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Aggressive Tax Planning in EU Law and in the Light of BEPS: The EC Recommendation on Aggressive Tax Planning and BEPS Actions 2 and 6

Ana Paula Dourado*

The purpose of this article is to critically assess the meaning of aggressive tax planning and its scope in the current international move to fight against base erosion and profit shifting (BEPS). In the context of the BEPS initiative, aggressive tax planning has been broadly used in several Organization for Economic Cooperation and Development (OECD) and EU soft law instruments. However, it is not clear what new features aggressive tax planning does bring to the settled legal concepts of tax avoidance and tax evasion, and whether it is a legal or merely a tax policy concept. In order to find the meaning of aggressive tax planning in the BEPS context, some of the recommendations put forward in BEPS actions 2 and 6 and in the EC Recommendation on Aggressive Tax planning are analysed and compared in this article.

*The article also aims to illustrate some of the reciprocal influences and interaction between EU law and OECD recommendations and tax treaties. For example, the EC Recommendation on ATP, proposing the introduction of a General Anti-Abuse Rules (GAAR) in the Member States' legislation, and the BEPS Action 6 proposal to introduce a GAAR (a Principal Purposes Test Rule or PPT Rule) in tax treaties illustrate the same spirit and a holistic approach. Moreover, a PPT Rule in tax treaties concluded by EU Member States will have to be compatible with the EU fundamental freedoms and the principle of abuse in EU law. The GAAR amending the EU Parent-Subsidiary Directive and approved by the Economic and Financial Affairs Council (ECOFIN) on 9 December 2014 illustrates how EU Member States could introduce a GAAR in their treaties compatible with EU law. These reciprocal influences among domestic, international and EU law and practices lead to an *acquis communautaire* and to international standards which may be justified as products of global identity and related to a global sense of fairness and unfairness and ultimately of a global tax morale calling for global solutions and global tax standards.*

I INTRODUCTORY REMARKS

The purpose of this article is to critically assess the meaning of aggressive tax planning and its scope in the current international move to fight against base erosion and profit shifting (BEPS). Previously to the BEPS initiative, aggressive tax planning has been associated in some contexts with the risks of tax avoidance or tax evasion. For example, in the Seoul Declaration of September 2006, as a result of a meeting among tax administrations promoted by the OECD, tax intermediaries have been linked to 'unacceptable practices of reducing taxation'. Some jurisdictions have subsequently required tax intermediaries to communicate, inform and give further clarification of promoted tax schemes and activities that might be considered aggressive tax planning to the tax administration.¹ The aforementioned information duties aim at helping the tax administration (and courts) to check correct compliance

with tax obligations. These information duties supposedly have a deterrent effect on tax avoidance and tax evasion behaviour in the aforementioned context of aggressive tax planning.²

In the context of the BEPS initiative, aggressive tax planning has been broadly used in several OECD and EU soft law instruments and goes much further than stipulating information duties in the case of tax planning schemes. However, it is not clear what new features aggressive tax planning does bring to the settled legal concepts of tax avoidance and tax evasion, and whether it is a legal or merely a tax policy concept. In order to find the legal meaning (if any) of aggressive tax planning in the BEPS initiative, some of the recommendations put forward in BEPS actions 2 and 6 and in the EC Recommendation C-(2012) 8806 of 12 December 2012 on Aggressive Tax Planning (hereinafter, the EC Recommendation on ATP) are going to be analysed and compared.

Notes

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¹ See the case of Canadian and Portuguese legislations: Dourado, Ana Paula/Silva Dias, Augusto 'Information Duties, Aggressive Tax Planning and *nemo tenetur se ipsum accusare* in the Light of Art. 6(1) of ECHR', *Human Rights in Europe and the World*, Kofler, Maduro, Pistone eds., IBFD Amsterdam (2011) pp. 143–152; G.N. Larin, R. Duong, M. Jacques, 'Policy Forum: Responses to Aggressive Tax Planning – a Study Framework', 56 *Canadian Tax Journal* (2008), p. 147.

² *Ibid.*

This article also aims to illustrate some of the reciprocal influences and interaction between EU law and OECD recommendations and tax treaties. For example, the EC Recommendation on ATP, proposing the introduction of a GAAR in the Member States' legislation, and the BEPS Action 6 proposal to introduce a GAAR (a Principal Purposes Test Rule or PPT Rule) in tax treaties illustrate the same spirit and a holistic approach, even if the contents and methodology are not coincident, as will be seen below. Moreover, a PPT Rule in tax treaties concluded by EU Member States will have to be compatible with the EU fundamental freedoms and the principle of abuse in EU law. The terms of the GAAR amending the EU Parent-Subsidiary Directive and approved by the Economic and Financial Affairs Council (ECOFIN) on 9 December 2014 can now be used by EU Member States to introduce a GAAR or PPT rule in their treaties that is compatible with EU law. Also, the recent agreement to amend the Parent-Subsidiary Directive on hybrid mismatch arrangements and double non-taxation³ is a multilateral implementation of one of the proposals in BEPS Action 2 (ii).

These reciprocal influences among domestic, international and EU law and practices lead to an *acquis communautaire* and to international standards which may be justified as products of global identity and related to a global sense of fairness and unfairness and ultimately of a global tax morale calling for global solutions and global tax standards.⁴

2 THE MEANING OF AGGRESSIVE TAX PLANNING AND TAX AVOIDANCE

2.1 Aggressive Tax Planning and a Call for Coordinated International Action

The legal meaning of aggressive tax planning is not clear. Until the recent movement against BEPS, a distinction has been made, both in international and in European tax

law, between tax evasion, tax avoidance (or abuse, in the terms of the European Court of Justice⁵) and tax planning.⁶ Whereas tax evasion corresponds to a tax crime or offense as defined by law, tax avoidance implies a difference between the legal form adopted (which is in conformity with the wording of the law) and the substance of the underlying activity or scheme (the substance is not in conformity with the spirit or purpose of the law) and implies recharacterization of the transaction or series of transactions carried out by the taxpayer.⁷ Tax planning has not only been considered legal in international tax law, but also compatible with the fundamental freedoms in EU law and even if aimed at reducing the tax burden, it complies both with the purpose of the legislation (main objective test), and the complementary business purpose test (under international tax law)⁸ or the genuine economic activity test (under EU law).⁹

As an aftermath to the 2008 financial crisis, there are increasing worries about international tax planning and BEPS which require going beyond the traditional classification and distinction between tax evasion, tax avoidance and what was until recently assessed as legitimate tax planning. Whereas the aforementioned catalogue (tax evasion, avoidance or planning) implied legal qualification of the taxpayer's behaviour (whether the behaviour fell in the legal *Tatbestand*), the new era involves States in finding an adequate response for behaviour that may be legal but is endangering the survival of the tax state and the global notion of fairness. In fact, the aforementioned worries have led to a call for international collective efforts.

Paragraph 5 of the 'Tax Annex to the St. Petersburg G20 Leader's Declaration', of September 2013 reads as follows:

5. International collective efforts must also address the tax base erosion resulting from international tax planning. Base erosion and profit shifting (BEPS) relates chiefly to instances where the interaction of different tax rules result in tax planning that may be

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³ At the meeting of ECOFIN without discussion of 8 Jul. 2014: amendment to Directive 2011/96/EC, Under the adopted amendment, which modifies Art. 4(1)(a) of the PSD, the EU Member State where the parent company is located shall 'refrain from taxing such profits to the extent that such profits are not deductible by the subsidiary, and tax such profits to the extent that such profits are deductible by the subsidiary'. This amendment links the tax treatment in the state of the parent company with that of the subsidiary. As such, the changes aimed at hybrid loan arrangements could affect certain group financing arrangements where such arrangements are not already limited under domestic rules. Many Member States already have introduced broader anti-avoidance rules to tackle hybrid loan arrangements and/or already deny exemption for deductible distributions. All remaining Member States will have to implement the new anti-hybrid rule within their domestic legislation by 31 Dec. 2015.

⁴ See Dourado, Ana Paula, 'Exchange of Information and Validity of Global Standards in Tax Law: Abstractionism and Expressionism or Where the Truth Lies', 11 *EUI Working Paper*, RSCAS (2013), p. 2, http://cadmus.eui.eu/bitstream/handle/1814/26059/RSCAS_2013_11.pdf?sequence=1.

⁵ On the Principle of Abuse in Tax Law, see the various articles by several authors in Ch. VII of *Prohibition of Abuse of Law, A New General Principle of Law?* (de la Feria/Vogel, eds., Hart Publishing 2011); and de la Feria, *Prohibition of Abuse of (Community) Law: The Creation of a New General Principle of EC Law through Tax* 45 Com. Mkt. L. Rev. 395 (2008).

⁶ On international tax planning, see, *inter alia*, Prokisch, Rainer, Artikel 1, in Vogel/Lebner, *DBA, Doppelbesteuerungsabkommen Kommentar*, 5. Auflage, München (2008), mno. 89.

⁷ On tax avoidance in International Tax Law, See the OECD Model Tax Convention on Income and Capital, OECD, July 2010, commentaries 7-9.5 to Art. 1. Zimmer, Frederik, 'Form and Substance in Tax Law, General Report', International Fiscal Association, *Cahiers de Droit Fiscal International*, vo. LXXXVIIa, Kluwer, The Hague, 2002, pp. 23-25, 37. On tax avoidance in domestic law and in international tax law, see, Prokisch, Rainer, *supra*, n. 6, mno 90-99b and 100-118 and the literature on the topic.

⁸ For example, valid commercial reasons, as mentioned in Action 6, commentary 8 to the PPT rule: OECD/G20 Base Erosion and Profit Shifting Project, *Preventing the Granting of Treaty Benefits in Inappropriate Circumstances* (2014), p. 69.

⁹ ECJ, 12 Sep. 2006, C-196/04, *Cadbury Schweppes, plc, Cadbury Schweppes Overseas Ltd v. Commissioners of Inland Revenue* [2006] ECR I-7995 paras 54-55.

used by multinational enterprises (MNEs) to artificially shift profits out of the countries where they are earned, resulting in very low taxes or even double non-taxation. These practices, if left unchecked, undermine the fairness and integrity of our tax systems. They fundamentally distort competition, because businesses that engage in cross-border BEPS strategies gain a competitive advantage compared with enterprises that operate mostly at the domestic level. Fair, transparent and efficient tax systems are not only key pillars for sound public finances, they also provide a sustainable framework for dynamic economies. For these reasons, G20 Leaders identified the need to address BEPS as a priority in their tax agenda at the Los Cabos Summit in June 2012. Additionally, we must achieve better international coordination on taxes. In this regard, we must move forward in fighting BEPS practices so that we ensure a fair contribution of all productive sectors to the financing of public spending in our countries.

In this paragraph there are two key elements that help us identifying the action that is required by international collective efforts: the first element is a reference to 'artificial shift of profits' which leads us to the concept of tax avoidance, traditionally dealt with by anti-avoidance rules.¹⁰ These rules may need to be improved after the G20 call. The second element is a reference to the need for better international coordination on taxes, which implies new domestic and international legal rules and therefore responsibility for the outcome very clearly depends on the States.

Whereas reference in the aforementioned G20 Tax Annex to the St. Petersburg G20 Leaders' Declaration is to international tax planning, several OECD (e.g., OECD BEPS Action Plan, p. 13, BEPS Action 2¹¹) and EU documents make reference to aggressive tax planning (e.g., EC Recommendation C (2012) 8806 of 6 December 2012).

Before the BEPS Action Plan and the EC Recommendation C(2012) 8806, aggressive tax planning was associated with globalization and free movement of capital and with the risks of tax evasion or avoidance. As

mentioned above, some States have required taxpayers to unveil their tax planning structures,¹² so that tax administrations can get the information on those schemes, better assess the compatibility of those schemes with national tax law and, if appropriate, exchange information spontaneously or request information.

In the context of BEPS, aggressive tax planning has been used in OECD and EU soft law instruments as a (vague) concept very much linked to a call to new policy developments and coordinated international action. Aggressive tax planning is generally described as the behaviour adopted by multinationals to explore the existing opportunities to decrease the tax burden granted by globalization and the interaction of tax rules in different jurisdictions. The indeterminacy in the meaning of aggressive tax planning induces us to conclude that it may cover both tax planning and tax avoidance or merely tax planning, depending on the context. As is below argued, aggressive tax planning is currently an umbrella concept to both international tax planning and tax avoidance.

2.2 Aggressive Tax Planning and Tax Avoidance in the EU

As a response to the G20 call for an action by the OECD against tax planning,¹³ the European Commission defines it in Recommendation C (2012) 8806 of 6 December 2012. The Recommendation adopts the technique of a definition followed by standard examples: according to the Recommendation, aggressive tax planning consists 'in taking advantage of the technicalities of a tax system or of mismatches between two or more tax systems for the purpose of reducing tax liability'. The Recommendation's broad definition of aggressive tax planning does not correspond to the concept of tax avoidance or abuse in EU Law.¹⁴ According to the European Court of Justice (ECJ), an EU taxpayer is entitled to exercise a fundamental freedom or to engage in operations in order to benefit from a more favourable tax regime¹⁵ which is equivalent to the purpose of reducing tax liability.

Notes

¹⁰ In fact, artificiality is one of the leading elements in EU law, in testing whether there is tax avoidance or abuse: See Cadbury Schweppes ... *supra*, n. 9, at para. 51.

¹¹ *Action Plan on Base Erosion and Profit Shifting – Report:2013* (OECD 2013), p. 13. OECD/G20 Base Erosion and Profit Shifting Project, *Neutralising the Effects of Hybrid Mismatch Arrangements* (2014), p. 23.

¹² See n. 1.

¹³ G20 Communiqué, Meeting of Finance Ministers and Central Bank Governors, Moscow, 15–16 Feb. 2013: MNO 20: "In the tax area, we welcome the OECD report on addressing base erosion and profit shifting and acknowledge that an important part of fiscal sustainability is securing our revenue bases. We are determined to develop measures to address base erosion and profit shifting, take necessary collective actions and look forward to the comprehensive action plan the OECD will present to us in July. We strongly encourage all jurisdictions to sign the Multilateral Convention on Mutual Administrative Assistance. We encourage the Global Forum on Transparency and Exchange of Information to continue to make rapid progress in assessing and monitoring on a continuous basis the implementation of the international standard on information exchange and look forward to the progress report by April 2013. We reiterate our commitment to extending the practice of automatic exchange of information, as appropriate, and commend the progress made recently in this area. We support the OECD analysis for multilateral implementation in that domain."

¹⁴ See below III. 3.

¹⁵ C-255/02, *Halifax plc, Leeds Permanent Development Services Ltd e County Wide Property Investments Ltd contra Commissioners of Customs & Excise*, ECR I-1609, paras 73–75; *Cadbury Schweppes, supra*, n. 9, para. 34, 36, 37; C-277/09, *The Commissioners for Her Majesty's Revenue & Customs v. RBS Deutschland Holdings GmbH*. (2010), ECR I-13805, paras 47–55.

In order to assess tax avoidance in the light of EU primary and secondary law, the ECJ has been engaged in building up a principle of abuse. At the current stage of the ECJ case-law it cannot be claimed that the principle of abuse has exactly the same features in direct and indirect taxes (in the latter case, mainly VAT).

2.3 The EU Concept of Abuse in Respect of Non-harmonized Direct Taxes

In respect of direct taxes, and in the absence of harmonization, abuse occurs in cases where a person tries to circumvent the provisions of domestic law and at the same time takes an improper advantage of the fundamental freedoms, by exercising the right to a fundamental freedom in an artificial manner. In these situations, abuse has to be assessed in the light of the fundamental freedoms (which constitute principles and therefore are inherently vague) and not in the light of domestic laws, even if the latter are the object of circumvention:

nationals of a Member State cannot attempt under cover of the rights created improperly circumvent their national legislation. They must not improperly or fraudulently take advantage of provisions of Community law (Case 115/78 *Knoors* [1979] ECR 399, paragraph 25; Case C-61/89 *Bouchoucha* [1990] ECR I-3551, paragraph 14; and Case C-212/97 *Centros* [1999] ECR I-1459, paragraph 24).¹⁶

Until now, still in the case of non-harmonized direct taxes, abuse is seen by the ECJ as a potential justification to a restriction of the fundamental freedoms,¹⁷ and this position implies that abuse is an exception to the rule and has to be interpreted restrictively.¹⁸ As a consequence, domestic anti-abuse provisions cannot rely on legal un rebuttable presumptions, but imply a case-by-case assessment.

This assessment is based on the following cumulative or concurring tests:

- (1) a main purpose or one of the main purposes to circumvent the application of the legislation of the

Member State concerned in order to obtain a more favourable tax regime;¹⁹

- (2) artificial arrangements or artificial exercise of the fundamental freedoms;
- (3) these artificial arrangements are aimed at circumventing the aforementioned national legislation;
- (4) national anti-abuse provisions have to be proportionate.²⁰

In *Cadbury Schweppes*, the reference to the purpose by the ECJ is then classified by the same Court as a 'subjective element, consisting in the intention to obtain a tax advantage' (paragraph 64). The Court states further that in addition to that element, there must be:

objective circumstances showing that, despite formal observance of the conditions laid down by Community law, the objective pursued by freedom of establishment...has not been achieved. (same paragraph 64).

It is herein contended that the purpose above mentioned in (1) is to be determined according to an objective analysis of the aims and objects of the arrangements or transactions in place and taking into account all relevant circumstances.²¹ It is recognized however, that in paragraph 64 of *Cadbury Schweppes*, the position of the ECJ is not clear.

In a group of cases related to cross-border losses and intra-group financial transfers, and deductibility of expenses, the ECJ has admitted abuse as a justification to a restriction of the fundamental freedoms based on a mere risk analysis – the mere risk of tax avoidance can justify a restriction to the freedom of establishment or the freedom to provide services.²² Underlying this broader acceptance of abuse, without requiring the artificiality test, is the recognition that the transfer of cross-border losses or intra-group financial transfers is not be possible to control on the basis of the artificiality test, without jeopardizing the OECD transfer pricing rules that apply to cross-border transfers within related enterprises. The fact that the ECJ applied the transfer pricing reasoning in the *SGI* case and in the *Thin Cap GLO* cases²³ also means recognition of

Notes

¹⁶ *Cadbury Schweppes*, *supra*, n. 9, para. 35.

¹⁷ *Cadbury Schweppes*, *supra*, n. 9, paras 47, 55, 57.

¹⁸ *Dourado*, Ana Paula, *A Single Principle of Abuse in European Union Law: A Methodological Approach to Rejecting a Different Concept of Abuse in Person Taxation*, in *De la Ferial Vogenauer*, *supra*, n. 5, at 481–482.

¹⁹ *Cadbury Schweppes*, *supra*, n. 9, para. 62.

²⁰ *Ibid.* at paras 34–38, 51–55, 57, 60–65.

²¹ See below: This is clear in the proposed GAAR (point 4.5): EC Recommendation (2012) 8806 12 Dec. 2012, on Aggressive Tax Planning. See, also, OECD/G20 Base Erosion and Profit Shifting Project..., *supra*, n. 8, p. 69, commentary 10 on the PPT Rule.

²² See, among others: Case C- 446/03, *Marks & Spencer plc v. David Halsey (Her Majesty's Inspector of Taxes)* (2005) ECR I-10837, para. 49.

²³ Case C-311/08, *Société de Gestion Industrielle SA (SGI) v. État Belge* (2010) ECR I-00487, paras 71–72; Case C-524/04, *Test Claimants in the Thin Cap Group Litigation v. Commissioners of Inland Revenue* (2007) ECR I-2107 para. 82.

transfer pricing rules in the EU, in the absence of harmonization.

2.4 The EU Concept of Abuse in Respect of Direct Taxes Partially Harmonized

Another group of cases on abuse in direct taxes has involved interpretation of Article 15(1) a. of the Merger Directive (ex- Article 11(1)(a)). Abuse occurs:

where it appears that one of the operations referred to in Article 1(a) has as its principal objective or as one of its principal objectives tax evasion or tax avoidance; the fact that the operation is not carried out for valid commercial reasons such as the restructuring or rationalization 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.²⁴

In *Foggia*, the ECJ clarifies both the meaning of ‘tax evasion or avoidance as [the] principal objective or as one of [the] principal objectives’ of the restructuring operation and of ‘valid commercial reason’. First, it clarifies the concept negatively: Referring to its previous case-law, namely to *Leur-Bloem*, the ECJ confirms that ‘with regard to ‘valid commercial reasons’... the concept involves more than the attainment of a purely fiscal advantage’.²⁵ The Court goes beyond *Leur-Bloem* by concluding that ‘predominant’ fiscal reasons can also indicate that there are no valid commercial reasons. According to the ECJ in *Foggia*, a ‘merger operation based on several objectives, which may also include tax considerations, can constitute a valid commercial reason provided, however, that those considerations are not predominant in the context of the proposed transaction’.²⁶ The Court does not positively define ‘valid commercial reasons’ but opts to negatively describe its boundaries.

But the ECJ examines, in a positive manner, the meaning of ‘valid commercial reasons’ taking into account the facts submitted by the national court. Essentially it considers that the savings in terms of overall cost structure of the group cannot constitute a ‘valid commercial reason’.

The ECJ finds that the fact that ‘the losses are very substantial and that their origin has not been clearly determined may constitute an indicator of tax evasion or avoidance’.²⁷ And it adds that the saving made by the group in terms of cost structure is quite marginal²⁸ and ‘is inherent in any operation of merger by acquisition as this implies, by definition, a simplification of the structure of the group’.²⁹

The ECJ moreover confirms that unrebuttable presumptions of tax avoidance or tax evasion are not acceptable, because they are disproportionate, and therefore ‘the competent national authorities may not confine themselves to applying predetermined general criteria but must subject each particular case to a general examination of the operation in question’.³⁰

2.5 The EU Concept of Abuse in Respect of VAT

Similarly to what happens in the case of the Merger Directive, in respect of VAT, it is the 6th Directive as amended (containing ‘a uniform definition of taxable transactions (*Halifax and Others*, paragraph 48)’) that is interpreted by the national courts and the ECJ. In contrast, the analysis of abuse in non-harmonized direct taxes requires interpretation of the fundamental freedoms, even if indirectly also of national legislation, as mentioned previously. It also results from the analysis undertaken above, that in the case-law involving direct taxes, the ECJ has focused on the (in)admissibility of unrebuttable presumptions and the artificiality test has been used as an argument by the Court to require a case-by-case analysis on whether there is abuse.

Differently, in VAT cases, the principle of abuse has been built up as an interpretive principle of the 6th Directive, as amended. Jurisprudential development of the principle of abuse has occurred in VAT cases in particular. The departure point of this case-law on VAT is *Halifax* where abuse is deemed to have occurred if two elements are present:

- (1) the accrual of a tax advantage the grant of which is contrary to purpose of the legal provision; and

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²⁴ On the meaning of abuse in the Merger Directive, see: Englisch, Joachim, ‘National Measures to Counter Tax Avoidance under the Merger Directive’, *Movement of Persons and Tax Mobility in the EU: Chnaging Winds*, Dourado, Ana Paula (ed.) IBFD, Amsterdam (2013), pp. 213–249, espec. 246–249.

²⁵ ECJ, C-28/95, *Leur-Bloem v. Inspecteur der Belastingdienst/Ondernemingen Amsterdam 2* [1997] ECR I-4161, para. 47; ECJ 10 Nov. 2011, C-126/10, *Foggia- Sociedade Gestora de Participações Sociais SA v. Secretário de Estado dos Assuntos Fiscais* (2011) ECR I-10923 para. 34.

²⁶ ECJ C-126/10, *Foggia, supra*, n. 25 para. 35.

²⁷ *Ibid.* at para. 42.

²⁸ *Ibid.* at para. 47.

²⁹ *Ibid.* at para. 48.

³⁰ *Ibid.* at para. 37. See Dourado, Ana Paula ‘Portugal: The Foggia (C-126/10) and Amorim (C-38/11) Cases, *ECJ – Recent Developments in direct Taxation 2011*, Lang, Pistone, Schuch, Staringer, Storck (eds.) Linde, Vienna (2012) pp. 213–222; Dourado, Ana Paula and Almeida Fernandes, José ‘Portugal’, *ECJ – Recent Developments in direct Taxation 2010* Lang, Pistone, Schuch, Staringer, Storck (eds.) Linde, Vienna (2011), pp. 205–206.

- (2) the obtaining of a tax advantage as the essential aim of the transactions concerned.

According to the ECJ in *Halifax*:

in the sphere of VAT, an 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 (...) (paragraph 74)

(...) 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 (para. 75).

In *Halifax* and the subsequent case-law on VAT cases, it has been discussed whether the aim to obtain a tax advantage has to be the essential, principal or the sole aim.³¹ Still in *Halifax*, 'normal commercial operations' is an additional criterion to the previously mentioned tests. This additional criterion is especially focused on the second test (paragraph 69 of *Halifax*)³² but it also helps in verifying whether the purpose of the rule was observed in the selected transactions, as it results from paragraph 80.

According to paragraph 69:

[t]he application of Community legislation cannot be extended to cover abusive practices by economic operators, that is to say transactions carried out not in the context of normal commercial operations, but solely for the purpose of wrongfully obtaining advantages provided for by Community law (see, to that effect, Case 125/76 *Cremer* [1977] ECR 1593, paragraph 21; Case C-8/92 *General Milk Products* [1993] ECR I-779, paragraph 21; and *Emsland-Stärke*, paragraph 51).

And as stated in paragraph 80:

[to] allow taxable persons to deduct all input VAT even though, in the context of their normal commercial operations, no transactions conforming with the deduction rules of the Sixth Directive or of the national legislation transposing it would have enabled them to deduct such VAT, or would have allowed them to deduct only a part, would be contrary to the principle of fiscal neutrality and, therefore, contrary to the purpose of those rules.

In *Part Service*,³³ *Weald Leasing* and *RBS Deutschland*³⁴ the ECJ follows the tests set up in *Halifax*, in order to check whether an abusive practice had taken place. In *Weald Leasing* the Court recognized that the essential purpose of the transactions was to obtain a tax advantage, but this test was not sufficient to determine the transactions abusive, because the accrual of the tax advantage was not contrary to purpose of the legal provision.³⁵

However, in a subsequent case, *Ocean Finance*³⁶ the Court abandoned the first of the aforementioned tests and focused on the artificiality of the transaction. The Court asks if pure artificial schemes have been carried out with the exclusive purpose of obtaining a tax advantage, without verifying whether the accrual of a tax advantage was contrary to purpose of the legal provision:³⁷

44. It may, however, become apparent that, sometimes, certain contractual terms do not wholly reflect the economic and commercial reality of the transactions.

45. That is the case in particular if it becomes apparent that those contractual terms constitute a purely artificial arrangement which does not correspond with the economic and commercial reality of the transactions.

46 The Court has held on various occasions that preventing possible tax evasion, avoidance and abuse is an objective recognised and encouraged by the Sixth Directive (see *Halifax and Others*, paragraph 71 and the case-law cited) and that the effect of the principle that the abuse of rights is prohibited is to bar wholly artificial arrangements which do not reflect economic

Notes

³¹ See ECJ Case C-425/06, *Ministero dell'Economia e delle Finanze formerly Ministero delle Finanze v. Part Service Srl company in liquidation, formerly Italservice Srl* [2008] ECR I-827, para. 62; See de la Feria, Rita, Case Comment *HMRC v. Weald Leasing Ltd* – not only artificial – the Abuse of Law Test in VAT, *BTR*, 2008, p. 2; Schön, Wolfgang *Abuse of Rights and European Tax Law*, in *Comparative Perspectives on Revenue Law – Essays in Honour of John Tiley 97* (J. Avery Jones, P. Harris and D. Oliver eds Cambridge U. Press 2008).

³² See de la Feria, Rita, *supra*, n. 31, at 4.

³³ *Supra*, n. 31. It has been contended that the ECJ in *Part Service* did not clarify the meaning of abuse in *Halifax*: Pasquale Pistone 'Abuse of Law in the Context of Indirect Taxation: From (Before) *Emsland-Stärke* 1 to *Halifax* (and Beyond) in Rita de la Feria/Stefan Vogenauer (eds.) *supra*, n. 5, at 392–393.

³⁴ C-103/09 [2010], I-13589 and C-277/09 [2010] I-13805.

³⁵ *Weald Leasing*, n. 34, para. 33.

³⁶ C-653/11, (2013) ECR I-00000.

³⁷ Detailed criticism can be read in de la Feria, Rita, 'O Impacto de *Ocean Finance* no Conceito de Abuso do Direito para Efeitos de IVA', 3, *Revista de Finanças Públicas e Direito Fiscal* (2013), pp. 325 et seq.

reality and are set up with the sole aim of obtaining a tax advantage (see Case C-162/07 *Ampliscentifica and Amplifin* [2008] ECR I-4019, paragraph 28; Case C-504/10 *Tanoarch* [2011] ECR I-10853, paragraph 51; and Case C-326/11 *J.J. Komen en Zonen Bebeer Heerbugowaard* [2012] ECR, paragraph 35).

This line of reasoning in *Ocean* is closer to the meaning of abuse in direct taxes, even if in respect of direct taxes the purpose to circumvent the application of the legislation of the Member State concerned is one of the required tests for verifying whether there is abuse.

2.6 Abuse as a Single Principle Applicable to All Taxes in the EU?

There are still inconsistencies in the jurisprudential design of the principle of abuse, not only as a principle applicable to all taxes, but also when the same tax and issue is at stake. Some of the remaining inconsistencies depend on whether the taxes at stake are harmonized or not and therefore on the degree of vagueness of the interpreted (and potentially avoided) rule or principle.

It is expected, however, that further developments in EU legislation and in EU case-law will go in the direction of a single concept of abuse, and that some of the main elements are common when courts have to assess whether there is abuse.³⁸

As a conclusion, the concept of tax avoidance in EU law requires some conditions and tests, and taking advantage of the technicalities of one tax system or of mismatches between two or more tax systems (the definition of aggressive tax planning) does not per se imply avoidance or abuse.

2.7 Aggressive Tax Planning as an Umbrella Concept Covering Legal Gaps, Mismatches and Tax Avoidance

In contrast to the principle of abuse, aggressive tax planning also covers the existence of legal gaps or mismatches exploited in transnational situations. Legal gaps have to be dealt with by law, due to the principles of no taxation without representation and of separation of powers in tax law. Thus, legal gaps cannot be overcome by GAARs, since these rules do not operate automatically and universally but require demonstration of abuse of (existing) law (or rules) on a case-by-case basis.

Furthermore, in point 5 of the EC Recommendation on ATP, reference is made to the necessity of addressing

'instances in which a taxpayer derives fiscal benefits through engineering its tax affairs in such a way that income is not taxed by any of the tax jurisdictions involved (double non-taxation)'. In the aforementioned Recommendation, there is no reference to intended or unintended mismatches by the State or the States involved.

According to the same point 5, '[t]he persistence of such situations can lead to artificial capital flows and movements of taxpayers within the internal market and thus harm its proper functioning as well as erode Member States' tax bases.' In spite of the reference to artificial capital flows and movements of taxpayers within the internal market, action is called for to counter the 'engineering' that leads to double non-taxation as such.

Reference is also made to the difficulty of Member States protecting their national tax bases from erosion through aggressive tax planning, in the economic global context: '... especially due to the cross-border dimension of many tax planning structures and the increased mobility of capital and persons' (point 3).

The Recommendation further clarifies that '[a]ggressive tax planning can take a multitude of forms. Its consequences include double deductions (e.g., the same loss is deducted both in the state of source and residence) and double non-taxation (e.g., income which is not taxed in the source state is exempt in the state of residence)'.

The risk of double deductions has been assessed by the ECJ as a valid justification for a Member State to deny deduction of cross-border losses and the recommendation suggests the adoption of legal rules in order to avoid double dips.³⁹ But double deduction of losses can also be the consequence of transfer pricing mismatches. Moreover, double non-taxation, as described in the Recommendation (point 5), is a consequence of hybrid mismatch arrangements (hybrid instruments or hybrid entities).

From the examples mentioned above, it can be concluded that an EU concept of abuse does not coincide with the concept of aggressive tax planning in the Recommendation on ATP. However, the legal concept of tax avoidance or abuse can be covered by a broader concept, an umbrella concept, the function of which is, in the EU as in the OECD, to call for collective action by the Member States.

Aggressive tax planning is not a legal concept allowing administrative or judicial action, e.g., re-characterizing for tax purposes the legal structure or scheme adopted by the taxpayer. It does not expand the concept of avoidance, it does not allow per se application of either a general anti-avoidance or a specific anti-avoidance rule. Anti-avoidance rules require avoidance behaviour.

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³⁸ Dourado, Ana Paula, *supra*, n. 18, pp. 469–483.

³⁹ See *inter alia*, Marks & Spencer, *supra*, n. 22, at para. 47.

Thus, aggressive tax planning requires coordinated legislative action targeted at the improvement of anti-avoidance rules, and the adoption of either EU or domestic legislative measures to overcome legal gaps or mismatches (for the latter case, point 4 of the Recommendation on ATP).⁴⁰

2.8 The Case of CFC Rules and of Rules Limiting Deductibility of Interest

In turn, a CFC rule or a rule limiting deductibility of interest can to a certain extent overcome the negative effects of aggressive tax planning as defined in the aforementioned Recommendation (namely, 'taking advantage of mismatches between two or more tax systems for the purpose of reducing tax liability'), but two aspects have to be noted:

First, in order to be compatible with the fundamental freedoms, a CFC rule in an EU Member State will still have to require application of the abuse tests.⁴¹ This means that a CFC rule in an EU Member State implies a case-by-case analysis in order to verify if there is abuse that goes beyond the definition of aggressive tax planning.

Second, rules limiting deductibility of interest can contribute to reducing the tax advantage sought in the 'technicalities of a tax system' (such as the legal right to deduct interest) or the 'mismatches between two or more tax systems' (such as mismatches concerning hybrid instruments).⁴² If rules limiting deductibility of interest are not discriminatory, they will be compatible with EU law, but they do not operate as anti-abuse rules – they neither rely on a rebuttable nor on an unrebuttable presumption of abuse. Instead, they exclude the possibility of abuse by simply forbidding deduction. They operate at a previous level, by avoiding mismatches.

Thus, CFC rules in the EU are anti-avoidance rules and do not coincide with the definition of aggressive tax planning. In turn, rules limiting deduction of interest may be used to combat aggressive tax planning but do not correspond to the concept of abuse either, because they operate at a moment previous to abuse, avoiding unintended gaps and mismatches.

2.9 Aggressive Tax Planning in the OECD

The OECD definition of Base Erosion and Profit Shifting behaviour is in part close to the EU concept of tax avoidance, where it makes reference to profit shifting 'to locations where there is little or no real activity': According to the OECD (BEPS 'Frequently asked questions'), BEPS:

refers to tax planning strategies that exploit gaps and mismatches in tax rules to make profits 'disappear' for tax purposes or to shift profits to locations where there is little or no real activity but the taxes are low resulting in little or no overall corporate tax being paid(mno 47).⁴³

In the light of the second part of the definition, a legal and real business structure would not be affected by the OECD BEPS Action Plan.

But BEPS Action Plan covers both tax avoidance (abuse) and aggressive tax planning, where they are handled as distinct but complementary targets: reference is made to artificiality, where it is argued that '[f]undamental changes are needed to effectively prevent double non-taxation, as well as cases of no or low taxation associated with practices that artificially segregate taxable income from the activities that generate it'.⁴⁴ It can be argued that 'artificial segregation of taxable income' corresponds to the abuse test used by the ECJ (to 'artificial schemes'), but the worries underlying the BEPS Action Plan go beyond tax avoidance, covering legal gaps and mismatches, and corresponding to what the EC Recommendation refers to as aggressive tax planning. The aforementioned double non-taxation in the BEPS Action Plan is not only caused by tax avoidance and this is clear in the reference to the need to 'ensure the coherence of corporate income taxation at the international level' (p. 13). In turn, the 'realignment of taxation and relevant substance' (p. 13) refers to the design as a whole of corporate taxes and includes improvement of anti-avoidance provisions, but goes beyond it.

Under the heading '[n]ew international standards must be designed to ensure the coherence of corporate income taxation at the international level', it is written:

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⁴⁰ See also: (6) and (7) of the EC Recommendation (2012) 8806: '(6) In 2012 the Commission carried out a public consultation on double non-taxation in the internal market. Since it is not possible to address all the issues covered by that consultation through one single solution, it is appropriate, as a first step, to deal with the issue which is linked to certain frequently used tax planning structures that take advantage of mismatches between two or more tax systems and often lead to double non-taxation.

(7) States often undertake, in their double taxation conventions, not to tax certain items of income. In providing for such treatment, they may not necessarily take account of whether such items are subject to tax in the other party to that convention, and thus whether there is a risk of double non-taxation. Such risk may also occur if Member States unilaterally exempt items of foreign income, irrespective of whether they are subject to tax in the source state. It is important to address both situations in this Recommendation.' Critically analysing the indeterminacy of aggressive tax planning in the above mentioned EC Recommendation, Lang. M., 'Aggressive Steuerplanung' - eine Analyse der Empfehlung der Europäischen Kommission', 2 *Steuer und Wirtschaft International*, (2013), p. 62.

⁴¹ After Cadbury-Schweppes, *supra* n. 9, this is considered to be *acte clair*.

⁴² See OECD/G20 Base Erosion and Profit Shifting Project, *Neutralising the Effects ...*, *supra* n. 11, e.g., pp. 51–57.

⁴³ 2014 BEPS Deliverables, <http://www.oecd.org/ctp/beeps-frequentlyaskedquestions.htm>, accessed on 10 Oct. 2014.

⁴⁴ Action Plan ..., *supra*, n. 11, at 13.

There is a need to complement existing standards that are designed to prevent double taxation with instruments that prevent double non-taxation in areas previously not covered by international standards and that address cases of no or low taxation associated with practices that artificially segregate taxable income from the activities that generate it. Moreover, governments must continue to work together to tackle harmful tax practices and aggressive tax planning (p. 13).

Thus, addressing BEPS also implies handling harmful tax regimes both at the OECD and the EU level (see Recommendation regarding measures intended to encourage third countries to apply minimum standards of good governance in tax matters C (2012) 8805 EC).

Careful interpretation will lead us to conclude that aggressive tax planning as described in the aforementioned EC Recommendation on ATP is very much linked to the BEPS concept and that avoidance is not necessarily present in BEPS behaviour. In mno 48, when it is asked if BEPS strategies are illegal, the answers clarify that most schemes are not illegal and that 'they just take advantage of current rules that are still grounded in a bricks and mortar economic environment rather than today's environment of global players which is characterised by the increasing importance of intangibles and risk management'. In turn, avoidance is a concept focused on the behaviour of taxpayer and not on the inadequacy of the existing tax rules.

Furthermore, mno 49 adds that BEPS is caused by the inadequacy of corporate tax as a domestic tax in a cross-border environment, and that gaps are caused by the interaction of more than one legal system, which 'result in income not being taxed anywhere'. Finally, it is argued that BEPS leads to an inefficient allocation of resources by distorting investment decisions and to unfair results (mno 50).

Even clearer is mno 51 where aggressive tax planning is identified with BEPS: when the OECD asks in 51 'Why worry about BEPS now?', the answer is that 'the OECD has been providing solutions to tackle aggressive tax planning for years'.

If attention is now paid to some of the recommended solutions to BEPS, the conclusion is the same: linking rules as recommended in Action 2 go beyond the concept of tax avoidance or abuse, and are focused in recommending legislative action by the adoption of a series of linking rules that are targeted to avoid gaps and mismatches.

The fact that aggressive tax planning is a broad concept, not necessarily coinciding with avoidance or abuse, is also illustrated by the increasing information duties about

'aggressive tax planning arrangements', falling on the taxpayer. Under BEPS Action 12, it is recommended that States require their taxpayers to disclose aggressive tax planning arrangements.: 'develop recommendations regarding the design of mandatory disclosure rules for aggressive or abusive transactions, arrangements or structures, taking into consideration the administrative costs for the tax administrations and business and drawing on experiences of the increasing number of countries that have such rules'.⁴⁵

Aggressive or abusive are not here used as synonyms but as different types of transactions, arrangements or structures: taxpayers may be legally bound to inform the tax administration of tax planning arrangements (which will lead to a more favourable tax result) and these duties may or may not constitute avoidance or abuse but will in any case help OECD Member States to take action. This action comprises fighting against legal gaps or mismatches and in the case of tax avoidance the information obtained will help States to take due action.

The latter purpose is also clear in the description of the work carried out by the Aggressive Tax Planning Steering Group:

The work of the Aggressive Tax Planning (ATP) Steering Group is supported by the ATP Directory, a secure online resource for government officials which is intended to help governments keep pace with aggressive tax planning... The directory contains information on scheme types, how they were detected, and what governments are doing about them. It does not contain any taxpayer-specific information (i.e., they do not disclose the identity of the taxpayers involved) and thus protects taxpayer privacy. Schemes set out fact patterns and the legal provisions being exploited. The inclusion of a scheme shows that one or more countries thought it useful to share information on a scheme with other interested countries, but it does not indicate any legal or other judgment about the scheme on the part of the OECD or its membership.⁴⁶

3 SOME PROPOSED MEASURES TO TACKLE AGGRESSIVE TAX PLANNING

3.1 Subject-to-tax clause in the EU Member States and in EU Law

EC Recommendation on ATP proposes the adoption of a subject-to-tax clause aimed to deal with double non-taxation and where both intended and unintended double non-taxation are covered:

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⁴⁵ *Ibid.* at 22.

⁴⁶ <http://www.oecd.org/ctp/aggressive/oecdaggressivetaxplanningdirectory.htm>.

To give effect to point 3.1, Member States are encouraged to include an appropriate clause in their double taxation conventions. Such clause could read as follows:

Where this Convention provides that an item of income shall be taxable only in one of the contracting States or that it may be taxed in one of the contracting States, the other contracting State shall be precluded from taxing such item only if this item is subject to tax in the first contracting State.

Where, with a view to avoid double taxation through unilateral national rules, Member States provide for a tax exemption in regard to a given item of income sourced in another jurisdiction, in which this item is not subject to tax, Member States are encouraged to ensure that the item is taxed.

3.4. For the purposes of points 3.1, 3.2 and 3.3 an item of income should be considered to be subject to tax where it is treated as taxable by the jurisdiction concerned and is not exempt from tax, nor benefits from a full tax credit or zero-rate taxation.

The subject-to-tax clause in the EC Recommendation does not distinguish between intended and unintended benefits and it is a 'general subject-to-tax clause'⁴⁷ that seems to introduce the 'duty to be taxed once' in the EU. The subject-to-tax clause in the EC Recommendation is much broader than the actions suggested by Action 2, where linking rules are recommended in the case of hybrids. This extremely broad scope, and ultimately naïve in simplifying national tax policy regarding cross-border movements and income, may be justified by the EC motivation to be at the forefront of the BEPS process.

In the current EU context of tax competition and lack of will to harmonize, it is very unlikely that EU Member States would adopt such a subject-to-tax clause, especially regarding intended gaps, aimed at promoting investment abroad or investment in developing countries. Moreover, EU Member States may also be resistant to adopting a general subject-to-tax clause geographically limited to the EU territory. Taking into account free movement of capital, subject-to-tax clauses should ideally be adopted universally or at least in the OECD context, in order to avoid diversion of investment to those States that do not adopt those rules.

Thus, it is more likely that measures against double non-taxation will be adopted in the context of the OECD, such as the saving-clause in OECD Action 6⁴⁸ and the linking rules in OECD Action 2. In the context of BEPS actions recommendations there is leeway for OECD Member States to only adopt measures against unintended mismatches and unintended double non-taxation.

3.2 Linking Rules in OECD Action 2

The EC Recommendation is previous to the OECD Action Plan on BEPS⁴⁹ and according to the latter, Action 2 is to develop model treaty provisions and recommendations regarding the design of domestic rules to neutralize the effect of hybrid instruments and entities. As in the aforementioned EC Recommendation, both in the OECD BEPS Action Plan and in Action 2, examples of aggressive tax planning are double non-taxation, double deduction, long-term deferral.⁵⁰

Reference in the OECD Action Plan is also made to domestic measures and are restricted to hybrid instruments and entities, and may include changes to the OECD Model Tax Convention to ensure that hybrids are not used to obtain the benefits of treaties unduly (i); domestic law provisions that prevent exemption or non-recognition for payments that are deductible by the payor (ii); domestic law provisions that deny a deduction for payment that is not includible in income by the recipient (and is not subject to taxation under CFC or similar rules) (iii); domestic law provisions that deny a deduction for a payment that is also deductible in another jurisdiction (iv); and where necessary, guidance on co-ordination or tie-breaker rules if more than one country seeks to apply such rules to a transaction or structure.⁵¹ Furthermore, the OECD Action Plan mentions that the work on Action 2 will be coordinated with the work on interest expense deduction limitations, on CFC rules and on treaty shopping.⁵²

The amendment in June 2014 to the Parent-Subsidiary Directive is a follow-up of the above-quoted point (i) in the OECD Action Plan (Action Plan 2). This illustrates the circular movements and reciprocal influences between the OECD and EC Recommendations, and its impact in EU law.

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⁴⁷ See a critical analysis of the subject-to-tax clause recommended by the European Commission in Marchgarber, Christoph, 'The Avoidance of Double non-taxation in Double Tax Treaty Law: A Critical Analysis of the Subject-To-Tax-Clause Recommended by the European Commission', 5 *EC Tax Review* (2014), p. 293. Lang, M., 'Aggressive Steuerplanung'..., cit., n. 40, pp 64–65.

⁴⁸ Action 6 recommends adding a para. 3 to Art. 1 of the Model Tax Convention: '3. This Convention shall not affect the taxation, by a Contracting State, of its residents except with respect to the benefits granted under paragraph 3 of Article 7, paragraph 2 of Article 8 and Articles 19, 20, 23, 24 and 25 and 28': OECD/G20 Base Erosion and Profit Shifting Project..., *supra*, n. 8.

⁴⁹ Action Plan ..., *supra* n. 11.

⁵⁰ *Ibid.*, pp. 13, 15; OECD (2014), *Neutralising the Effects of Hybrid*, n. 11, pp. 23–25.

⁵¹ Action Plan ..., *supra*, n.11, at 15–16.

⁵² *Ibid.*

3.3 Recommended GAARs for the EU Member States and EU Law

The EC Recommendation also proposes that multiple but common GAARs be adopted domestically by the EU Member States in order to tackle ‘aggressive tax planning’.

As already quoted above, according to the Recommendation, aggressive tax planning consists ‘in taking advantage of the technicalities of a tax system or of mismatches between two or more tax systems for the purpose of reducing tax liability’.

The multiple common GAARs are proposed as a measure to combat abuse of domestic and cross-border situations:

4. General Anti-Abuse Rule

4.1. To counteract aggressive tax planning practices which fall outside the scope of their specific anti-avoidance rules, Member States should adopt a general anti-abuse rule, adapted to domestic and cross-border situations confined to the Union and situations involving third countries.

The EC Recommendation adopts a holistic approach to combat aggressive tax planning, and the fact that it will also apply to combat abuse of domestic law is not incompatible with the allocation of competences between the EU and the Member States. This is mainly due to the fact that the proposed GAARs are in a Recommendation (soft law) and the binding instruments will be domestic law.

Although GAARs are to be adopted domestically and are not approved by an EU Directive, the Commission suggests that they are a key element against aggressive tax planning:

(8) As tax planning structures are ever more elaborate and national legislators are frequently left with insufficient time for reaction, specific anti-abuse measures often turn out to be inadequate for successfully catching up with novel aggressive tax planning structures. Such structures can be harmful to national tax revenues and to the functioning of the internal market. Therefore, it is appropriate to recommend the adoption by Member States of a common general anti-abuse rule, which should also avoid the complexity of many different ones. In this context, it is necessary to take account of the limits imposed by Union law with regard to anti-abuse rules.

Moreover, the recommended multiple common GAARs are complementary to the EU anti-abuse rules that are part of EU directives harmonizing partial aspects of direct taxes and do not overlap with them. In fact, the Recommendation excludes application of the proposed GAAR to the Merger Directive, the Parent-Subsidiary Directive and the Interest and Royalties Directive:

(9) So as to preserve the autonomous operation of existing Union acts in the area concerned, this Recommendation does not apply within the scope of Council Directive 2009/133/EC, of Council Directive 2011/96/EU and of Council Directive 2003/49/EC. A revision of those Directives with a view to implement the principles underlying this Recommendation is currently considered by the Commission.

In 4.2 the Recommendation designs a draft GAAR, encouraging Member States to introduce it in their national legislation, in order to give effect to point 4.1:

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.

Points 4.3 and 4.4 clarify point 4.2: Point 4.3 defines arrangement by using examples of legal or informal agreements that will result in an arrangement;⁵³ in turn, 4.4 defines artificial as the lack of ‘commercial substance’, adopting a substance over form test, broadly corresponding to the ‘pursuit of genuine economic activity’ (paragraph 54 of *Cadbury Schweppes*) and ‘economic reality’ (paragraph 55 of *Cadbury Schweppes*).

4.4. also adds criteria that will help determining artificiality: ‘4.4. For the purposes of point 4.2 an arrangement or a series of arrangements is artificial where it lacks commercial substance. In determining whether the arrangement or series of arrangements is artificial, national authorities are invited to consider whether they involve one or more of the following situations:

- (a) the legal characterization of the individual steps which an arrangement consists of is inconsistent with the legal substance of the arrangement as a whole;⁵⁴
- (b) the arrangement or series of arrangements is carried out in a manner which would not ordinarily be

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⁵³ ‘4.3. For the purposes of point 4.2 an arrangement means any transaction, scheme, action, operation, agreement, grant, understanding, promise, undertaking or event. An arrangement may comprise more than one step or part’.

⁵⁴ Cf. Case C-349/96 *CPP* [1999] ECR I-973 para. 17; Case C-240/99 *Skandia* [2001] ECR I-1951, paras 37 and 41; Case C-8/01 *Taksatorringen* [2003] ECR I-0000, paras 39–41; Opinion of the AG Poiares Maduro delivered on 12 Jan. 2005, Case C-472/03, *Staatssecretaris van Financiën v. Arthur Andersen & Co. Accountants c.s.* (point 16); ECJ, *Staatssecretaris van Financiën v. Arthur Andersen & Co. Accountants c.s.*, Case C-472/03, 3 Mar. 2005 paras 34–36.

employed in what is expected to be a reasonable business conduct;⁵⁵

- (c) the arrangement or series of arrangements includes elements which have the effect of offsetting or cancelling each other;⁵⁶
- (d) transactions concluded are circular in nature;⁵⁷
- (e) the arrangement or series of arrangements results in a significant tax benefit but this is not reflected in the business risks undertaken by the taxpayer or its cash flows;⁵⁸
- (f) the expected pre-tax profit is insignificant in comparison to the amount of the expected tax benefit.'

The design of the GAAR in the Recommendation aims to follow the ECJ case-law on abuse, by making reference to the several tests that are included in the analysis:

- (1) The spirit and purpose of the legal provision (the aforementioned first criterion in *Halifax* or test 1) are to be taken into account (4.5.).
- (2) 4.2. refers to the purpose of avoiding taxation (the second criterion in *Halifax* and subsequent case-law following it, or test 2) and to the artificiality test (*Cadbury Schweppes* and *Ocean*).
- (3) It is also recommended that assessment of abuse does not require analysis of the subjective intentions of the taxpayer (4.5.) and that the purpose to avoid taxes is an essential purpose and not an exclusive purpose (4.2. and 4.5.). Potential doubts regarding the two latter elements (irrelevance of subjective intentions and the fact that abuse does not depend on a sole purpose to avoid taxes) are thus to be eliminated by a legally binding GAAR (i.e., multiple GAARs adopted in the Member States).

The criteria selected in the Recommendation to illustrate artificiality are complementary to the interpretation of artificiality. Some of these complementary criteria correspond to cases previously examined by the ECJ, both in direct and indirect tax cases.

In respect of criterion a) ('the legal characterisation of the individual steps which an arrangement consists of is inconsistent with the legal substance of the arrangement

as a whole'), the Court has previously referred to the 'essentials of a transaction' in the interpretation of a concept, although not using the concept of avoidance or the artificiality test.⁵⁹

And in general, probably with the exception of the aforementioned *Ocean* case, 'artificiality' and a 'reasonable business conduct' (see criterion (b)) have been interpreted by the ECJ in a more tolerant manner than what is suggested in BEPS Action Plan and action 6.

Example of this tolerant interpretation of 'artificiality' and 'reasonable business conduct' ('normal commercial operations') are the aforementioned *Weald Leasing Ltd* and *RBS Deutschland Holdings GmbH* cases. For example, in *RBS Deutschland Holdings GmbH* the UK tax authorities contended that the leasing terms were drawn up in order to enable the taxpayer to exploit the differences in the ways in which the directive had been transposed in the United Kingdom and in Germany and that the legal arrangement which it had put in place had the essential aim of obtaining a fiscal advantage contrary to the purpose of the directive (paragraph 23 of the decision).

The ECJ, in paragraphs 49–52, based the assessment of abuse on the purpose of the relevant provisions (test 1), the essential or sole aim to obtain a tax advantage (test 2), and artificiality and normal commercial operations (complementary test). The latter seem to occur if they are legally available to private parties and if there are no legal connections between the parties involved:

49 At paragraphs 74 and 75 of *Halifax and Others*, the Court held, *inter alia*, that, in the sphere of VAT, an 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 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 the relevant provisions of the directive and, second, it is apparent from a number of objective factors that the essential aim of the transactions concerned is solely to obtain that tax advantage.

50 As regards the facts at issue in the main proceedings in the present case, it should be noted that the various transactions concerned took place between two parties which were legally unconnected. It is also common

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⁵⁵ Regarding VAT cases, the ECJ has been very tolerant when interpreting the transactions or series of transactions carried out by the companies and when interpreting what is expected to be a reasonable business conduct, even if the latter expression has not been used: See ECJ 22 May 2008, *Amplificativa Srl, Amplifin SpA v. Ministero dell'Economia e delle Finanze, Agenzia delle Entrate*, C-162/07, ECR I-4019, n. 28; ECJ 22 Dec. 2010, C-277/09, *The Commissioners for Her Majesty's Revenue & Customs v. RBS Deutschland Holdings GmbH*, paras 47–54.

⁵⁶ This is the case of hybrids: See OECD (2014), *Neutralising the Effects ...*, *supra* n. 11, Chs 2–4.

⁵⁷ See Case C-110/99 *Emsland Stärke GmbH v. Hauptzollamt Hamburg-Jonas* (2000) ECR I-11569.

⁵⁸ See Daniel N. Shaviro & David A. Weisbach, *The Fifth Circuit Gets it Wrong in Compaq v. Commissioner, Chicago*, *John M. Olin Law & Economics Working Paper* n. 142 (2D Series), The Chicago Working Paper Series Index: <http://www.law.uchicago.edu/Lawecon/index.html>. This could cover the carry forward of losses in the case of mergers, reverse mergers and leverage-buy-out arrangements.

⁵⁹ See the case-law cited in n. 52.

ground that those transactions were not artificial in nature and that they were carried out in the context of normal commercial operations.

51 As the national court has observed, the characteristics of the transactions at issue in the main proceedings and the nature of the relations between the companies that carried out those transactions contain nothing to suggest an artificial arrangement that does not reflect economic reality and the sole aim of which is to obtain a tax advantage (see, to that effect, Case C-162/07 *Ampliscientifica and Amplifin* [2008] ECR I-4019, paragraph 28), since RBSD is a company established in Germany carrying on business providing banking and leasing services.

52 In those circumstances, the fact that services were supplied to a company established in one Member State by a company established in another Member State, and that the terms of the transactions carried out were chosen on the basis of factors specific to the economic operators concerned, cannot be regarded as constituting an abuse of rights. RBSD in fact provided the services at issue in the course of a genuine economic activity.

The other criteria in 4.4. of the Recommendation do not correspond to facts assessed in existing ECJ case-law and are related to current worries concerning derivatives (letter c)) and transactions leading to the elimination of risks (e)), although facts as those assessed in *Foggia* could be covered under e) or f) and thin capitalization cases (*Thin Cap GLO*) and the *SGI* case⁶⁰ could be covered under e).

As the case-law using the criterion of ‘normal commercial operations’ to assess abuse already illustrates, artificiality in the proposed GAAR is to be interpreted in the light of the criteria enumerated in 4.4. from a) to f). The aforementioned criteria will contribute to reaching the conclusion on whether an artificial scheme was adopted.

3.4 Multiple GAARs and Legal Uncertainty

Even if the recommended GAAR tries to follow the ECJ case-law on abuse, one of the main problems caused by multiple common domestic GAARs, instead of one GAAR adopted by an EU Directive, will be an increase of legal uncertainty. As a matter of principle, it is questionable that the ECJ will be competent to assess any issues related to the interpretation of domestic GAARs applicable to domestic situations.

If, as recommended, the same GAARs are applicable to both cross-border and domestic situations, the Court will declare itself competent to assess the validity of the national GAARs in the light of EU law: the ECJ has consistently maintained since the *Leur-Bloem* case⁶¹ that it considered itself competent to rule on merely domestic issues where the case involves the interpretation of a concept in an EU law instrument that might be relevant for cross-border situations and where a uniform interpretation was required across the European Union. The Court has been building up the principle of abuse so that the 6th VAT Directive is correctly interpreted. Moreover, the Court has been assessing the compatibility of domestic specific rules with EU primary law. Thus, any litigation arising from the interpretation by national courts of the domestic GAARs will be assessed in the light of the EU principle of abuse or in the light of EU specific anti-abuse provisions.

Moreover, if Member States adopt a GAAR that is identical or very close to the one that is recommended, it can be argued that the ECJ is competent to interpret it in the light of the definition in the Recommendation, even in domestic situations.⁶²

3.5 BEPS Action 6 and Anti-Anti-Abuse Rules and their Compatibility with EU Law

Action 6 makes no reference to aggressive tax planning but focuses on ‘treaty abuse’, recommending new anti-abuse rules and the strengthening of existing ones.

Following the BEPS Action Plan, OECD Action 6 develops ‘model treaty provisions and recommendations regarding the design of domestic rules to prevent the granting of treaty benefits in inappropriate circumstances’.⁶³ It distinguishes between cases where limitations in a tax treaty are circumvented and cases where domestic tax provisions are circumvented using treaty benefits.

Abuse of a tax treaty is comparable to the aforementioned abuse of an EU tax directive: in both cases the legal provision(s) abused are part of a supra-national legal instrument which implies that the anti-abuse provision or principle has to be included in the supra-national instrument: either the tax treaty or the EU directive, as the case may be. In contrast, abuse of domestic tax law using treaty benefits requires anti-abuse provisions in domestic law. In the latter case, it is

Notes

⁶⁰ Case C-524/04, *Thin Cap GLO*, *supra* n. 23 and C-311/08, *SGI*, *supra*, n. 23.

⁶¹ ECJ 17 Jul. 1997, C-28/95, *Leur-Bloem* [1997] ECR I-4161, paras 16–34.

⁶² ECJ 13 Dec. 1989, 322/88, *Salvatore Grimaldi*, residing in Brussels, and *Fonds des maladies professionnelles*, paras 12–19.

⁶³ OECD/G20 Base Erosion and Profit Shifting Project... *supra* n. 8, p. 10 et seq.

necessary to assess the compatibility of the domestic anti-abuse provisions with the benefits granted by tax treaties (in case these prevail over domestic law)⁶⁴ or granted by EU law (because of the principle of primacy).

In order to tackle the complex phenomenon of treaty abuse, different but complementary anti-abuse measures have to be both included in tax treaties and in domestic law: 'First, it is recommended that tax treaties include in their title and preamble a clear statement that the Contracting States intend to avoid creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance including through treaty shopping arrangements Second, it is recommended to include in tax treaties a specific limitation-on-benefits ... rule (the 'LOB' rule) Third, in order to address other forms of treaty abuse, including treaty shopping that would not be covered by the LOB rule ... , it is recommended to add to tax treaties a more general anti-abuse rule based on the principal purposes of transactions or arrangements (... .the 'PPT' rule). Furthermore, Action 6 includes additional recommendations for new specific treaty anti-abuse rules ('targeted rules'), which are supplemented by the PPT rule.⁶⁵

Since tax treaties concluded by EU Member States have to comply with EU law (Article 307 TFEU)⁶⁶ it has to be seen if and to what extent the proposals in Action 6 can be adopted by the EU Member States.

The first recommendation raises no issues of compatibility with EU law, since, as analysed above, tax advantages in domestic or EU Law cannot be obtained by using abusive transactions. Regarding LOBs, the ECJ has declared them compatible with EU law in the *ACT GLO* case.⁶⁷ However, the arguments used by the ECJ are far from satisfactory. The nature of LOB clauses was not analysed: are they entitlement rules, allocation of taxing rights rules or anti-abuse rules containing un rebuttable presumptions?⁶⁸ Instead, the ECJ decision was based on the argument that tax treaties are negotiated bilaterally on a give-and-take basis,⁶⁹ which is basically true for all treaties. Moreover, the decision was in contradiction to

previous case-law involving the analysis of the compatibility between bilateral treaties concluded by at least one Member State and another State.⁷⁰ In spite of the above-mentioned unsatisfactory answers, it can be taken as settled case-law that LOB rules are not incompatible with EU law.

In the subsequent paragraphs, attention is focused in the general anti-abuse rule recommended in Action 6: 'in order to address other forms of treaty abuse... it is recommended to add to tax treaties a more general anti-abuse rule based on the principal purposes of transactions or arrangements (the principal purposes test or PPT rule).⁷¹

The proposed rule reads as follows:

Notwithstanding the other provisions of this Convention, a benefit under this Convention shall not be granted in respect of an item of income or capital if it is reasonable to conclude, having regard to all relevant facts and circumstances, that obtaining that benefit was one of the principal purposes of any arrangement or transaction that resulted directly or indirectly in that benefit, unless it is established that granting that benefit in these circumstances would be in accordance with the object and purpose of the relevant provisions of this Convention.⁷²

The proposed PPT rule includes the two *Halifax* elements of the abuse principle in EU Law:

- (1) Whether the tax benefit granted is in accordance with the object and purpose of the relevant provisions in the tax treaty;
- (2) Whether obtaining the tax benefit was one of the principal purposes of any arrangement or transaction.

Commentary 10 on the PPT rule also is in line with point 4.5. of the EC Recommendation on Aggressive Tax Planning, clarifying that the purpose is to be determined by an objective analysis:

To determine whether or not one of the principal purposes of any person concerned with an arrangement

Notes

⁶⁴ *Ibid.*, p. 10: see the reference to a potential conflict between domestic anti-abuse rules and the provisions of tax treaties.

⁶⁵ *Ibid.*, p. 13.

⁶⁶ Vogel, Gutmann, Dourado, – 'Tax Treaties between Member States and Third States: "Reciprocity" in Bilateral Tax Treaties and Non-discrimination in EC Law', *EC Tax Review* 2006, n.° 2, pp. 83–94; Dourado, Ana Paula, 'National Report Portugal', *The EU and Third Countries*, Lang/Pistone (eds), Linde, Vienna (2007), pp. 523–526.

⁶⁷ C-374/04 *Test Claimants in Class IV of the ACT Group Litigation v. Commissioners of the Inland Revenue* (2006) ECR I-0000; C-376/03, *D. v. Inspecteur van de Belastingdienst/Particulieren/Ondernemingen buitenland te Heerlen* (2005) ECR I-5821.

⁶⁸ Vogel, Gutmann, Dourado, *supra*, n. 64, pp. 92 et seq.

⁶⁹ ECJ C-376/03, *D. v Inspecteur van de Belastingdienst/Particulieren/Ondernemingen buitenland te Heerlen*, 5 Jul. 2005, ECR 2005 I-05821, para. 61: 'The fact that those reciprocal rights and obligations apply only to persons resident in one of the two Contracting Member States is an inherent consequence of bilateral double taxation conventions'; and, confirming this case law: ECJ C- 374/04, *Test Claimants in Class IV of the ACT Group Litigation contra Commissioners of Inland Revenue*, 12 Dec. 2006 I-11673, para. 88.

⁷⁰ See C-55/00, *Gottardo* (2002) ECR I-413; C-1/93, *Halliburton* (1994) ECR I-1337. C-466/98 and 467/98 *Open Skies* (2002) ECR I-09427.

⁷¹ OECD/G20 Base Erosion and Profit Shifting Project, *Preventing the Granting supra*, n. 61, at 11.

⁷² *Ibid.* at 12.

or a transaction is to obtain benefits under the Convention, it is important to undertake an objective analysis of the aims and objects of all persons involved in putting that arrangement or transaction in place of being a party to it. What are the purposes of an arrangement or transaction is a question of fact which can only be answered by considering all circumstances surrounding the arrangement or event on a case by case basis.⁷³

Moreover, the expression 'one of the principal purposes' in the PPT rule at least formally corresponds to 'the main purpose or one of the main purposes' in *Cadbury Schweppes*⁷⁴ and to the 'one of the principal purposes' used in the Merger Directive.⁷⁵ But 'one of the principal purposes' is broader than the 'sole purpose' as results from some ECJ case-law (see the recent *Ocean* case, paragraph 46)⁷⁶ or even 'the essential purpose' as results from *Halifax* and is proposed in the EC Recommendation on aggressive tax planning (4.2.);

Besides the aforementioned qualification of the 'purpose', the proposed PPT rule includes several relevant differences from the EU principle of abuse and from the proposed GAAR in the EC Recommendation on aggressive tax planning:

- (1) In the PPT rule, if obtaining the tax benefit was one of the principal purposes of the arrangement or transaction, there is a presumption that the tax benefit is not in accordance with the object and purpose of the tax treaty provision. This is clear in the wording of the proposed PPT rule and is confirmed in commentary 2 to the PPT rule.⁷⁷ Such a presumption neither exists in the EU principle of abuse nor in the GAAR proposed in the EC Recommendation on aggressive tax planning and in the light of settled ECJ case-law, it would most probably be contrary to the fundamental freedoms (it would be disproportionate).
- (2) There is no reference to 'artificiality', or 'normal commercial operations» in the PPT rule. One example refers to 'valid commercial reasons'⁷⁸ without defining it.
- (3) The commentary to the PPT rule makes reference to 'bona fide exchanges of goods and services, and movements of capital and persons as opposed to

arrangements whose principal objective is to secure a more favourable tax treatment'. It is at the very least dubious that a bona fide analysis is adequate to determine tax avoidance or abuse. Moreover, due to its vagueness, a GAAR needs to be progressively determined so that legal uncertainty is progressively reduced. In contrast, the use of broad principles such as the bona fide principle will not contribute to reduce the aforementioned vagueness and legal uncertainty.

- (4) In the examples of abuse put forward in the commentary to the PPT rule, either a third State comes into play, so that a tax benefit is obtained,⁷⁹ or the taxpayer moves his or her residence shortly before entering into a transaction.⁸⁰ If a Member State applied a PPT rule to the latter situation, there would be a restriction to a fundamental freedom.

3.6 Final Remarks: Will the EU Principle of Abuse Move Towards the OECD PPT Rule?

In this article, special attention was paid to the meaning aggressive tax planning and the meaning of tax avoidance in the EU and in the OECD in the BEPS era.

Although aggressive tax planning covers the classic phenomenon and legal concept of tax avoidance, it is a call for innovative legislative action. Aggressive tax planning in the EU and OECD Member States requires joint coordinated action directed at eliminating mismatches and legal gaps and improving existing anti-abuse rules, as well as introducing new anti-abuse rules. The general anti-avoidance rules that are being proposed by the EC Recommendation on Aggressive Tax Planning and OECD Action 6 illustrate a holistic approach towards abuse.

Taking into account the aforementioned differences between the PPT rule and the EU principle of abuse, if the PPT rule designed were to be included in tax treaties by EU Member States, some issues of incompatibility with EU law could be raised.

It is, however, foreseen in Action 6, that EU Member States may have to adapt the recommendations in Action 6, so that they are compatible with EU law: '... some countries may have ... EU Law restrictions that prevent them from adopting the exact wording of the model

Notes

⁷³ OECD/G20 Base Erosion and Profit Shifting Project, *Preventing the Granting ... supra*, n. 61, at 69.

⁷⁴ *Cadbury Schweppes*, *supra* n. 10, at para. 62.

⁷⁵ ECJ C-28/95, *Leur-Bloem ... supra*, n. 25, at para. 47; ECJ C-126/10, *Foggia*, *supra* n. 25, at paras 34–35.

⁷⁶ See also Case C-162/07 *Amplisientifica and Amplifin* [2008] ECR I-4019, para. 28; Case C-504/10 *Tanoarcb* [2011] ECR I-10853, para. 51; and Case C-326/11 *J.J. Komen en Zonen Bebeer Heerbugovaard* [2012] ECR, para. 35.

⁷⁷ See OECD/G20 Base Erosion and Profit Shifting Project, *Preventing the Granting ... supra* n. 62, at 66–67.

⁷⁸ *Ibid.* at 68–69, commentary 8.

⁷⁹ *Ibid.* at 67, comm. 5, pp. 68–69, commentary 8; pp. 71–72, commentary 14.

⁸⁰ *Ibid.* at 70, commentary 12.

provisions that are recommended in this report'.⁸¹ Moreover, a minimum action is recommended: 'at a minimum ... countries should agree to include in their tax treaties an express statement that their common intention is to eliminate double taxation without creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance, including through treaty shopping arrangements'. But this minimum action is meaningless and if EU Member States only adopted the minimum in their tax treaties, action 6 would be deprived of any meaning.

The PPT rule in tax treaties is complementary to the GAAR in domestic laws proposed in the EC Recommendation on ATP, since they have different scopes. Whereas the PPT rule aims to combat abuse of tax treaties the GAAR in domestic laws aims to combat abuse of domestic law using a tax treaty or an EU fundamental freedom.

It can be argued that the principle of abuse in EU law will develop along the lines of the OECD/G20 actions and other documents addressing BEPS: EU Member States may want to take a risk and adopt the recommended PPT rule in their tax treaties. In the absence of harmonization, the ECJ has accepted the OECD recommendations as valid standards for EU law. But it is also true, that the ECJ has been more tolerant when interpreting EU law instruments

in the light of the fundamental freedoms than when interpreting domestic law in the light of those freedoms.⁸²

On 9 December 2014, the ECOFIN has approved a GAAR amending the EU Parent-Subsidiary Directive. The approved GAAR requires Member States to refrain from granting the benefits of the Directive if one of the main purposes of an arrangement is to obtain a tax advantage that would defeat the object or purpose of the Directive and such arrangement is not 'genuine'. This recently approved GAAR combines elements of the aforementioned PPT rule in Action 6 (whether the tax benefit granted is in accordance with the object and purpose of the relevant provisions in the tax treaty; whether obtaining the tax benefit was one of the principal purposes of any arrangement or transaction) and the artificiality test as required by the ECJ and proposed in the EC Recommendation on ATP.

Thus, the GAAR amending the Parent-Subsidiary Directive can now be used as a standard to PPT rules introduced by EU Member States in their tax treaties, and this standard requires the analysis of the genuine character of the arrangement. All in all, the inclusion of domestic GAARs in EU Member States as is proposed in the Recommendation on ATP and of PPT rules in their tax treaties following the same criteria of abuse will probably be the best way to reduce legal uncertainty in the EU.

Notes

⁸¹ *Ibid.* at 9; see also p. 11.

⁸² Szudoczky, Rita, *The Sources of EU Law and their Relationships: Lessons for the Field of Taxation – Primary Law, Secondary Law, Fundamental Freedoms and State Aid Rules*, Acadmemisch Proefschrift, Universiteit van Amsterdam, 26 Nov. 2013, Part II, Chs 7 and 8; Kofler, Georg, 'The Relationship between the Fundamental Freedoms and Directives in the Area of Direct Taxation', *Diritto e Pratica Tributaria Italiana* 2/2009, pp. 471–514; Dourado, Ana Paula, 'The Relationship between Primary and Secondary EU Law in Tax Law: The Legitimacy of Different Interpretation Criteria Applied to EU and National Legal Sources', *Traditional and Alternative Routes to European Tax Integration*, Weber (ed.), IBDE, Amsterdam (2010), pp. 171–189.

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