends and Interest – A New Test to Disentangle Abuse from Real Economic Activity? World Tax Journal, 2020 (Volume 12.), No.1

[63] This interpretation had to be addressed in light of the Interest and Royalties Directive and could not be derived from the domestic provisions. So was clarified in paragraph 84 of the ruling N Luxembourg 1 and Others C-115/16 "It should be pointed out at the outset that the concept of 'beneficial owner of the interest', which appears in Article 1(1) of Directive 2003/49, cannot refer to concepts of national law that vary in scope."

[64] It should be noted that the cases in their domestic first instance started almost a decade before they were presented for the Court's consideration. Therefore, some of the developments suffered by the Interest and Royalties Directive and the Parent Subsidiary Directive could not be considered. Likewise, since the ATAD GAAR was to be applicable from 1 January, 2019 onwards its content could as well not serve for the purpose of disentangling the cases.

[65] Ibid; N Luxembourg 1 and Others C-115/16

[66] Which in opinion of the Court should be considered as they were the backbone internationally at the time in which the Interest and Royalties Directive was created. Specifically, the Court mentions that the Commission Proposal for the Interest and Royalties Directive of 1998 connected the Directive with article 11 of the OECD model tax convention of 1996.

[67] Ibid; N Luxembourg 1 and Others C-115/16 paragraph 6

- After reviewing various similar expressions used in other member states, the Court defines that the concept of beneficial ownership *"concerns not a formally identified recipient but rather the entity which benefits economically from the interest received and accordingly has the power freely to determine the use to which it is put*."[68]

Regarding the principle of *prohibition of abuse of law* the Court ratifies that it can be considered as self-contained, since no transposition of specific EU GAARs or SAARs needed to be observed when the principle could be applied.[69] Although not a novel approximation to the stand-alone character of the principle, these are the rulings were such characteristic is openly emphasized in opposition of requesting the actual transposition of secondary law provisions.[70]

Additionally, attention should be drawn to the considerations stated within joined cases rulings in regards to reject the ban on the withholdings in those situations where a) wholly artificial arrangement existed; and b) obtaining a tax advantage remains as the main purpose behind a transaction. Paragraphs 107 of *N Luxembourg 1* and 79 of by referring to Advocate General Kokott's opinion state the former, in the following terms:

*"To permit the setting up of financial arrangements whose sole aim is to benefit from the tax advantages resulting from the application of Directive 90/435 would not be consistent with such objectives and, on the contrary, would undermine the effective functioning of the internal market by distorting the conditions of competition. As the Advocate General has, in essence, observed in point 51 of her Opinion in Case C-116/16, that would also be the case even if the transactions at issue do not exclusively pursue such an aim, as the Court has held that the principle that abusive practices are prohibited applies, in tax matters, where the accrual of a tax advantage constitutes the essential aim of the transactions at issue."*

Although aligned with the main purpose tests included in some of the more recently developed GAAR within the EU Directives[71] this remark may imply that the Court is no longer willing to restrict the abuse concept to purely artificial constructions in direct taxation cases[72]. Conversely, rejecting the tax benefits as part of a weighing exercise between the purposes underpinning a transaction. The actual nature of this new scope will only be confirmed if in the following cases the ECJ reinstates these same considerations.

Summarizing the features of the principle of *prohibition of abuse of law* one could identify the following landmarks[73]:

| Legitimate Use | Conditions – Tests | Outcomes |
|---|---|---|
| - Self-contained: Applicable in absence of transposition of EU directives. | - Compliance with formal requirements of the legislation granting the tax advantage is not enough to secure the benefit. Because the tax advantage can still be rejected if considered that the | - The right conferred is removed.<br>- If an advantage was already granted it should be restituted. |

[68] Ibid; N Luxembourg 1 and Others C-115/16 paragraph 89

[69] Ibid; N Luxembourg 1 and Others C-115/16 paragraph 119 and Op. Cit; T Danmark et al – C-116/16 paragraph 91

[70] This result has been heavily criticized by scholars. See W Haslehner & G.W. Kofler, *Three Observationson the Danish Beneficial Ownership Cases,* Kluwer International Tax Blog (Marz 2019); A Mollin Ottosen & S. Andersen, *Preliminary Judgements in the EU Beneficial Ownership Cases,* 21 Derivatives & Financial Instruments 4 (2019), Journal Articles & Papers IBFD.

[71] The main purpose test reference appears in the Merger Directive, Parent Subsidiary Directive and the ATAD.

[72] It must be remembered that in VAT cases such as Halifax the option to analyze the main purpose of the case was still permitted. However, such broad consideration was not equally adopted for direct taxation cases.

[73] Some of these features were already addressed by Op.Cit; R. de la Feria, EU General Anti(-Tax) Avoidance mechanisms, p 15

| | | |
|---|---|---|
| - Transversally applicable with primary and secondary EU law.<br>- Applicable to domestic situations in absence of national legislation. | object and purpose of the concerned legislation is being defeated.<br>- Objective factors need to be reviewed to understand if the transaction or series of transactions correspond to wholly artificial arrangements. In which case tax advantages can be denied.<br>- Likewise, tax benefits could be refused if the main purpose of the transaction is tax oriented. This even if there exist other non-tax oriented considerations that weigh to be less relevant giving the facts of the case and its circumstances. | - The tax authority can disregard the artificial arrangements in order to properly assess the tax burden of the genuine activity of the taxpayer. (Re-characterization of the transactions) |

### 3.3. Particularities of the GAARs introduced in the EU Directives[74]

The effort for combating the abuse of tax law was also adopted in a secondary law level. In this case, the Commission introduced several GAARs within the EU Directives, which resembled the elements of a dual test. In addition, those GAARs were inclusive of the hallmarks developed by the ECJ when scoping the principle of *prohibition of abuse of law.*

By looking at the Directives one perceives an evolution in the terminology employed and the construction of the anti-avoidance provisions. The most ancient GAARs were exclusively aimed at allowing member states to use domestic or agreement base anti-tax avoidance provisions in order to protect the tax advantages granted through the Directives.

However, as the time passed by the most recent GAARs were specifically delimited to curb abuses via wholly artificial arrangements and were addressed to find "genuine economic activity" to allow the granting of a tax benefit. Both conceptions were adopted as mandatory tests. The above, since the ECJ developed those hints, as part of the EU principle of *prohibition of abuse of law*, which exhorted compliance as comprised within EU primary law[75].

It shall be noted that the transition between allowing the usage of anti-abuse measures to the express command of curbing abuse of tax law was gained in attention to the evolution of the ECJ case law in taxation matters. As pointed out in the previous sections, the ECJ and the Commission were engaged into unveiling the term abuse of tax law by introducing a common objective. Thus, member states were allowed to protect tax benefits granted to taxpayers by enacting domestic GAARs, but latter on they were requested to actively deny the tax benefits in sham situations.[76]

Some GAARs as the one inclusive in the Parent Subsidiary Directive and the Anti-Tax Avoidance Directive (ATAD) presented somehow different wordings than those adopted by the ECJ and the Commission in previously amended Directives. This generated controversy among the scholars, yet no official communication was arranged by the EU Commission to

[74] This section has been based on Cubillos González, Juliana. Is the OECD principal purpose test a threat to EU consolidated approach towards abuse? Master Thesis, University of Amsterdam-IBFD, Chapter 2.

[75] As explained in the first citation of this contribution EU principles are to be considered within the primary rules of the Union and therefore, they are expected to be complied with by member states when developing their internal legislations and policies.

[76] Article 6 of the ATAD 2016/1164 of 12 July 2016

clarify the matter. Therefore, terminology such as “main purpose” and “principal purpose” were perceived as interchangeable terms.

Regardless, if aligned or diverse in their specific terminology the GAARs in EU secondary legislation are progressively gaining uniformity, as they embrace the same objective of combating abuses of tax law as instructed by the ECJ. Simultaneously, the inclusion of other GAARs in the international arena, such as the PPT, motivated the further amendment of the Union’s GAARs. The overall idea embodied in the constant development of these GAARs is to strike a balance between being competitive in the world by providing tax benefits, but rebuffing them by enacting a GAAR that at the same time complies with international and supranational commitments.

The following subsections aim at reviewing the elements of some of the Secondary GAARs suggested or actually enacted by the Commission. This approximation counts on the grounds of identifying the elements that permit member states to adhere to the objective of contesting tax law abuses within the EU.

#### 3.3.1. GAAR in the Interest and Royalties Directive and the Merger Directive

The Interest and Royalties Directive included a GAAR aiming at disallowing the directive’s benefits in those cases were the “principal motive or one of the principal motives” to conduct a transaction were connected with “tax evasion, avoidance or abuse”.[77] At the same time the Directive allowed member states to apply domestic or agreement-based provisions in order to prevent tax fraud or abuse.[78] No further considerations were provided in regards of cases in which both norms could be conjointly applied. The lack of such guidance might reside in assuming that the local anti-abuse measures were resulting from the transposition of the Directive’s provisions.

Also, that any implementation of secondary law, domestic or agreement based GAARs had to be observant of the general principles of EU law. The former as in 2003 the consolidation of the wholly artificial arrangements element in *Cadbury Schweppes* highlighted the concerns already established in more recent case law[79] in regards to limiting anti-abuse measure’s tests to sham situations. Undoubtedly, by this point in time the concerns regarding abuse of law limited themselves to observe it as a member states matter instead of an EU concern.

Likewise, the wording of article 15 of the Merger Directive provided for member states to “withdraw the benefits” of the directive if during the course of an investigation it ***appears*** that the operation *“has as its principal objective or as one of its principal objectives tax evasion or tax avoidance (...)”.* Section (a) in this provision includes as well the presumption that an operation lacking valid commercial reasons may be considered as being instructed for a tax evasion and tax avoidance purpose or main purpose[80].

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[77] Article 5 (2) of the Interest and Royalties Directive expressly mentioned *“Member States may, in the case of transactions for which the principal motive or one of the principal motives is tax evasion, tax avoidance or abuse, withdraw the benefits of this Directive or refuse to apply this Directive”.*

[78] Article 5 (1) of the Interest and Royalties Directive identified that *“This Directive shall not preclude the application of domestic or agreement-based provisions required for the prevention of fraud or abuse.”*

[79] Rita de la Feria identifies the former when explaining that: *“the legitimacy of so-called “tax location shopping” could have already been inferred from the Centros line of case law. Nor the Court’s reference in the judgement to “wholly artificial arrangements”; in ICI the Court had already held that national legislation, which restricts the exercise of the freedom of establishment, could only be justified where it had “the specific purpose of preventing wholly artificial arrangements.”* Op. Cit, Rita de la Feria, p.10

[80] The exact wording of the provisions considers that *“the fact that the operation is not carried out for valid commercial reasons such as the restructuring or rationalisation of the activities of the companies participating in the operation may constitute a presumption that the operation has tax evasion or tax avoidance as its principal objective or as one of its principal objectives;”*

According section (b) of the same article, all benefits of the directive could be denied if a company ceases to fulfil the requirements for representing employees or company organs in accordance with the agreements established prior to the operation[81]. In plain terms the GAAR permitted member states to disallow the directive's benefits, if in the future the entities participating or not in the transaction ceases to have the status it used to have when the transaction was carried on. It must be noted that both general presumptions had the effect of targeting specific elements of any transaction in place, but for which application the tax authorities needed to go further into the facts and circumstances of the analysed scheme. For this reason, it might have been accepted to include two general presumptions within a Directive, as those should be read in accordance with the ECJ's requirement of wholly artificial arrangements and genuine economic activity.

The first presumption refers specifically to the existence of a prior investigation, where no evidence of an economic activity was found. The term "valid commercial reasons" seems to be added to preserve the logic with which the GAAR should be read, as in reference for other companies in the same circumstances as the one audited. Some commentators might see this as to represent a convincing economic purpose for the tax authorities, nevertheless such interpretation would be a blatant breach of primary EU law.

What can be inferred from the second presumption is that the Merger Directive's GAAR relied on giving member states guidelines to uncover situations of unrightfully enjoyment of Community benefits. Specifically, the Merger Directive relied on the representation element as one of the triggers to be observed for accessing the benefits. Hence, a restriction in the compliance of this element highlights immediately a situation where the Merger Directive benefits cannot be allowed. Even without the GAAR a finding such as the repeal of representation in any group company would leave itself or any other subsidiary out of the scope of the directive.

Both Directives were inclusive of terminologies that were oriented into ascertaining objective factors to identify the breach of the Directive's intention when granting a benefit. Neither of those focusses on determining the elements of the subjective text in a way that departs from the factual study of the facts and circumstances of the case. This could however be further by resorting to ECJ's case law additional considerations when required.

#### 3.3.2. GAAR in the Common Consolidate Corporate Tax Base proposals

The GAAR of the Common Consolidate Corporate Tax Base proposals had three versions in 2011, 2016 and 2018. This is relevant as the GAAR wording evolved from a basic norm to derive into a simple reference to the GAAR of the ATAD. The first version of the GAAR in 2011 provided for member states to withdraw tax benefits mentioned in the proposal[82] in cases of artificial transactions or arrangements where the "sole purpose" was to avoid taxation.[83]

In order to distinguish between acceptable practices and non-acceptable ones the 2011 proposal explained that *"genuine commercial activities* [could be found] *where the taxpayer is able to choose between two or more possible transactions which have the same commercial result but which produce different taxable amounts"*.[84]

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[81] The exact wording of the provision established: *"results in a company, whether participating in the operation or not, no longer fulfilling the necessary conditions for the representation of employees on company organs according to the arrangements which were in force prior to that operation"*.

[82] In this case calculating the tax base in accordance with the CCCTB proposal parameters.

[83] Article 10 of the CCCTB, COM (2011) 121/14

[84] Ibidem. Art 80 COM (2011) 121/4

The above calls for identifying several alternative options to arrive at the same desired result. Such exercise establishes a comparable set of interactions that could be identified in the acting of the taxpayer (i.e. reports on alternative analysis or economic impact of alternative options). In essence, the GAAR's interpretation should be directed to study the steps followed by the taxpayer rather than their result (i.e. obtaining the tax exemption or reducing the effective rate of taxation).

In comparison with the GAARs of the Interest and Royalties Directive and the Merger Directive this provision introduced a test based in logic, according to which genuine activities shall be found looking at the actions taken to establish the arrangement, forgetting the tax final outcome. However, this novelty did not last long, as in 2016 the GAAR was amended in order to align it with the 2016 ATAD, aiming at the following objectives:

- Identifying if the essential purpose of the arrangement or series of them was to obtain a tax advantage defeating the object and purpose of the Directive.

- Testing if there was if the transaction was genuine considering the facts and circumstances of the case. Non-genuine transactions were to be identified if they were *"not put into place for valid commercial reasons that reflect economic reality."*[85]

As it can be observed the GAAR extended its scope by reviewing series of transactions. Also, a baseline was established in regards to the object and purpose of the Directive for those cases in which the tax advantage (result oriented) was granted disregarding the intention searched by the legislator.

Two year after, the provision was reduced to include a wording in article 58 affirming that the GAAR to be used for the Common Consolidate Corporate Tax Base was the same employed for the ATAD I[86]. This provision included most features identified in the previous paragraphs, while changing the consideration of essential purpose to "the main purpose or one of the main purposes". It shall be remembered that the terms "main" and "sole" have been regarded by some scholars as interchangeable.[87]

### 3.3.3. GAAR in the Recommendation on Aggressive Tax Planning

The statutory general anti-avoidance provision included in the Recommendation on Aggressive Tax Planning aimed at disposing a GAAR specially intended to counter aggressive tax planning practices not covered by SAARs or other anti-avoidance measures. It was expressly established that the introduction of this new GAAR had to be in accordance with the Common Consolidate Corporate Tax Base GAAR issued in the proposal of 2011. Thus, the elements of the GAAR guarded similarity with those of the proposal as it can be observed:

*"An **artificial arrangement or an artificial series of arrangements** which has been put into place for the **essential purpose of avoiding taxation** and leads to a tax benefit shall be ignored. National authorities shall treat these arrangements for tax purposes by reference to their **economic substance**."* (highlight outside the original text)[88]

Other elements definitions were provided by the Commission within the body of the Recommendation. Among them, a definition to the term "arrangement" identified *"any transaction, scheme, action, operation, agreement, grant, understanding, promise,*

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[85] Paragraph 2 of article 58 CCCTB 2016/0336, 25 October 2016, 683 final.
[86] Article 6 of the Council Directive (EU) 2016/1164 ATAD I availabe at: https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32016L1164&from=DE
[87] Opcit. Bull 1. Paulo, Rossenblatt, *General Anti-Avoidance Rules for Major Developing Countries*. Chapter 2. Title 2.4, section 2.4.1.
[88] RATP 2016/136, 28 January, 2016, final 271.

*undertaking or event",* regardless if comprises one step, or more than one[89]. Also, a definition for the term "artificial arrangement" was introduced, this included a list of points to be used by the tax authorities in their assessments.[90]

In the same vein, tax authorities were exhorted to test the suspicious cases for overlapping purposes within a transaction in order to assess its essential purpose. It was directly pointed out that the decision-making purpose had to appear as the most eligible in view of all circumstances of a case. This enquiry could not rely on the subjective intentions of the taxpayer since those should not be considered when determining if the transaction had a tax avoidance aim. The Commission suggested to compare the amounts of tax due for the taxpayer being assessed with those of taxpayers in similar situations.[91] The Recommendation voiced that a clear avoidance intent was to be seen in the effective defeat of the object and purpose of the legislation being abused.[92]

Despite being one of the most detailed legislations in regards to the effective application of a GAAR, it remains as a recommendation having no binding force as per article 288 of the Treaty of the functioning of the European Union (TFEU). Additionally, the fact that the GAAR was intended to work hand-in-hand with the Common Consolidate Corporate Tax Base, which ultimately was amended by the ATAD, whose guidelines are not entirely aligned.

#### 3.3.4. GAAR in the Parent Subsidiary Directive and the Anti-Tax Avoidance Directive- ATAD

The GAARs of the Parent Subsidiary Directive and the ATAD are the most developed GAARs within secondary legislation at the EU level. They enjoy from the ample dissertation that the ECJ had in matters of direct taxation while delineating the principle of *prohibition of abuse of law.* This feature incentivised the inclusion of a mandatory character in both GAARs, since the concept of prohibiting abuses of law was fully established. Hence the old considerations as to defend the Directive's benefits exclusively with domestic or agreement-based provisions were fully abolished. Those provisions could as well be applied conjointly with the GAARs, as long as they would not contravene with their hallmarks[93].

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[89] Ibid; Recommendation on Agressive Tax Planning points 4.3 and s.s.

[90] Find below a short summary of the elements mentioned:

- Look for the legal substance of the arrangement as a whole and then test if the legal characterization of the individual steps of the whole arrangement is consistent with the former;
- Operations have normally a reasonable business conduct, while the way in which the arrangement/series of agreements where carried out departs from the ordinary manner that would be employed;
- *"the arrangement or series of arrangements includes elements which have the effect of offsetting or cancelling each other";*
- *"transactions concluded are circular in nature";*
- The tax benefits obtained with the arrangement/series of arrangements are significant but they do not go in accordance with the business risks undertaken or the cash flow reported by the taxpayer.
- There is an inverse relationship between the pre-tax profit and the expected tax benefit, where the first is insignificant in comparison with the amount of the latter.

Although providing examples when talking about statutory GAARS might render them inapplicable in practice, Rosenblatt explains that a balance is desirable to be found between broad definitions and specific examples (illustrative indicia) to guide the tax authorities practice. Opcit. Bull 1. Paulo, Rosenblatt, *General Anti- Avoidance Rules for Major Developing Countries.* Chapter 3, Title 3.3, section 3.3.3

[91] When looking at this comparison the benefit to be reviewed in regards to a possible aggressive tax planning structure could be the following:

a. "an amount is not included in the tax base;
b. The taxpayer benefits from a deduction;
c. A loss for tax purposes is incurred;
d. No withholding tax is due;
e. Foreign tax is offset" Point 4.7 of the RTAP 2016/136, 28 January, 2016, final 271.

[92] Ibid; Recommendation on Aggressive Tax Planning points 4.5

[93] The Parent Subsidiary Directive (2011/96/EU of 30 November 2011) includes this reference in article 1 (4) and it was not amended in the year 2014.

Finding a GAAR functional to the object and purpose of the Parent Subsidiary Directive was problematic, because the aim of the Directive was closely related with the elimination of tax barriers for cross-border interactions between group entities. Therefore, the main object of the legislations was to *"foster transactions by abolishing juridical double taxation of profit distributions between companies of different Member States."*[94] Basically, tax authorities could misinterpret the abusive character of a given transaction by the simple fact of the attaining the Directive's benefits.

Hence, the subjective test of the Parent Subsidiary Directive's GAAR could not frame the sole purpose of a transaction. It had to refer to several in tandem aims and purposes. Therefore, the provision reflected a subjective test that identified if "the main" or "one of the main" purposes of a given transaction was to obtain a tax advantage allowed as per the directive.[95]

Although criticized[96] this approach is similar to the one followed in the Merger Directive, which relies on a subjective test that considers the "essential purpose" of a given transaction. [97] Regardless, if the term avails shallow interpretations or not, it is clear that these terms shall be "interpreted restrictively" [98], as emphasised in *Kofoed* and *Foggia* cases.[99] Additionally, a balance should be struck when implementing the objective and non-genuine tests[100].

Contrastingly the ATAD scope of action was broader than the Parent Subsidiary Directive, while aimed at disallowing any type of corporate tax advantages to be granted within the EU or in the interactions of the member states and third Countries in abuse situations.[101] Nevertheless, the elements of the GAAR resemble those of the Parent Subsidiary Directive as it includes a main purpose test, with non-genuine complementary hallmarks that shall be tested in regards to objective factors. In full the GAAR indicates the following:

- *"MS shall ignore arrangements or series of arrangements that have been "put into place for the main purpose or one of the main purposes of obtaining a tax advantage".*[102]
- *Obtaining such advantage defeats the object and purpose of the applicable tax law.*
- *And on top of these analysis the arrangement needs to be perceived as not genuine having regard to all relevant facts and circumstances.*

[94] Ashley Bergmans, *"The Principal Purpose Test: Comparison with EU-GAAR Initiatives"* in Michael Lang (Ed) *"Preventing Treaty Abuse"*, Series of International Tax Law, Linde, 2015, p. 340; Filip Debelva and Joris Luts, *The General Anti-Abuse Rule of the Parent-Subsidiary Directive*, European Taxation, IBFD, June 2015, p.226

[95] *"In other words, a broader textual formulation of the subjective test was preferred. The presence of "other main purposes" does not, after all, detract from the fact that tax avoidance is one of the main purposes, while the term "essential" suggests that the subjective test is not met if there is another equally compelling (commercial) purpose."* Room document # 1, Working party on Tax Questions – Direct Taxation, PSD – Anti- abuse rule, 24 Jul. 2014, p. 4, published in: Highlights & Insights on European Taxation, H&I 2015/274 See: Room document # 1, Working party on Tax Questions – Direct Taxation, PSD – Anti-abuse rule, 24 Jul. 2014, p. 4, Quoted in: Dennis Weber, The New Common Minimum Anti-Abuse Rule in the EU Parent-Subsidiary Directive: Background, Impact, Applicability, Purpose and Effect. Intertax, Vol. 44, Issue 2, Kluwer International, 2016, p. 98

[96] Filip Debelva and Joris Luts, *The General Anti-Abuse Rule of the Parent-Subsidiary Directive*, p. 224

[97] Ibid, 15 Filip Debelva and Joris Luts, *The General Anti-Abuse Rule of the Parent-Subsidiary Directive*, p. 226.

[98] ECJ, 10 November 2011, C-126/10 Foggia and ECJ, 5 July 2007, C-321/05 Kofoed.

[99] Ibid, Filip Debelva and Joris Luts, *The General Anti-Abuse Rule of the Parent-Subsidiary Directive*, p. 226

[100] Scholars have mentioned that "non-genuine" is an interchangeable term to be used in exchange of "artificial. As such the search for genuine interactions would remain as a logically based search for any economically relevant act that discourages artificial arrangements. At least this has been argued by Filip Debelva and Joris Luts, *The General Anti-Abuse Rule of the Parent-Subsidiary Directive*, p. 227; and by Otto, Marres and Isabella de Groot, *The general Anti-Abuse Clause in the EU Parent – Subsidiary Directive.* Section 10.4.3, p.6

[101] The ATAD was to be applicable to *"to all taxpayers that are subject to corporate tax in one or more Member States, including permanent establishment in one or more Member States of entities resident for tax purposes in third"* countries.

[102] Article 6 (1) ATAD 2016/1164 of 12 July 2016.

- *Transactions are supposed to be considered as not-genuine "to the extent that they are not put into place for valid commercial reasons which reflect economic reality"*[103]
- *Finally, article 6 (3) explains that in case the GAAR is applied the logic way of proceeding is to "ignore the arrangement or series thereof and calculate the tax liability in accordance with national law."*[104]

An interesting remark about this directive is that consideration 11 of ATAD I preamble provides a whereas indicating that taxpayers are able to *"choose the most efficient structure for its commercial affaires"*. In other words that taxpayers are enabled to conduct tax planning without being stopped by the GAAR. In tandem, this was enforced by the ECJ in *Centros* considering that simply obtaining tax benefits allowed in a given jurisdiction (even if it was a cross-border situation) could not derive into believing those benefits should be repealed.

## 4. Final remarks

The administration of local GAARs in the EU context has been consistently guided by the principle of prohibition on abuse of tax law on one side, and the evolution of GAARs in the international context. The pressure established by both the MS requesting rulings on tax abusive situations before the ECJ and the rapid implementation called by the adoption of the Base Erosion and Profit Shifting minimum standards as well as the MLI on the PPT, made possible the inclusion of new GAARs into the Tax Directives and the development of a general consolidated GAAR through the ATAD.

It could still be argued that some of these GAARs are problematic in practice, since their contributions are guided always in light of diverse benefits and hence provide for unequal tests towards probing situations of abuse by the domestic courts. However, most of these GAARs are inclusive of the wholly artificial arrangement approach, a genuine test or a reasonableness tests, which provide certainty towards the configuration of the legal instruments.

Two further commentaries could be made in regards to the administration of a GAAR in the EU level, namely one addressing the internal situation and one in regards to the external compatibility of these GAARs with the PPT.

### 4.1. Consolidating terminologies and objectives in the struggle against tax avoidance within the EU

The inclusion of similar hallmarks among the ECJ's case law and secondary law GAARs reduce the uncertainty for taxpayers, inasmuch tax authorities will be better prepared to apply the domestic and supranational GAARs when needed. The emphasis made in regard to use objective factors to assess the suspected abuse cases contributes to the reduction of biased judgements. Local Courts should also remain attentive of not completely closing the possibilities for taxpayers to better choose the most economically convenient option as long as it is consistent with the business purpose of the company or group of companies[105].

In connection with the former an upper bound can be established in regard to the enjoyment of Community tax advantages, as long as those come within the normal course of business carried on by a company. This could be extensive to those cases where despite of not finding comparable taxpayers in the same circumstances, the set-up remains logically consistent with

[103] Article 6 (2) ATAD 2016/1164 of 12 July 2016.

[104] Op. Cit; Cubillos González, p .40

[105] This comprehends tax planning supported with economically convenient reasons for the taxpayer enacting the transaction.

the aims supporting the actions of the companies involved. Also, that those actions seem connatural to the field in which the company develops its businesses. This upper limit permits and encourages the enjoyment of tax benefits when formal and substantial requirements are complied with.

Contrastingly the lower bound is determined by the presence of wholly artificial constructions that contravene the object and purpose of the legislation granting the tax advantages. In light of the same elements considered for the upper bound the artificiality must be tested in regard to objective factors, avoiding to rely too much in the personal aims which evidence might be elusive.

Despite the framework previously presented, it is true that the Court struggles for keeping a single concept of abuse of law through direct and indirect tax cases. The issue resides in the country's terminology given to the same or similar legal terms and the jargon adopted within each specific legal system. Differences in language might as well contribute to the misinterpretation of certain terminologies. It is also relevant to become aware that the ATAD introduced a GAAR only four years ago. Also, the last cases on abuse of tax law were shared two to three years ago[106]. These time gap might have been used by member states to test their domestic provisions in an attempt to keep the consolidated approach followed before cases mentioned in section 3.2.6 of this document.

### 4.2. Compatibility of the EU GAARs and the PPT

As explained by the OECD commentaries conflicts with the PPT would arise only in those cases where the supranational or domestic provisions restrict the attribution of treaty benefits, while those tax advantages would not be restricted by the treaty GAAR. This would not be the case if the member state decides to apply a supranational GAAR as it will be comprising the same type of tests included in the PPT. Specifically, a subjective test based on reasonableness assumptions considering objective factors and objective presumptions destined to protect the object and purpose of the legislation in which the benefit is comprised. Moreover, the element of wholly artificial arrangements prevents the option to disallow benefits based on purely general presumptions, which are normally considered to be colliding with the PPT.

Likewise, member states must amend their local regulations, GAARs and SAARs in order to avoid broad scope restrictive measures, causing disturbances on the commonly used schemes by taxpayers in comparable situations (i.e. placing a subsidiary in a jurisdiction where the nominal income tax rate is lower or establishing a holding in another member state). The above, as those would not respect the wholly artificial arrangements limit or even the reasonableness test. Besides, this provides an opportunity for tax authorities to use the general provision selectively to assess companies in given sectors or certain taxpayers without conducting a thoughtful investigation.

It is not expected to have a controversy when applying the EU GAARs instead of the PPT in a given situation, as from the international point of view only tests restricting the implementation of the PPT should be disallowed in compliance with the public international law. At the same time, it must be accepted that the PPT is a less complex structure, since it will only defend tax benefits under a given treaty. While the GAARs in EU law represent not only the interests of the tax legislation being protected, but those of EU primary law. For instance, EU GAARs need to be read in compliance with the fundamental freedoms. Restricting the possibilities for tax

[106] This referes to *The Danish Beneficial Ownership Cases.*

administrations and local court to disallow any tax advantage in regard to situations where a sensitive unjustifiable breach of a freedom arises.

In a previous contribution[107], the author discussed that the PPT was a much broader norm in terms of interpretation as the EU GAARs. This affirmation was sustained by the fact that EU GAARs were designed to test wholly artificial arrangements, while the PPT addressed progressive milestones going from the total sham to find an actual business activity. The gap between these two extremes could still be explored based on comparative analysis with the common attitude of other taxpayers[108]. Nonetheless, the alleged difference does not hold true after the rulings on the *Danish Beneficial Ownership Cases*, since the restrictive scope of the wholly artificial arrangements test was extended as to bridge with the main purpose test, creating a possible gap as the one existing for the PPT. This means that the local court can target for the existence of wholly artificial arrangements, and in their absence the weighing of purposes other than obtaining the tax advantage.

Furthermore, the specific attention given by the Court to the commentaries of the 1996 OECD model tax convention in order to define the meaning to be given to the term beneficial ownership in the Interest and Royalties Directive allows the interpreter to consider that other secondary law provisions could also be interpreted in alliance with the OECD commentaries. The former provided that the commentaries or the OECD model tax convention were relevant for establishing the Directive. To this regard, it seems that a static approach towards using the commentaries as means of interpretation could be accepted by the ECJ. In the same vein, it could be possible to find in the near future other ECJ rulings in which other internationally accepted hallmarks are adopted to enrich the principle of *prohibition of abuse of law*.

According to these arguments, the difference between the PPT and the EU GAARs is destined to disappear, if ever existed. Nevertheless, the protection of the fundamental freedoms is still a corner stone that should be carefully observed in future cases, as not to forego the dual objective that EU anti-abuse provisions serve.

[107] Op. Cit; Cubillos Gonzalez, Is the OECD principal purpose test a threat to EU consolidated approach towards abuse?

[108] It must be reminded that the only GAAR that actively resorts to compare the attitudes of other taxpayers to identify if the transaction is close to the business reality, is the one included in the Recommendation on Aggressive Tax Planning. Also, that this GAAR has no mandatory character.