Tax Avoidance Revisited in the EU BEPS Context

Tax Avoidance Revisited in the EU BEPS Context

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Ana Paula Dourado

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Visitors' address:
Rietlandpark 301
1019 DW Amsterdam
The Netherlands

Postal address:
P.O. Box 20237
1000 HE Amsterdam
The Netherlands

Telephone: 31-20-554 0100
Fax: 31-20-622 8658
www.ibfd.org

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Preface

This volume is the outcome of the 2016 Congress of the EATLP held in Munich from 2 to 4 June. The main subject of the Congress was tax avoidance: "Tax Avoidance Revisited - The Meaning of Avoidance and Aggressive Tax Planning in the BEPS Context", which was discussed on 3 June.

For the purposes of the Congress, the aforementioned subject was divided into four panels: (i) Section 1, "The Meaning of Avoidance and Aggressive Tax Planning in the BEPS Context" (Ana Paula Dourado; Luc De Broe; Adolfo Martín Jiménez; and Yariv Brauner); (ii) Section 2, "Reactions to Avoidance and Aggressive Tax Planning" (Ana Paula Dourado; Judith Freedman; Joachim Englisch; and Lilian Faulhaber); (iii) Section 3, "Avoidance and Aggressive Tax Planning in the EU: Its Meaning and Adequate Reaction to BEPS" (Ana Paula Dourado; Pasquale Pistone; Edoardo Traversa; and Richard Lyal); and (iv) Section 4, "Multilateralism, Coordinated Bi-/Unilateralism or Chaos" (Ana Paula Dourado; María Teresa Soler Roch; Daniel Gutmann; and Reuven Avi-Yonah).

The preparation of the Congress involved a questionnaire sent to the national reporters, national reports and thematic reports on the four sessions.

This volume of the EATLP International Tax Series is organized as follows: my general report (Part I), thematic reports (Part II), the aforementioned questionnaire and 23 national reports, involving European and non-European jurisdictions (Part III).

My general report focuses on the answers given by the national reporters to the questionnaire, and tries to illustrate how the reported jurisdictions have been handling tax avoidance in recent years and whether the BEPS Project has brought any novelties to the reported national tax systems.

The four thematic reports cover some of the main topics discussed during the Congress in each of the four sessions: (i) "Tax Avoidance and Aggressive Tax Planning as an International Standard – BEPS and the 'New' Standards of (Legal And Illegal) Tax Avoidance" (Adolfo Martín Jiménez); (ii) "Transfer Pricing and Tax Avoidance" (Yariv Brauner); (iii) "The Meaning of Tax Avoidance and Aggressive Tax Planning in European Union Tax Law: Some thoughts in connection with the reaction to such practices by the European Union" (Pasquale Pistone); and (iv) "Consistency and Hierarchy among the BEPS Actions" (María Teresa Soler Roch).

I wish to express my deepest gratitude to all national reporters, thematic reporters and panellists in the Congress who contributed with many ideas to this book; to Peter Essers, who, as the EATLP Academic Chairman, strongly upheld the topic and the involving academic preparation by the reporters and panellists; to Kristy Jonas (the EATLP Academic Assistant) for her assistance in collecting the texts for this book and in the academic preparation of the Munich Congress; and to Raphael Monteiro de Oliveira, Dinis Tracana and especially Aakriti Srivastav for their assistance in editing the book.

Last, but not least, grateful acknowledgment goes to Wolfgang Schoen and the Max-Planck Institute fuer Steuerrecht und Oeffentliche Finanz in Munich; and to Klaus-Dieter Drüen and the Ludwig-Maximilians-Universität in Munich, for hosting the 2016 EATLP Congress; and to IBFD and the aforementioned Max-Planck Institute for their contribution to the editing costs of this book.

Ana Paula Dourado
Lisbon, March 2017

About the Authors

Sebastian Bergmann is an Associate Professor at Johannes Kepler University, Visiting Professor at Alpen-Adria-University Klagenfurt and Manager at EY, as well as a specialist in direct taxation.

Emmanuel Raingeard de la Blétière is Associate Professor of Tax Law at University Rennes 1, partner at PWC and member Of Counsel of its law firm.

Yariv Brauner is a Professor of Law at the University of Florida and at the New York University School of Law.

Jakob Bundgaard is the managing director of CORIT Advisory LLP, advising leading companies broadly on tax law and strategic matters. He possesses a special expertise within the fields of company and group taxation, and international tax law, including EU law, financial instruments, corporate finance, private equity and energy. Concurrently with his counselling activities, he has been active in the academic world for several years, where he has been the initiator of CORIT Academic, amongst others. Mr Bundgaard is an honorary professor of international tax law at the University of Aarhus and the author of a significant number of publications on tax law issues. He is often invited as a keynote speaker for other advisors, tax authorities, universities and at conferences.

Gustavo Lopes Courinha is a Professor of Tax Law, and International and European Tax Law at the University of Lisbon and IDEFF, and Visiting Professor at the Catholic University Lisbon. He has been a member of the Commission for Fiscal Reform (2008-2009) and the Commission for the Reform of the Corporate Income Tax Code (2013).

Ana Paula Dourado is a Professor of Tax Law and International and European Tax Law at the University of Lisbon. She has been a Visiting Professor at several European universities, the University of Florida, Lusophone Universities in Africa and MoF Taiwan. She is a founding member of the Group for Research on European and International Taxation (GREIT). She has drafted and negotiated the tax reforms in Portuguese-speaking countries as an expert in the legal department of the International Monetary Fund (since 2003). Prof. Dourado was a Member of the Centre for Tax Studies at the Portuguese Ministry of Finance and a delegate for Portugal in the working groups for direct tax harmonization at the European Community and in the working group for tax avoidance and evasion at the

OECD. She is a correspondent for H&I and several other tax law journals, and a member of the editorial board of Intertax, Rev. de Finanças Públicas e Direito Financeiro and the Executive Board of the EATLP.

Sandra Eden is a senior lecturer and Director of Undergraduate Studies at the University of Edinburgh. Her main area of research interest is tax law and policy. She is also an expert in pension law, especially the taxation of pensions, and has published widely in these fields. She has also published articles on questions of legal process and access to justice.

Benn Folkvord is a Professor of Tax Law at the University of Stavanger Business School. He is the editor of the two largest tax research journals in Norway (*Tidsskrift for Skatterett* and *Gyldendal Rettsdata Skatterett*), and has authored or co-authored a number of books and articles in the field of tax law.

Elizabeth Gil García is a postdoctoral researcher at the Tax Law Department of the University of Alicante, from which she received her Bachelor's degree in Law and LLM (with honours) in 2012 and 2013, respectively, and was awarded the Bachelor's degree Extraordinary Prize. She finished her PhD on R&D tax incentives at the University of Alicante in 2016, with the additional title of International Doctor, written under the supervision of Prof. Dr Amparo Navarro. She has carried out several research stays in prestigious centres and institutes such as the Max Planck Institute for Tax Law and Public Finance, the Institute for Austrian and International Tax Law and the International Bureau of Fiscal Documentation. In addition to 16 publications in the area of EU and international tax law, she has presented at national and international conferences.

Werner Haslehner is a Professor of Law at the Faculty of Law, Economics and Finance, holder of the ATOZ Chair for International and European Taxation and Director of the LLM Programme in European and International Tax Law at the University of Luxembourg. He obtained Master's degrees in Law as well as in Business and Economics in Austria and the United Kingdom, earned his doctorate in 2009 after three years as a researcher at the Johannes Kepler University Linz, and was subsequently appointed Assistant Professor at the Institute for Fiscal Law, Tax Law and Tax Policy at the same university. In 2010, he joined the Law Department of the London School of Economics as a postdoctoral fellow, before coming to Luxembourg as Associate Professor in 2013, where he was appointed Full Professor in 2015. His research focuses on all aspects of international taxation, including the impact of EU law, and tax policy.

Anders Hultqvist is Professor of Tax Law at the Karlstad University, Assistant Professor of Tax Law at the Stockholm School of Economics and Assistant Professor of Finance at the Stockholm University.

Raimo Immonen is Professor Emeritus (Commercial and Tax Law) at the University of Turku. In addition to his academic career, Prof. Immonen has worked as an attorney at law. His research focus is on topics concerning company law and business taxation, especially the reorganization of business structures, as well as M&A transactions. He has published, among other things, several books for universities and professionals.

Ricardo André Galendi Júnior is a lawyer in São Paulo and has an LLB from the University of São Paulo.

Nataša Žunić Kovačević is a Full Professor and Head of the Department for Financial Law at the Faculty of Law, University of Rijeka. She is a Vice Dean for Graduate University Study Affairs and co-convener at the Specialist Study Programme "Law on Corporate Finance" at the same faculty. She is a member of the Croatian Academy of Legal Sciences, European Association of Tax Law Professors (EATLP), International Academy of Comparative Law (IACL), Croatian Association for Comparative law (HUPP), the editorial committee of the Croatian Law Review, and appointed by the Croatian parliament as a member of the Commission on Fiscal Policy. Her interests include European and international tax law and tax procedural law. She has authored a number of book chapters and papers on tax law, financial law and local finances, and has participated in many scientific conferences organized at national and international level.

Juha Lindgren is a Professor of Tax Law, University of Vaasa, and is the head of the research group (BLINK), which concentrates on different aspects of legal information and knowledge in order to help the decision making on various economic issues. His research focus is on the direct taxation of corporations, shareholders and entrepreneurs, administrative sanctions in corporate taxation, tax issues on transferring a company to a descendant and company law in tax law interpretation. He has published several articles on Finnish and international taxation and is the co-author with Prof. Immonen on "Onnistunut sukupolvenvaihdos" (5th edition 2017). He is the chair of the Central Tax Board in Finland (2015-2019) and, since spring 2016, the editor of the Finnish tax law journal *Verotus*.

Jorge Martín López is an Associate Professor at the Tax Law Department of the University of Alicante. He received his Bachelor's degree in Law

(Extraordinary Prize) and Advanced Tax Law Studies (with honours) from the University of Valencia in 2001 and 2003, respectively, and completed a PhD at the University of Bologna in 2005 (Doctor Europeus). His main line of research is tax avoidance and harmful tax competition. He has carried out several research stays in prestigious centres such as the Georgetown University or the UC Louvain. He is (co-)director of the public funding research project "La seguridad jurídica en el ordenamiento tributario español" (Spanish Ministry of Economy), which tackles the impact of the different anti-BEPS measures implemented in the Spanish legal system in the light of the principle of legal certainty. He has around 30 publications, including two books, in addition to presenting at several conferences, both national and international.

Adolfo Martín Jiménez is a Tax Law Professor and Jean Monnet Chair (European Commission) at the University of Cádiz, Spain. He specializes in international taxation and EU tax law, and has authored or co-authored several books and numerous articles on the topic in Spanish and English (published in several countries). He has been a visiting professor/scholar at Spanish and foreign universities, and often participates in conferences on international and EU tax law in Spain and abroad. He has also broad experience in advising public and private entities on international and EU tax law, is a member of the Executive Board of the EATLP, and represents the EATLP in the EU Joint Transfer Pricing Forum.

Danuše Nerudová is an Associate Professor and the Head of the Department of Accounting and Taxes, Faculty of Economics and Business, Mendel University Brno, Czech Republic, and a researcher at the Research Center of Faculty of Economics and Business, Mendel University Brno.

Agnieszka Olesińska is a Professor at the Public Finance Law Department of the Faculty of Law and Administration, Nicolaus Copernicus University in Toruń (Poland), editor-in-chief of Toruński Rocznik Podatkowy (Toruń Tax Yearbook), and a judge on the Regional Administrative Court in Warsaw. From 2014-17 she was a vice-president of the Commission for Codification of the General Tax Law in Poland appointed by the Polish government. She is a member of the International Fiscal Association.

Bart Peeters is a Professor at Ghent University specializing in corporate income tax law, as well as European and international tax law. He is also a part-time professor at the universities of Liege and Antwerp. He is a member of the editorial staff of various Belgian legal periodicals, regularly publishes in national and international legal doctrine and often speaks at national

and international congresses. He defended his PhD on tax transparency and hybrid entities at the University of Antwerp in 2010, for which he also obtained several academic prizes. Although he still conducts research on the topic of hybrid entities, his current scope has been broadened to tax avoidance more generally.

Pasquale Pistone is the Academic Chairman of IBFD, holds a Jean Monnet ad personam Chair in European Tax Law and Policy at WU Vienna University of Economics and Business (Austria) and is an Associate Professor of Tax Law at the University of Salerno (Italy). His main fields of expertise are European and international tax law, in which he is regarded as a top academic expert in various parts of the world. He is the editor-in-chief of the World Tax Journal (IBFD) and one of the founding members of GREIT.

Evgeniy Pustovalov is a lecturer at the Department of Financial and Tax Law, Ural State University of Law, and a researcher at the BRICS Law Institute. He is a PhD candidate in Tax Law and has been practising Russian Tax and Commercial Law for more than 10 years. He co-authored the research papers for the Russian government on the application of double tax conventions, conducts LLB courses on financial law and tax law at the University, and is the author of 10 publications.

Ekkehart Reimer is a Professor at Heidelberg University and a researcher at the University of Munich. His research and teaching specialities comprise public and administrative law; German, European and international tax law, in particular double taxation agreements; and comparative tax law.

Jennifer Roeleveld is an Associate Member at EATLP and a Professor at the University of Cape Town.

Andrey Savitskiy is an Assistant Professor at the Department of Financial and Tax Law, Ural State University of Law, and the lead researcher at the BRICS Law Institute, and has a PhD in Tax Law. He has been practicing Russian and international tax law for more than 14 years and is a member of the Russian branch of the IFA, and national expert for IBFD, EATLP and other international organizations. He co-authored the research papers for the Russian government and the Federal Tax Service on the application of double tax conventions and transfer pricing rules and case law, conducts LLM courses on international tax law and foreign tax systems and LLB courses on Financial Law and Tax Law at the University, in addition to being the author of 30 publications and co-author of 3 monographs.

Peter Koerver Schmidt is an Associate Professor in Tax Law at Copenhagen Business School (Law Department) and Technical Advisor at CORIT Advisory P/S. His research and teaching is mainly focused on Danish and International Corporate Tax Law, and has been published in Danish, Nordic and international journals/anthologies. In addition, he has (co-)authored a number of books, including a PhD dissertation on Danish CFC legislation in an international and comparative perspective.

Luis Schoueri is a Full Professor of Tax Law at the University of São Paulo Law School (USP), the Vice-President of the Brazilian Institute of Tax Law (IBDT) and a founding partner at Lacaz Martins, Pereira Neto, Gurevich & Schoueri Advogados. He obtained a master's degree in law from the University of Munich, and a doctoral and free professor's degree at USP. Since 2007, he has been a Professor at several universities in Europe and the United States in the area of tax law, including the position of Professor in Residence at IBFD (2017-2018) and Hauser Global Professor of Law at New York University (2016 – Spring Semester). In addition to several articles published in Brazil and abroad, he has authored various books on tax law, such as Direito Tributário ("Tax Law", 7th edition, 2017) and Preços de Transferência no Direito Tributário Brasileiro ("Transfer Pricing in Brazilian Tax Law", 3rd edition, 2013).

Mustafa Sevgin is Chief Tax Inspector and member of the Turkish Tax Inspection Board of the Ministry of Finance.

María Teresa Soler Roch is a Doctor in Law (University of Valencia, 1977) and has been full-time Tax Law Professor in the Spanish Universities of Valencia, Murcia and, since 1985, Alicante. She has also been visiting scholar at the Universities of Florida and Paris II (Panthéon Assas) and is a founding member of the European Association of Tax Law Professors. She is also a member of the Spanish IFA Branch and the Board of Trustees of the IBFD. She held a position as a member (2005-2008) and chair (2008-2012) of the Consejo para la Defensa del Contribuyente (Taxpayer's Advocate) appointed by the Spanish Minister of Finance.

Veronika Solilova is Project Analyst and Research Assistant at the Department of Accounting and Taxes of the Faculty of Business and Economics of Mendel University in Brno.

Eleni Theocharopoulou holds a PhD from the University of Paris II, France and is a University Associate Professor in Tax Law of Democritus University in Greece and attorney at law. She has published various studies

concerning national, international and European tax law, of which the most important are: (i) La fiscalité de la propriété littéraire et artistique. Etude comparée des droits français et hellenique (PhD, University of Paris II 2002) (in French), (ii) Taxation of Income Derived from E-Commerce (Athens 2007) (in Greek), (iii) Tax Transparency and Exchange of Information in Times of Financial and Global Economic Crisis (Thessaloniki 2016) (in Greek).

Namık Kemal Uyanik is a tax advisor and former Chief Inspector of the Ministry of Finance.

Craig West is the Managing Editor of IBFD's World Tax Journal and of the IBFD Doctoral Series. He is an Associate Professor at the University of Cape Town, his areas of expertise being international and South African income tax, on which he has published a number of articles and chapters. He has regularly presented at conferences and seminars on both international and South African taxation and has been appointed as a national reporter for South Africa on several occasions. He holds a PhD from the University of Cape Town (2009) as well as a Master of Commerce in Accounting and is a Chartered Accountant (SA). He has been a visiting researcher at the Institute for Austrian and International Tax Law (WU, Vienna) (2015) and the Fiscal Institute for Taxation (UvT, Tilburg) (2013), in addition to being a member and Secretary General of the South African IFA branch.

Maarten de Wilde is an Assistant Professor at Erasmus University Rotterdam, specializing in international and European company taxation. He also works as a tax advisor at Loyens & Loeff, a Rotterdam-based law firm, where he is a member of the firm's general tax practice and tax knowledge centre. He obtained his LLMs at Utrecht University (Dutch Civil Law, Tax Law, 2005; both with honours) and was awarded a doctorate by Erasmus University Rotterdam in 2015 (with honours). He is furthermore associated with EFS, Erasmus University, an education (post-master) and research institute in the area of international and European taxation.

Ciska Wisman is a PhD candidate at Radboud University Nijmegen, specializing in company taxation with a particular focus on corporation tax aspects involving cross-border profit repatriation. She also works as a university teacher at Erasmus University Rotterdam and the University of Amsterdam. Ciska is a tax lawyer at PwC Rotterdam, where she is associated with the firm's Knowledge Centre TAX & HRS and its EU Direct Tax Group. She obtained her LLM in tax law from Utrecht University (2009)

and is furthermore associated with PAOB, an educational (post-master) institution in the field of Dutch taxation.

Joanna Witkowska is a postgraduate student at the Faculty of Law and Administration of Jagiellonian University in Kraków (Poland) and a court trainee of the National School of Judiciary and Public Prosecution in Kraków. She was a participant in the Polish-German Tax Law Seminar co-organized by the Jagiellonian University in Kraków, Ruhr-Universität in Bochum and Fachhochschule für Finanzen in Nordkirchen, and the author of articles concerning legal and illegal methods of tax burden reduction.

Funda Başaran Yavaşlar is the Head of Chair of Fiscal Law at Marmara University Law Faculty, İstanbul. She is also the director of the Tax Criminal Law Division of CEHAMER/IKU, head of VEHUP (Platform for Tax Law), Turkish representative at EATLP-AC and has been visiting professor at various universities, including Free University Berlin. She studied law at Istanbul University, received a PhD with her dissertation "Conditions of Capitalization of Immaterial Assets in Turkish and German Tax Balance Sheet Laws" in 1999, became an Associate Professor in 2004 (habilitation-thesis: "Fundamentals of Income Taxation") and a Professor in 2013 (professorship-monography: "German Taxation Procedure through Sides of Tax Liability Relationship – from Perspective of Constitutional State"). Funda has worked with Prof. Dr Tipke and received various scholarships from several foreign institutions, including Alexander von Humboldt Foundation. Her research focuses on constitutional framework of taxation, income tax law, corporate tax law, tax procedure law and tax sanction law.

Giuseppe Zizzo is a Full Professor of Tax Law at the Law School of the Carlo Cattaneo University. He is engaged mainly in the fields of corporate tax, tax aspects of M&A, and tax litigation.

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Part I

General Report

Chapter 1

Tax Avoidance Revisited in the EU BEPS Context

Ana Paula Dourado

1.1. The meaning of avoidance and aggressive tax planning and the BEPS initiative

1.1.1. The meaning of tax avoidance in national legal systems

1.1.1.1. The role of GAARs and judicial interpretation

Tax avoidance is a legal concept that emanates from the interpretation of either statutory general anti-avoidance rules (GAARs), sometimes also from targeted and specific anti-avoidance rules, from the judicial creation of GAARs or a principle of abuse, or from the reconciliatory interpretation of all of the mentioned sources.

Avoidance can be described as an arrangement leading to tax advantages, the granting of which is not intended by the legal system.[1] GAARs specify in what circumstances tax advantages are not intended by the legislator and are therefore denied to the taxpayer's arrangement(s). Such circumstances can include abuse of law, *fraus legis*, legal substance in contradiction to the legal form, absence of valid economic non-tax, etc.

Due to the rule of law, the principle of separation of powers and disputable exercise of discretionary powers by the tax authorities granted by an economic-oriented interpretation of tax law, statutory GAARs can be seen as a legal instrument empowering the tax administration to tackle avoidance where the purposive interpretation would not suffice (for example, in step-by-step transactions). In some national reports in this book, legal tax planning is emphasized as a taxpayer's right:[2] the right to choose the less-taxed path, according to the French *Cour de Cassation* and *Conseil*

1. Austrian national report, sec. 7.1.; and French national report, sec. 14.1.
2. Belgian national report, sec. 8.1.; French national report, sec. 14.2.; Turkish national report, sec. 27.11.1..; UK national report, sec. 28.1.2.; and US national report, sec. 29.1.

Constitutionnel,[3] and the *Duke of Westminster v. CIR*[4] decided in 1935, and often quoted not long ago in the United Kingdom.[5]

Differently from this perspective, GAARs can be interpreted as a legal means to transfer the legislative taxing power to the tax administration[6], even if courts are supposed to control the application of a GAAR by the tax authorities.

Tax avoidance is also defined by a negative delimitation of its borders: it is neither tax evasion (including sham transactions[7]), which constitutes an offence, either criminal or administrative;[8] nor is it tax planning (fully legal and a fundamental right).[9] It can be characterized as a grey zone.

Although the national reports published in this book have been written in English, the translation of the English concepts "tax evasion" and "tax avoidance" and the French concepts *fraude fiscale* and *évasion fiscale* in different languages has contributed to add confusion to the topic. Tax evasion corresponds to *fraude fiscale* and tax avoidance to *évasion fiscale* or *évitation fiscale* in French and this correspondence has not always been made.[10] The CJEU case law, the EU Directives and other documents have often referred to "tax evasion" when they meant "tax avoidance", misleading the implementation of the Directives in every language.

The French reporter mentions a report by his parliament referring to the OECD glossary of fraud, evasion, avoidance and planning and translating them as *fraude*, *évasion*, *évitement* and *optimisation*.[11]

The German-speaking countries reported in this book (Austria, Luxembourg, Germany) make reference to a concept (*Steuerumgehung*) that can be literally translated as "tax circumvention", but is interpreted broadly as abuse of law. This means that *Steuerumgehung*, according to the national courts,

3. FR: Cass., 7 Mar. 1984, n. 81-13728 and 81-16259; Cons. Const., 29 Dec. 2013, n. 2013-685 DC, Loi de finances pour 2014. *See also* Luxembourg national report, sec. 18.1.
4. (1935) 19 TC 490.
5. UK national report, sec. 28.1.2.
6. US national report, ch. 29.
7. Commenting on some confusion between sham and avoidance in Luxembourg: sec. 18.1.
8. Emphasizing this aspect: Belgian national report, sec. 8.1.; and French national report, sec. 14.1.
9. Swedish national report, sec. 26.2; and French national report, sec. 14.1.
10. *See* the French and Luxembourg national reports: secs. 14.1. and 18.1, respectively.
11. French national report, sec. 14.1.

does not require comparison between a tax arrangement that is adopted and another that would be the "appropriate" arrangement:[12] it means detrimental from an economic viewpoint, a U-turn arrangement, artificial, ineffective, absurd,[13] or it requires a sole purpose test.[14] In Austria, it is disputable whether the "inappropriate arrangement" requires a comparison and what kind of comparison.[15]

In most jurisdictions that are reported in the book, tax avoidance is acknowledged and identifiable by the courts and the legal doctrine. That is the case of common law jurisdictions, such as the United States, and more recently the United Kingdom and South Africa; of continental law jurisdictions, such as Austria, Belgium, France, Germany, Greece, Luxembourg, Italy, the Netherlands, Portugal, Spain, the Czech Republic, Croatia, Poland, Russia and Turkey; and of other jurisdictions belonging to different (sub)families of law, such as the Nordic countries (Denmark, Finland, Norway and Sweden).

An exception is Brazil, where the recognition of tax avoidance is controversial due to a strong perception of separation of powers and allegedly to the refusal of any theory linked to "economic interpretation".[16] Moreover, whereas the introduction of a GAAR was arguably intended by the Congress, the rule introduced in the Brazilian complementary law makes reference to "dissimulated transactions". Current Brazilian legislation is based on a difference between tax evasion (simulated schemes) and legitimate tax planning.[17] Nevertheless, courts have introduced a substance-over-form approach and are using "business purpose" and "abuse of law" doctrines when interpreting tax cases.[18]

In the Turkish national report, the expression "tax avoidance" is not acknowledged as being different from "tax planning". Avoidance is described as "a completely legal act, which is neither subject to criminal tax penalty nor to administrative tax penalty or to collateral tax sanctions" and "related to the fundamental rights and freedoms guaranteed in the constitution".[19] Examples that are given of tax advantages correspond to the use of gaps in

12. German national report, sec. 15.1.1.3.2.; and Luxembourg national report, sec. 18.2.1.2.
13. German national report, sec. 15.1.1.3.2.
14. Luxembourg national report, sec. 18.2.1.3.
15. Austrian national report, sec. 7.2.
16. Brazilian national report, secs. 9.1. and 9.2.
17. Brazilian national report, secs. 9.1. and 9.2.
18. Brazilian national report, sec. 9.2.
19. Turkish national report, sec. 27.1.1A.

the law, where there seems to be a coincidence between the tax advantages resulting both from the letter and the spirit of the law.[20]

However, what the Turkish national report describes as “bypassing the law” (circumvention of the tax law, *Steuerumgehung*), as well as the examples of circumvention given and the legal reaction to it, correspond to what the other national reports characterize as tax avoidance: lack of economic substance and the purpose of obtaining a tax benefit contrary to the legal intention.[21]

In some jurisdictions, tax avoidance has been acknowledged and dealt with for a long time, either by a statutory GAAR (Germany[22] and Finland[23]) or by specific anti-avoidance rules (SAARs) (Sweden[24]). In others, it is a recent legal category or principle (the United Kingdom,[25] Poland[26] and Greece[27]).

In some jurisdictions, statutory GAARs (such as the abuse of tax law in France[28], also referred to as abuse of rights[29] and principal purpose test in Norway[30]) or statutory interpretation criteria (substance over form, for example, in the Czech Republic[31]) coexist with judicial GAARs (such as the abnormal act of management theory in France,[32] abuse of law doctrine in the Czech Republic[33] and substance over form in Norway[34]), and the two do not overlap.[35] The same scenario occurred in Italy, where the 1997 statutory GAAR (replaced in 2015) referred to the (mere) circumvention of tax obligations or prohibitions, and the Supreme Court started to apply the abuse of law doctrine to tax cases on the basis of the CJEU jurisprudence on tax abuse.[36]

20. Turkish national report, sec. 27.1.1A.
21. Turkish national report, sec. 27.1.2B.
22. German national report, sec. 15.1.
23. Back to the 1930s: Finnish national report, sec. 13.1.
24. Swedish national report, sec. 26.1.
25. UK national report, ch. 28.
26. Polish national report, sec. 21.2.1.
27. The Greek GAAR has been in force since 1 Jan. 2014: Greek national report, sec. 16.1.
28. French national report, sec. 14.2.1.
29. French national report, sec. 14.2.1.1.
30. Norwegian national report, sec. 20.1.
31. Czech Republic national report, sec. 11.1.
32. French national report, sec. 14.2.1.
33. Czech Republic national report, sec. 11.1.
34. Norwegian national report, sec. 20.1.
35. Czech Republic national report, sec. 11.1.
36. Italian national report, sec. 17.1.

In other jurisdictions, such as Denmark[37] and the United Kingdom,[38] a written GAAR has been introduced recently and it is not certain how the courts will combine its application with the judicial interpretation (purposive interpretation) of tax cases.

In Sweden, statutory GAARs have been discussed since the 1930s. One was introduced in 1981-1983, based on a tax circumvention test, and the most recent one uses a principal purpose test (tax predominant reason test).[39] In Sweden, it is considered that GAARs were introduced as a means to tax by analogy.[40]

In the United States, a statutory GAAR has not been introduced, which presumably means that the authority to tax is retained by the legislator and courts. In the absence of a statutory GAAR, SAARs have to be efficiently drafted.[41] In a cross-border setting, TP rules in the United States may play the role of a GAAR because "it provides the Internal Revenue Service with significant discretion to intervene in the characterization of income from related-party transactions".[42]

In Turkey, the "economic approach" is an old statutory principle (of 1961) used to tackle the tax circumvention of the law.[43]

While both statutory and judicial GAARs describe the elements that constitute avoidance, judicial GAARs operate more as interpretive tools[44]. Denmark[45] and Norway[46] are examples of this. In some cases, statutory GAARs seem to be more specific than judicial GAARs, which will lead to a higher level of certainty in recognizing and tackling avoidance.

Most national reports give notice of statutory GAARs. Germany seems to be the first, among the reported jurisdictions, to have introduced a statutory GAAR: its first GAAR was part of the 1919 General Tax Code

37. A GAAR aimed at international (cross-border) avoidance: Danish national report, sec. 12.2.
38. UK national report, sec. 28.12.
39. Swedish national report, sec. 26.4.
40. Swedish national report, sec. 26.4.
41. *See* this idea in US national report, sec. 29.3.3.
42. Id.

43. Turkish national report, sec. 27.2B.
44. Norwegian national report, sec. 20.1.
45. Danish national report, sec. 12.2
46. Norwegian national report, sec. 20.1.

(*Abgabenordnung*)[47]. Some GAARs in the jurisdictions reported in this book have been introduced recently: that is the case for the United Kingdom,[48] Poland[49] and Greece.[50]

The date of the introduction of a GAAR is indicative of the date of recognition of tax avoidance. For example, in the United Kingdom, recognition of avoidance on a case-by-case basis, requiring purposive interpretation, is relatively recent.[51] The CJEU exercised indirect pressure on its recognition when deciding on abuse in cases like *Halifax* and *Cadbury Schweppes*.[52]

Italy introduced a new statutory GAAR in 2015, applying to all abusive practices. Italy's first GAAR goes back to 1990, although it uses the ambiguous term "fraudulently": "The tax authorities may refuse to recognize the tax benefit received through business combinations …for the sole purpose of fraudulently obtaining tax savings."

Each jurisdiction is sovereign to draft its own GAARs. In respect of the EU Member States, implementation of the Anti-Tax Avoidance Directive (ATAD) will not change this state of affairs, since article 6 introduces a GAAR that is a *de minimis* rule and will probably not be adopted by those Member States that have GAARs in force. Moreover, concrete cases and interpretation of each GAAR in the different jurisdictions leads to different GAARs in action.

The reason for this is down to the different legal traditions of the reported jurisdictions, including their approach to tax law, separation of powers and legal certainty in taxes. Nevertheless, common elements in the concept of avoidance can be found and both statutory GAARs and judicial tools to combat avoidance can be grouped according to doctrines or principles.

Statutory GAARs can be grouped according to the following doctrines on avoidance (some of which overlap): abuse of law (Austria,[53] France,[54]

47. German national report, sec. 15.1.
48. UK national report, sec. 28.1.
49. Polish national report, sec. 21.2.1.
50. Greek national report, sec. 16.1.
51. UK national report, sec. 28.1.
52. UK national report, sec. 28.2.
53. Austrian national report, sec. 7.1.
54. French national report, sec. 14.1.

Germany,[55] Luxembourg[56] and Portugal[57]); *fraus legis* (the Netherlands,[58] Portugal[59] and Spain[60]); business purpose or principal purpose test (Belgium,[61] Finland,[62] Sweden[63] and the United Kingdom[64]), equivalent to genuine commercial reasons (Finland[65]); substance over form (the Czech Republic[66]); and more recently, due to CJEU case law and EC Recommendation 8806/EU, genuine transactions (Greece[67] and Italy[68]) or artificiality are playing a relevant role in some jurisdictions (France,[69] the Netherlands[70] and Spain,[71] for example). The concept of abuse in EU law is also influencing the United Kingdom in VAT cases (the main purpose test).[72]

Judicial GAARs often use a substance-over-form test to assess avoidance, operating as a principal purpose test: the purpose of the circumvented or avoided rule is compared with the taxpayer's purpose of saving taxes.[73] In Russia, avoidance is tackled by the bona fide principle or where an unjustified tax benefit is obtained, even if it is formally legal.[74]

In some reported jurisdictions, avoidance is tackled by interpretation theories according to "economic substance", or a substance-over-form approach. That is the case of jurisdictions as different as Brazil (courts also

55. German national report, sec. 15.1.
56. Luxembourg national report, sec. 18.1.
57. Portuguese national report, sec. 22.1.
58. Netherlands national report, sec. 19.1.1.
59. Portuguese national report, sec. 22.1.
60. *See* the case law for Spain, sec. 25.1., also referring to some overlapping between "avoidance" and "sham".
61. Belgian national report, sec. 8.1.
62. Finnish national report, sec. 13.1.
63. Swedish national report, sec. 26.1.
64. UK national report, sec. 28.1.
65. Finnish national report, sec. 13.1.
66. Czech Republic national report, sec. 11.1.
67. Greek national report, sec. 16.1.
68. Italian national report, sec. 17.1.
69. French national report, sec. 14.2.1.1.
70. Netherlands national report, sec. 19.2.1.3.3.
71. Spanish national report, sec. 25.1., referring to art. 15 GTA.
72. UK national report, sec. 28.1.2.
73. Norwegian national report, sec. 20.1.
74. Russian national report, sec. 23.1.

use a business purpose test),[75] Croatia,[76] the Czech Republic,[77] Denmark,[78] Norway,[79] Turkey[80] and the United States.[81]

Nevertheless, the economic substance of a business transaction is interpreted differently in each of the jurisdictions. In Croatia, for example, economic substance is assessed in light of sham transactions: "if a sham transaction conceals another legal transaction, the basis for the assessment of tax liability shall be that concealed legal transaction".

In Croatia, sham is interpreted as opposite to genuine intention and applies to situations such as deduction of costs, sales contracts concealing the legal business such as loans and sales agreements where partnership agreements were sham transactions: interpretation of sham transactions makes it equivalent to avoidance schemes.[82] In contrast, in Brazil, sham is not considered equivalent to avoidance.[83]

Because the concept of avoidance is closely related to GAARs, the main features of avoidance in a legal system are common to domestic and cross-border avoidance.

Avoidance normally involves refusal of the tax advantages that were sought and requalification of the transaction, but some jurisdictions have recently introduced penalties in the case of avoidance (e.g. France) or abolished the prohibition of penalties (Spain[84]).

1.1.1.2. The role of administrative regulations and rulings clarifying the meaning of tax avoidance

Administrative regulations and rulings do not normally clarify the meaning of avoidance, but in some jurisdictions they describe the type of arrangements that may be considered avoidance.[85]

75. Brazilian national report, sec. 9.2.3.
76. Croatian national report, sec. 10.1.
77. Czech Republic national report, sec. 11.1.
78. Danish national report, sec. 12.1.
79. Norwegian national report, sec. 20.1.
80. Turkish national report, sec. 27.I.IA.
81. US national report, sec. 29.1.
82. Croatian national report, sec. 10.1.
83. Brazilian national report, sec. 9.1.
84. Spanish national report, sec. 25.2.
85. For example, Austrian national report, ch. 7; Belgian national report, sec. 8.1.; and Netherlands national report, sec. 19.1.2.

The Belgian national report makes reference to several administrative instruments (circulars, general commentaries and ministerial answers on parliamentary questions) aimed at clarifying the meaning of abuse. However, those administrative instruments are only binding to the tax administration.[86]

Rulings are used in some jurisdictions to state whether a specific scheme is avoidance or not. Tax rulings are frequently adopted in France, for example: tax rulings on the interpretation of the law or to confirm that a scheme is not abusive and pre-authorization procedures on intra-group reorganizations;[87] in Germany, advance binding rulings are issued on the relevance of specific facts and the consequences on tax law, but they are forbidden in respect of transfer pricing (TP) issues, according to instructions by the Federal Ministry of Finance; binding statements after tax audits and retrospective agreements on facts (not anticipating future facts) are also possible.[88] Advance pricing agreements (APAs) are also concluded in Italy,[89] Netherlands[90] and the United Kingdom.[91]

1.1.1.3. Case law on the meaning of tax avoidance

Some jurisdictions reported in this book mention the relevant role of case law to clarify the meaning of national GAARs. For example, the Austrian Supreme Administrative Court (VwGHs) clarifies that avoidance constitutes arrangements that are unusual and inadequate with respect to their economic result, entered into with the sole purpose of avoiding taxes and not necessarily constituted by a single transaction. Moreover, this Court considers the Austrian GAAR to be in line with the ECJ principle of abuse.[92] The Finnish national report makes reference to case law on the national GAAR mainly aimed at identifying domestic avoidance, on the basis of the valid commercial reasons (division of a company, sales losses and incentive systems[93]).

The Russian national report divides potential disputes on tax avoidance that have been tackled by the courts into four categories: (i) the creation of schemes aimed at increasing the value of goods for VAT deduction purposes and increasing deductible costs for corporate income tax purposes; (ii) the

86. Belgian national report, sec. 8.1.2.
87. French national report, sec. 14.1.
88. German national report, sec. 15.2.
89. Italian national report, sec. 17.4.3.
90. Netherlands national report, secs. 19.1.1.3. and 19.3.2.
91. UK national report, sec. 28.3.2.3.
92. Austrian national report, sec. 7.1.
93. Finnish national report, sec. 13.1.4.

use of organizations (in some cases, directly or indirectly controlled by the taxpayer) that do not perform real financial and/or economic activities; (iii) the "splitting" of business aimed at the opportunity to apply preferential tax treatment; and (iv) the carrying on business activities that formally are within the scope of tax legislation, but actually do not have business purpose.[94]

1.1.1.4. BEPS repercussion on the meaning of avoidance

Many of the reported jurisdictions mentioned the influence of the BEPS Project in their legislation, but only Spain expressly refers to the influence of that project in the meaning of avoidance. That is clear in the latest Supreme Court case law, which interprets the Spanish GAAR in light of the CJEU case law on abuse.[95]

1.1.2. The meaning of tax planning, abusive tax planning and aggressive tax planning in national legal systems

In the jurisdictions reported on in this book, tax planning, abusive tax planning or aggressive tax planning are not legal concepts.[96] However, there are exceptions: those jurisdictions where legislation on the disclosure of aggressive tax planning schemes was proposed and subsequently rejected (e.g. Brazil[97]) or where it was approved and is in force (e.g. Portugal[98] and the United Kingdom[99]). In the latter case, the expression "aggressive tax planning" is used, although it is not defined. Aggressive tax planning schemes to be disclosed cover schemes that may not constitute avoidance. The tax administration is then competent to determine which schemes constitute avoidance and which do not. Courts are expected to control the interpretation by the tax authorities.

To some authors, the difference between tax avoidance and tax planning is clear (France[100]), but the difference between abusive or aggressive tax plan-

94. Russian national report, sec. 23.1. and "Letter of the Federal Tax Service of the Russian Federation of 31 October 2013 No CA-4-9/19592".
95. Spanish national report, sec. 25.2.
96. *See*, for example, Danish national report, sec. 12.2.; Finnish national report, sec. 13.2.; and Swedish national report, sec. 26.3.
97. Brazilian national report, sec. 9.3.
98. Portuguese national report, sec. 22.1.
99. UK national report, sec. 28.1.3.
100. French national report, sec. 14.2.

ning and avoidance is not (Austria[101] and Sweden[102]). Aggressive or abusive tax planning may coincide with tax avoidance (the Czech Republic[103]) or may indicate that the behaviour may be challenged under the GAAR (Sweden[104]); some national reports assume that aggressive tax planning in the BEPS Project coincides with the concept of tax avoidance (Belgium[105]); others mention that aggressive tax planning is part of the political debate where the latter requires legislation to respond to the former (Denmark[106]).

1.2. The reaction to avoidance and aggressive tax planning in the BEPS context

1.2.1. Domestic GAARs

All jurisdictions reported have either statutory or judicial GAARs, or interpretive tools with functions similar to GAARs (e.g. the Brazilian or the US's substance-over-form approach rules on tax circumvention, as mentioned in the Turkish national report). General anti-avoidance rules aim to tackle tax avoidance on a case-by-case analysis.

Some jurisdictions have several GAARs: that is the case of the Belgian tax codes, each of which contain a GAAR, all of them following the same approach.[107] Moreover, in some jurisdictions, judicial doctrines seem to be sufficient to combat avoidance by using an autonomous interpretation of tax law (e.g. Brazil[108]). This interpretation is normally based on a substance-over-form analysis, although departing from the meaning of the concepts in civil law.

GAARs either operate on the basis of legal principles (abuse of law, *fraus legis*, principal purpose and genuine character of the transaction) or require interpretation on a principle-based analysis (substance over form and economic interpretation).

101. Austrian national report, sec. 7.1.
102. Swedish national report, sec. 26.3.
103. Czech Republic national report, sec. 11.2.
104. Swedish national report, sec. 26.3.
105. Belgian national report, sec. 8.2.
106. Danish national report, sec. 12.2.
107. Belgian national report, sec. 8.1.
108. Brazilian national report, sec. 9.3.1.

Because GAARs require an analysis on a case-by-case basis, the burden of proof may lie either on the taxpayer or on the tax administration, depending on the drafting of the legislation. In the former case, GAARs often operate with rebuttable presumptions. They may apply to domestic and cross-border avoidance, and to every kind of tax in force in the national jurisdiction.

The recent GAARs introduced by Greece,[109] Italy[110] and Poland[111] are inspired by the GAAR proposed in EC Recommendation C-(2012) 8806 of 6 December 2012. All other EU jurisdictions reported in this book consider their GAAR to be compatible with the TFEU and that their GAARs contain some elements contained in the EC Recommendation GAAR, even if not all (e.g. the Czech Republic[112]). Moreover, most EU jurisdictions consider that they will not introduce the new GAAR in article 6 of the ATAD because they see no added value in doing so. Most reported jurisdictions are satisfied with their national GAARs, considering them compatible with the recommended GAAR.

Even if the latter GAAR may be more precise and detailed in respect of some aspects than the national GAARs (regarding clarification of "avoiding taxation", "essential" and "tax benefit"[113]), introduction of a new GAAR would bring legal uncertainty for taxpayers, since interpretation of its concepts would take long to settle. In general, both conditions and consequences in the national GAARs are compatible with the conditions and consequences in the recommended GAAR: that is the case with Germany.[114]

National reporters consider their GAARs to be compatible with the EU/EEA concept of abuse.[115] However, except for Finland[116], France[117], Italy[118] and the Netherlands,[119] most jurisdictions consider that CJEU case law on abuse, which is based on the artificiality test, has had little or no impact in their concept of abuse or in the interpretation of their national GAARs.

109. Greek national report, sec. 16.1.
110. Italian national report, sec. 17.2.1.
111. Polish national report, sec. 21.1.
112. Czech Republic national report, sec. 11.2.2.
113. German national report, secs. 15.2.2.3. to 15.3.2.3.
114. Id.
115. *See*, for example, Finnish national report, sec. 13.3.; and Luxembourg national report, sec. 18.1.
116. Finnish national report, sec. 13.3.1.6.
117. French national report, sec. 14.2.1.1.
118. Italian national report, sec. 17.1.1.
119. Netherlands national report, secs. 19.1.4. and 19.2.1.3.3.

In some jurisdictions, either the tax authorities or the courts interpret their national GAARs in light of the "wholly artificial" test, as put forward in *Cadbury Schweppes*.[120]

Most statutory GAARs in the reported jurisdictions contain the following elements:

- a main objective test (the accrual of a tax advantage the grant of which is contrary to purpose of the legal provision);
- the obtaining of a tax advantage as the essential aim of the transactions concerned;
- a complementary business purpose test (under international tax law) or the genuine economic activity test (under EU law); and
- a subjective element, consisting in the intention to obtain a tax advantage, and which is in many cases interpreted by means of objective parameters, for example, whether there are valid and reasonable non-fiscal reasons behind the transaction.[121]

National reporters do not mention the principle of proportionality as part of their GAARs.

National GAARs are used by the tax authorities as a powerful preventive tool, with a "deterrent effect" (Germany) on taxpayers' behaviour. In many of the reported jurisdictions, courts are reluctant to apply GAARs (Germany[122] and Sweden[123]), but they have been successfully applied in others (Austria[124]).

1.2.2. EC Recommendation C(2012) 8806 of 6 December 2012 and the subject-to-tax rule and the ATAD Proposal of Directive of 28 January 2016

EC Recommendation (8806) proposes a subject-to-tax rule aimed to deal with double non- taxation:

120. Austrian national report, sec. 7.1.; added as an alternative path to abuse, if necessary, without disapplying the German GAAR: sec. 15.3.1.; and Italian national report, sec. 17.2.1.
121. Austrian national report, sec. 7.1.; Belgian national report, sec. 8.1.; Danish national report, sec. 12.2.1.; and Portuguese national report, sec. 22.2.
122. German national report, sec. 15.1.1.
123. Swedish national report, sec. 26.4.
124. Austrian national report, sec. 7.1.

> 3.2…..Member States are encouraged to include an appropriate clause in their double tax convention ("DTC")…it could read as follows: Where this DTC provides that an item of income shall be taxable only in one of the Contracting State ("CS"), the other CS shall be precluded from taxing such item if this item is subject to tax in the first CS.
>
> 3.3. 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 the item is not subject to tax, Member States are encouraged to ensure that the item is taxed.
>
> 3.4….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.

Reported jurisdictions did not introduce a subject-to-tax rule, as suggested in the EC Recommendation or Action 6. However, general subject-to-tax rules can be found in the Protocol to the DTT between France and Italy and in the DTT between Germany and Italy and specific subject-to-tax rules are included in other DTTs concluded by Italy.[125]

The French *Conseil D'État* recently interpreted the DTT residence provision and the meaning of "liable to tax" to companies, refusing them access to the DTT if those persons are not subject to tax due to their status or activity:[126] this interpretation plays a similar role to a subject-to-tax rule.

Some EU jurisdictions will have to introduce new rules (e.g. the Czech Republic, Greece and Poland[127]), following to the ATAD, others will make adjustments (e.g. Portugal, Germany and France).

1.3. TP rules, GAARs, SAARs and linking rules

All reported jurisdictions with the exception of Luxembourg have been applying TP rules. Moreover, all reported jurisdictions, including Luxembourg have been applying the arm's length principle, for cross-border and domestic transactions between related parties. However, Luxembourg only introduced TP rules in January 2015 and before that the arm's length principle was applicable to "hidden dividends" and "hidden capital contributions" and no documentation requirements were required.[128] Most reported

125. Italian national report, sec. 17.2.
126. French national report, sec. 14.2.2
127. Polish national report, sec. 21.2.2.4.
128. Luxembourg national report, sec. 18.3.2.

jurisdictions acknowledge TP rules as anti-avoidance rules,[129] even if they are primarily aimed at allocating taxing rights.[130]

The TP methods and compliance obligations are normally foreseen in domestic regulations or rulings and the OECD Transfer Pricing Guidelines are in the origin of those domestic regulations and rulings and are applied domestically by courts.[131] An exception is Brazil, where the TP rules deviate in important aspects from the OECD guidelines.[132] TP documentation is not mandatory in every reported jurisdictions (for example, it is not mandatory in the Czech Republic[133]), others have been at the forefront of the BEPS recommendations (for example, Spain in the case of the CbCR[134]) and the degree of detail and capacity to deal with TP varies among the jurisdiction.

Litigation involving TP rules is described in some national reports.[135] One interesting example is Finland, which applies TP rules to the deductibility of interest.[136] The French and German national reporters mention that litigation in TP is increasing but it is still minimal taking into account the number of reassessed cases.[137]

1.3.1. LOB rules

LOB rules are part of the US's treaty policy and therefore they are included in all US bilateral tax treaties. Leaving the US's case aside, LOB rules are included in some tax treaties of the reported jurisdictions (so far, Greece has not included LOBs in its treaties[138]). In most cases, LOB clauses have been introduced in the most recent bilateral treaties and the ones concluded with the United States are usually more complex than the LOBs inserted in other DTTs.[139]

129. *See* the case of Finland and its case law: sec. 13.4.
130. *See* Italian national report, sec. 17.3.1.
131. Again, the case of Finland, sec. 13.6.
132. Brazilian national report, sec. 9.4.
133. Czech Republic national report, sec. 11.3.1.
134. *See*, for example, Spanish national report, sec. 25.1.
135. *See*, for example, Italian national report, sec. 17.3.1.2.; Norwegian national report, sec. 20.3.; and UK national report, sec. 28.3.2.2.
136. Finnish national report, sec. 13.4.
137. French national report, sec. 14.3.1.; and German national report, sec. 15.4.3.
138. Greek national report, sec. 16.3.
139. *See*, for example, Italian national report, sec. 17.3.2.

1.3.2. CFC rules

CFC rules are in force in most of the reported jurisdictions, with the exception of Austria, the Czech Republic and Luxembourg. In Brazil, CFC rules are not considered as SAARs but related to the universal taxation of Brazilian resident companies with controlled and subsidiary companies abroad, without deferral[140]. In Greece, they were recently introduced.[141]

1.3.3. Linking rules as recommended in G20/OECD BEPS Action 2

Some reported jurisdictions introduced linking rules as recommended under OECD/BEPS Action 2,[142] and others as a result of the EU Directives approach to BEPS. Domestic unilateral linking rules (which are not implementing EU Directives or amendments to EU Directives) may be replaced by different rules enacted in the ATAD. Others introduced linking rules as a result of the Parent-Subsidiary and Interest-Royalty Directives (2014/86/EU and 2015/121/EU).[143]

1.3.4. Limits on the deduction of interest

Most jurisdictions have rules limiting deduction of interest. Some have thin capitalization rules (Brazil[144], Poland[145] and Russia[146]) while others have interest limitation rules (e.g. France,[147] Germany,[148] Finland,[149] Italy,[150] Portugal, South Africa,[151] Spain and the United Kingdom[152]). The Netherlands has diversified rules limiting interest deduction.[153] Luxembourg

140. Brazilian national report, sec. 9.4.3.
141. Greek national report, sec. 16.3.
142. French national report, sec. 14.3.4.; and UK national report, sec. 28.3.6.3.
143. Finnish national report, secs. 13.1.7. and 13.4.6.
144. Brazilian national report, sec. 9.4.2.
145. Polish national report, sec. 21.7.
146. Russian national report, sec. 23.3.
147. French national report, sec. 14.3.5.
148. German national report, sec. 15.4.2.
149. Finnish national report, sec. 13.4.7.
150. Finnish national report, sec. 13.4.8.; and Italian national report, sec. 17.3.5.
151. South African national report, sec. 24.4.
152. In force since 2017: UK national report, sec. 28.3.5.2.
153. Netherlands national report, sec. 19.3.7.

does not have any in its law, but administrative practice imposes a thin capitalization rule on the basis of an arm's length test.[154]

1.3.5. Other SAARs

Other SAARs put forward in the G20/OECD BEPS Project are already in force in some of the reported jurisdictions. Examples include dividend-interest mismatches (Germany[155]), the prevention of double dip of cross-border losses (Germany[156]) or cross-border expenses (Denmark[157]), other hybrid mismatches (Germany[158]), switch-over clauses (Austria[159] and Germany[160]), beneficial ownership[161] and higher taxation of dividends distributed to non-disclosed beneficiaries.[162] The United Kingdom has also introduced several anti-avoidance rules in response to BEPS: "targeted anti-avoidance rules".[163]

National reports mention SAARs in other tax areas, such as business restructurings (Finland,[164] Italy[165] and Poland[166]) and concerning other taxes, such as inheritance and gift taxes (Finland[167]); exit taxes, CbCR, transfer of assets to a trust or a comparable institution (France[168]), rules on companies in non-cooperative jurisdictions (France[169] and Portugal[170]), subject-to-tax provisions and switch-over rules (Germany[171]). In contrast, the Greek national reporter, for example, is of the opinion that most anti-avoidance rules in the ATAD will have to be introduced or redrafted in Greece, including the recent GAAR.[172]

154. Luxembourg national report, sec. 18.3.6.
155. German national report, sec. 15.4.3.
156. Id.
157. Danish national report, sec. 12.3.6.
158. German national report, sec. 15.4.3.
159. Austrian national report, sec. 7.3.
160. German national report, sec. 15.4.3.
161. Italian national report, sec. 17.3.6.4.
162. Russian national report, sec. 23.3.
163. *See* UK national report, sec. 28.3.6.
164. Finnish national report, sec. 13.4.8.
165. Italian national report, sec. 17.3.6.2.
166. Polish national report, sec. 21.3.8.
167. Finnish national report, sec. 13.1.1.
168. French national report, sec. 14.3.6.
169. French national report, sec. 14.3.6.
170. Portuguese national report, sec. 22.3.
171. German national report, sec. 15.4.7.
172. Greek national report, sec. 16.2.2.

The Luxembourg national report points out that, according to its country's position (observation on the Commentary on Article 1 of the OECD Model), cross-border situations covered by DTTs only allow application of national anti-abuse provisions, following a mutual agreement procedure.[173] Explicit provision allowing the application of GAARs are only foreseen in a few DTTs.[174]

1.4. Application of GAARs, TP rules and SAARs

1.4.1. Interaction of GAARs, TP rules and SAARs

National jurisdictions reported in this book do not specify a specific hierarchy between SAARs and GAARs, but most of the national reporters admit that if a SAAR is not applicable, a GAAR can come into play. The Finnish, French and Norwegian national reports mention the possibility of joint application of the TP rules and the national GAAR.[175]

According to the German national reporter, application of the GAAR requires that the preconditions of a SAAR have not been met. Furthermore, it has to be determined that the SAAR does not exclude application of a GAAR. There must be additional circumstances covered by the GAAR and not foreseen in the SAAR. The SAAR itself may have been circumvented. Most reports mention that SAARs and GAARs are submitted to the principle that *lex specialis* prevails over *lex generalis*.[176]

Taking the example of CFC rules (a SAAR) as an exception to deferral, it can be argued that they cannot be replaced by a GAAR if the conditions under the CFC rules are not met. For example, if the CFC rules only apply to companies with a direct holding of at least 50% in another company, where the CFC is an artificial arrangement, a GAAR can not be applied to tax the undistributed dividends of an individual shareholder who holds 50% in a non-resident company because this company is not an artificial arrangement.

173. Luxembourg national report, sec. 18.3.1.
174. Luxembourg national report, sec. 18.3.1.
175. Finnish national report, sec. 13.5.2.; French national report, sec. 14.3.7.; and Norwegian national report, sec. 20.4.
176. The French national report mentions that interaction is provided by regulation or by the tax authorities' guidelines: French national report, sec. 14.3.7.

If a SAAR were potentially applicable in the concrete case, but the conditions in the SAAR are not fulfilled (i.e. the arrangement is genuine), a GAAR is only applicable if additional conditions on avoidance are not part of the SAAR. For example, even if the controlled foreign company is a genuine arrangement but there is a step-by-step transaction not caught by a SAAR, the GAAR can be applied.

It could instead be argued that before the BEPS Project, in cross-border scenarios, national SAARs should exclude application of a national GAAR. The reason for this is that application of a national SAAR, targeted at a cross-border situation (such as a CFC or a thin capitalization rule) is itself controversial because it leads to an allocation of taxing rights that is different from the one foreseen in the tax treaty. Application of a GAAR if the CFC rule condition is not verified will increase legal uncertainty as to which jurisdiction is entitled to tax the income.

In the context of the BEPS Project however, it can also be argued that national GAARs are not applicable to cross-border situations, unless a subject-to-tax clause and PPT rules are signed under the multilateral convention.

In some of the reported jurisdictions, TP rules are applied as anti-avoidance rules, when the tax authorities consider that costs and profits did not respect the arm's length principle. Although TP rules are considered to be SAARs by the national reporters, the fact that they allocate taxing rights implies that they precede application of other SAARs, a PPT rule or another GAAR.

All national reports seem to indicate that specific anti-avoidance rules are applied more often than GAARs.[177] In many of the reported jurisdictions, GAARs are seldom applied.[178]

GAARs function as fall-back tools when TP rules and SAARs are not applicable, as well as tools to prevent avoidance. Vagueness in the design of GAARs is an important feature to assure their effectiveness to combat new schemes of avoidance. However, vagueness does not necessarily mean legal uncertainty. Administrative and judicial interpretation of GAARs will progressively reduce their vagueness. The CJEU could play an important role to reduce legal uncertainty in respect of avoidance. The ATAD may contribute to reduce legal uncertainty in the interpretation of SAARs and

177. German national report, secs. 15.1.1.1. and 15.1.1.2.
178. Finland makes reference to cases involving application of their GAAR: Finnish national report, sec. 13.5.4.

GAARs in EU Member States, depending on how coherent and consistent the CJEU's actions will be.

GAARs seem to be necessary to guarantee an autonomous interpretation of tax law. In Germany, legislation facilitating avoidance has been declared unconstitutional on the basis of the principle of equality ("a tax act or single elements thereof … are unconstitutional if they do not prevent the taxpayer from entering into arrangements that reduce the burden of tax in a way that was obviously not intended by legislators and is not justifiable under the right to equality")[179]. According to this interpretation of the German Constitutional Court, anti-avoidance legislation is an obligation of the parliament under the German Constitution.

1.4.2. Procedural rules underlying application of national GAAR, TP rules and/or SAARs

Some jurisdictions have procedural rules regarding the application of GAARs, TP rules and SAARs. They generally aim to achieve greater legal certainty and allow the taxpayer to defend himself.[180] Procedures regarding TP rules are often connected to APAs and mutual agreement procedures.[181] According to its national report, the United Kingdom has been entering into APAs since the 1990s and, by 2014, it had 88 APAs.[182]

179. *See* the German national report, sec. 15.2. and the reference to the BVerfG (First Senate) of 17 Dec. 2014 – 1 BvL 21/12.
180. *See*, for example, Italian national report, sec. 17.4.2.
181. For example, Italian national report, sec. 17.4.3.; and UK national report, sec. 28.3.2.3.
182. UK national report, sec. 28.3.2.3.

Part II

Thematic Reports

Chapter 2

Tax Avoidance and Aggressive Tax Planning as an International Standard – BEPS and the "New" Standards of (Legal and Illegal) Tax Avoidance*

Adolfo Martín Jiménez

2.1. Introduction

This chapter tries to answer two main questions: (i) is "aggressive tax planning" (ATP) a new international standard that draws the line between what is permitted and what is prohibited to taxpayers? It can be anticipated that the answer to this question is "no" (the reasons for giving this answer are explained in section 2.2.); and (ii), if the answer to the first question is "no", what is the international standard, if any, on tax avoidance, prohibition of illegal avoidance and permitted tax planning? The answer to this second question is directly connected with the outcomes of the various BEPS Actions.

The structure of the chapter is conditioned by the response to these two questions. In section 2.2., it is shown that aggressive tax planning is not really a new standard in the international context. If anything, it is an aspiration, albeit a very general one, to give "substance" a stronger presence in international tax law or to achieve a limited agreement on principles in a world of disharmonized tax systems and values. But new anti-avoidance standards have to be defined by reference to the OECD Base Erosion and Profit Shifting (BEPS) Actions (the EU context is not dealt with in this chapter), which hardly use a unitary concept or a single conceptual tool to define avoidance (or the new international standards), with the exception, again, of the idea that substance (legal or economic, but in either case conceived of as the antithesis of empty legal constructions) is here to stay. In this new order, section 2.3. shows that Actions 8-10 BEPS have tried to give transfer pricing rules a preeminent role in the definition of international anti-avoidance standards (and, therefore, substance), so that they relegate other anti-avoidance rules (general anti-avoidance rules (GAARs) and some special anti-avoidance rules (SAARs)) to a more subsidiary role.

* This chapter has greatly benefited from discussions with and comments by H. Ault (Boston College, emeritus) and S. Wilkie (Blakes). Needless to say, the usual disclaimers apply.

That section also explores the potential weaknesses of the new standard that places transfer pricing rules at the centre of the international tax scene and principles, and how Actions 8-10 BEPS also admit a considerable margin for tax planning and even (admitted and blessed) BEPS behaviours for multinational groups (MNLs). Therefore, a standard for "legal or allowed tax avoidance" can also be derived from those Actions. In addition, allowed tax avoidance is also reinforced by the fact that tax and legal orders may not be prepared (some more than others) to receive the main principles derived from the BEPS Actions; thus, unless they are reformed, the new principles may facilitate tax planning within those systems.

In section 2.4., the connection between Action 7 BEPS (preventing artificial avoidance of permanent establishments (PEs)) and Actions 8-10 BEPS (transfer pricing) is explored, with the conclusion that they are perfect companions, since Action 7 reinforces the tax planning effects admitted in Actions 8-10 BEPS and even has the effect of disaggregating tax bases and economic activity (contrary to the main guiding principle of BEPS and the concept of substance represented in the new standards). Last but not least, section 2.5. argues that Action 6 BEPS (preventing the granting of treaty benefits in appropriate circumstances), which is the Action that refers to traditional anti-avoidance clauses (limitation on benefits (LOB) and principal purpose test (PPT) clauses), is subordinated and does not have relevant effects in fighting behaviours that are permitted under Actions 8-10 BEPS.

The different sections of this chapter, therefore, explore the boundaries of the BEPS standards, their strengths and weaknesses, what they have achieved and permit, and what is the likely "new scene" for tax planning and the definition of illegal tax avoidance.

2.2. The rise and fall of aggressive tax planning as an anti-avoidance standard: BEPS Actions as the international standard on avoidance

Illegal tax avoidance and evasion are concepts directly linked with domestic tax systems, since, in the end, what is permitted or not in a given country is defined in domestic law, as interpreted by tax administrations and courts in that country. Even in the current international context, the final shape and contours of anti-avoidance standards are defined in domestic law. This chapter will concentrate on the "international standard" of avoidance, which derives from the action of international organizations (the G-20/OECD

BEPS outputs) and exerts an important influence on domestic legislation and categories but does not replace them. It will also explore their interconnection. It tries to answer the two questions posed in the introduction: (i) is ATP the new international standard of avoidance? and (ii) if not, what are the new standards (if any)?

ATP is a (relatively) new concept,[1] but it probably also represents – with all its flaws – an old aspiration of any legal and tax system, namely that transactions must have not only a form but also a (legal) substance that permits considering them as legitimate and founded, and it is indicative of the fact that a certain degree of harmonization in the international context is needed to prevent taxpayers having easy options for avoiding the tax levels of their domestic systems. In the end, it simply reflects the reality of a world without uniform taxation principles or tax systems, in which different values have made harmonization or agreement on certain fundamentals (to a certain extent) desirable. Despite its diffuse contours (which, in the end, are the effect of a world without common tax principles or values), ATP has had an important impact on the process of transparency/good governance and the procedural aspects of the relationship between taxpayers and tax administrations, but it has no value as such in terms of giving meaning to the concept of tax avoidance within domestic systems.[2] As will be shown, it also has a limited value in the post-BEPS context.

ATP first appeared in the international arena in the works of the OECD Forum on Tax Administrations and received a considerable push from the EU initiatives in the field of direct taxation.[3] It seems, however, that, in the

1. On the origins of the concept in the OECD works, *see* J. Calderón and A. Quintas, *The Concept of "Aggressive Tax Planning" Launched by the OECD and the EU Commission in the BEPS Era: Redefining the Border between Legitimate and Illegitimate Tax Planning*, 44 Intertax 3 (2016), pp. 209 ff.

2. The concept is having some impact on the attitude of tax administrations and even courts in terms of broadening the notion of tax avoidance. From a strictly legal perspective, this is unfortunate. The reasons for this are clearly explained by P. Essers, *International Tax Justice between Machiavelli and Habermas*, 68 Bulletin for International Taxation 2 (2014), Journals IBFD, p. 65: "A meaningful debate on international tax justice is only possible if a clear distinction is made between regular tax planning, tax avoidance and tax fraud. Tax planning leading to a result that is considered to be in conflict with the 'spirit of the law', not being tax fraud or tax planning within the aforementioned 'grey area', should be tackled by (multilateral) regulation. Naming and shaming of taxpayers by governments or judging them on ethical grounds in these cases is not appropriate".

3. The relevance of ATP within the European Union can only be criticized. As known, the European Commission included the fight against ATP among its goals in the Commission Recommendation of 6 Dec. 2012 on aggressive tax planning, C(2012) 8806 final, which gave a very broad and confusing definition of ATP (it "consists in taking advantage of the technicalities of a tax system or of mismatches between two or more tax systems for

context of the BEPS project, the concept has been absorbed by and accommodated to the BEPS Actions, and this has had the effect of reducing its practical value as such, even if it has helped push forward the idea that there is a need to have common standards in a world characterized by heterogeneity and a lack of harmonization of tax laws – and even of fundamental principles. In the first BEPS Report, ATP was clearly identified as a concept that goes beyond illegal tax avoidance,[4] but the fight against BEPS – not ATP – was the main priority of the G-20/OECD in the BEPS initiative. The BEPS Action Plan of 2013 marked the initial dilution of ATP within the BEPS standards – ATP is scarcely mentioned in this document.[5] Finally, ATP seems to have given way to "BEPS concerns" in the final BEPS deliverables of 5 October 2015, in which, as explained below, the concept is hardly used.

This all means that BEPS and its guiding principles, minimum standards and best practices are the new international benchmark (principles) for giving content to the category of (illegal or legal) tax avoidance. BEPS standards have replaced ATP, even if they represent the same old search for substance and common points of agreement between different international tax systems. But what are those standards? Again, as with ATP, the BEPS

the purpose of reducing tax liability"). Recommendation of the European Commission 2016/136, 28 Jan. 2016 (OJ L 25/67, 2 Feb. 2016), however, adopted the PPT derived from Action 6 BEPS and advised that this clause be included in tax treaties between Member States and in tax treaties between Member States and third countries. EU law issues, however, will not be dealt with further in this chapter. However, the same arguments that limit the value and usefulness of ATP in the international scene are also valid within the European Union.

4. *Addressing Base Erosion and Profit Shifting*, OECD: Paris (2013). In this Report, ATP is referred to at p. 31 in connection with disclosure of aggressive tax schemes; otherwise, the report refers to "base erosion or profit shifting" only. Avoidance is also identified with ATP when it is said that anti-avoidance strategies of states "often focus on deterring, detecting and responding to aggressive tax planning" (p. 37). At p. 43, the Report explains that there are difficulties in identifying what is aggressive and what is not; domestic and treaty-based provisions are "the benchmark against which to decide whether a given strategy should be implemented (from the perspective of the taxpayer) or challenged". It is added on the same page that "situations which cannot be tacked under existing tax rules, but that still generate concerns at the level of the revenue body, should be brought to the attention of tax policy officials in order to determine whether changes to the current rules need to be introduced". Further, strategies that are used to escape anti-avoidance rules and secure an overall low taxation seem to be included in this "concept".

5. The BEPS Action Plan 2013 (*Action Plan on Base Erosion and Profit Shifting*, OECD: Paris (2013)) only refers three times to ATP: once in which it seems that BEPS and tax planning are somehow assimilated as "evils" to fight against (p. 13); once in connection with the insufficiency of audits for early detection of ATP (p. 14); and once in connection with Action 12 (p. 22), which is the only Action that specifically refers to ATP in the original BEPS Action Plan.

standards do not have clear contours. The guiding principle is found in the original BEPS Action Plan of 2013:

> BEPS relates chiefly to instances where the interaction of different tax rules leads to double non-taxation or less than single taxation. It also relates to arrangements that achieve no or low taxation by shifting profits away from the jurisdictions where the activities creating those profits take place. *No or low taxation is not* per se *a cause of concern, but it becomes so when it is associated with practices that artificially segregate taxable income from the activities that generate it. In other words, what creates tax policy concerns is that, due to gaps in the interaction of different tax systems, and in some cases because of the application of bilateral tax treaties, income from cross-border activities may go untaxed anywhere, or be only unduly lowly taxed* [emphasis added].[6]

Apart from this guiding principle, the BEPS Action Plan does not have much to say about the contents of the international standards. It simply identified 15 Actions, for which the solutions provided are not always coherent with a single underlying principle. The best explanation of the meaning of BEPS guiding principles is found in the Action probably regarded as the least important from a strictly legal perspective, even if it is a truly fundamental Action that shows that there really is no standard or form to measure the effects of BEPS. In fact, Action 11 BEPS explains three ideas very clearly:

(1) "reproachable" (or "unwarranted", if the term is to be softened) BEPS[7] occurs when nothing of (real or economic) substance happens in a jurisdiction to which income is "diverted";[8]

6. BEPS Action Plan 2013, p. 10.

7. The term "reproachable BEPS" is used here to describe BEPS behaviours that are no longer accepted from an international perspective following the BEPS outputs. This term pretends to make clear that there is also admitted BEPS in the international landscape following the BEPS outputs.

8. *Measuring and Monitoring BEPS, Action 11 – 2015 Final Report*, OECD: Paris (2015) (Action 11 BEPS), p. 42: "The important distinguishing characteristic of BEPS is tax planning strategies that result in a disconnect between the geographic assignment of taxable profits and the location of the underlying real economic activities that generate these profits. As a result of this disconnect, MNEs may be able to shift profits from higher-taxed countries to lower-taxed countries without a corresponding material change in the way the taxpayer operates, including where products and services are produced, sales and distribution occur, research and development is undertaken, and how the taxpayer's capital and labour are used. In some cases, BEPS involves placing just enough economic activity in a jurisdiction to attempt to justify the tax planning strategy."

(2) BEPS that has to do with effective reallocation of real functions, assets and risks (as defined by the OECD standards) is permitted;[9] and
(3) BEPS can only really be defined by reference to specific BEPS Actions.[10]

Action 11 BEPS hardly uses the concept of ATP. It only refers to the BEPS main guiding principle and, when ATP is used (only in paragraphs 168 and 170), it seems to cover BEPS behaviours identified in specific Actions. Moreover, in the BEPS deliverables of 5 October 2015, the concept of ATP is again hardly used, with the exception of Action 12 BEPS, on mandatory disclosure rules. This Action focuses on avoidance and non-avoidance transactions, and, in the end, it seeks to identify arrangements with a "material tax impact" in the jurisdiction that applies mandatory disclosure rules, regardless of their characterization as artificial avoidance (or not).[11] Apart from Action 12, specific BEPS Actions (e.g. Actions 2 and 4) can also provide guidance on transactions with a material tax impact (e.g. hybrid mismatch arrangements and interest deductions) that are regarded as deserving some reaction (harmonization) on the part of states in order to neutralize them but are not labelled as "ATP". (In fact, those transactions in Action 2, specifically, are outside the traditional version of SAARs and GAARs and represent an aspiration to form a connection between legally disharmonized tax systems.) This shows that specific BEPS Actions define the standard of reproachable BEPS without using a concept such as ATP that can unify or give coherence to all of them.

Therefore, what seems relevant today is the concept of reproachable BEPS, or behaviours included within the scope of BEPS Actions or "BEPS minimum standards and best practices". ATP as a category does not seem to exist anymore, unless that term is used to refer to the BEPS minimum standards and best practices identified in the various BEPS Actions or to the

9. Action 11 BEPS, p. 82: "MNEs taking advantage of differences in countries' tax rates does not amount to BEPS on its own. However, artificial arrangements put in place to exploit these differences do amount to BEPS … If economic functions, assets and risks are effectively relocated to another country to take advantage of a low tax rate or tax credit, this does not constitute BEPS."

10. Action 11 BEPS, p. 83: "120. One possible definition of BEPS could refer to the specific BEPS channels identified in the various actions set out in the BEPS Action Plan. By defining BEPS with reference to the individual BEPS channels, the scale would draw upon the consensus reflected in the BEPS Action Plan. Estimation of the scale of each of the BEPS channels would be closely related to what individual governments would estimate for the fiscal and economic impacts of their country's implementation of specific BEPS Actions."

11. *See*, for instance, the definition of "material tax impact" as the gateway criterion to apply these rules in Action 12 BEPS (*Mandatory Disclosure Rules, Action 12 – 2015 Final Report*, OECD: Paris (2015)), p. 73.

functional concept of ATP in Action 12. In the latter case, it makes a lot of sense to use a concept – ATP – connected with "arrangements with material tax impact" that could help tax administrations identify desirable policy goals without the hassle of having to decide beforehand whether that behaviour is illegal from the perspective of the different tax systems that the tax administrations represent. It should be remembered that, in Action 12, ATP may have been kept because of the link this Action has with the Aggressive Tax Planning Directory kept by the OECD as an initiative for cooperation between tax authorities and the Aggressive Tax Planning Working Party of the OECD (also in charge of Actions 2, 3, 4 and 12).[12] Here, ATP serves to select policy goals, reach practical agreements or work towards a common goal, but it has no normative or legal effect.

In fact, the position of the OECD with regard to the BEPS deliverables of not using the category of ATP (or any other single category or principle) is both clever and astute. First, it avoids the criticism that the concept of ATP attracts,[13] while keeping it as a practical tool in the context of Action 12 and the Aggressive Tax Planning Directory. Second, if the OECD had used the concept of illegitimate avoidance, abuse or any other familiar concept in national systems, it could have been misinterpreted, because avoidance standards are not the same in all countries. By simply using minimum standards and best practices in BEPS, and the vague principle of alignment of tax bases and substantial activity, the OECD is defining desirable policy goals and the standards or international principles to which states should (progressively) adhere.

Nothing more (and nothing less, since, in the end, this is the embryo of a new international standard that did not exist before) could probably have been done by the OECD, since, ultimately, what is permitted or prohibited, what is acceptable or not, depends on domestic law. The problem therefore lies in the domestic authorities and courts when they use ATP as an interpretative

12. *See* http://www.oecd.org/tax/aggressive/.
13. *See* J. Calderón and A. Quintas, *supra* n. 1, at sec. 2, p. 210; A. Dourado, *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*, 43 Intertax 1 (2015), p. 43; and P. Essers, *supra* n. 2, at sec. 2. For instance, Calderón and Quintas see the concept of ATP as having two purposes: (i) creating a new international tax system or paradigm; and (ii) attempting to "curtail and constraint the limits of legitimate tax planning", which "would 'delegitimise' all those tax optimization schemes that operate in the so-called 'grey area'" (i.e. that are not clearly illegitimate tax avoidance or abuse). For the reasons explained in this chapter, the author does not agree with considering this concept as a new paradigm. If there is a new paradigm, it directly derives from BEPS and its standards. Quite another thing is the fact that tax administrations may use ATP in a Machiavellian sense, as P. Essers, *supra* n. 2, at sec. 2, explains.

or quasi-normative benchmark without formally adapting their rules and tax systems to the new (desirable) policies and standards the OECD has defined in the BEPS initiative. BEPS – and this is forgotten by tax administrations and courts that directly use ATP or BEPS outputs – requires a highly relevant exercise of "transformation" of tax systems. Illegal avoidance is a legal standard that is not to be confused with ATP, a practical tool without legal value. Regrettably, ATP is having a tremendous impact on the perception of taxpayers by society in general, even if law and moral or policy judgements should be kept at different levels and, as defended here, the international standards (there is no single standard) already have content (represented by the BEPS Actions) towards which domestic legislation should converge. The international standards, represented by BEPS, really need the help of domestic legislation and legal systems. Otherwise, they will remain ineffective, or worse, they will fuel tax planning if domestic systems are unable to capture the essence of the new standards (especially if some states react to them by promoting themselves as new tax planning hubs and others do not).

Once it is clear that ATP *is not* the standard, but that those standards are represented by the BEPS Actions, are there common features that we may extract from the "BEPS minimum standards"? Or should we stop at this point and say that there is a multiplicity of standards, depending on the BEPS Action in question and how it is implemented in different countries or regions (e.g. the European Union)? There are indeed common features in these BEPS minimum standards, some of them not as satisfactory as they may seem at first sight, others of an undeniable value. Among the latter are the fact that the standards provide very useful materials for defining a coherent policy in tax terms; that outstanding results were achieved in an extremely short period of time; that some of the proposals can be implemented and have noticeable consequences in the short run (either as soft law, for instance by incorporating Actions 8-10 and 13 BEPS in the OECD TP Guidelines,[14] or upon ratification of the Multilateral Agreement

14. P. Saint-Amans and R. Russo, *The BEPS Package: Promise Kept*, 70 Bulleting for International Taxation 4 (2016), Journals IBFD, p. 241, remark that "[s]ome of the revisions may be immediately applicable, such as the revisions to the OECD TP Guidelines, while others may require changes to domestic laws and bilateral tax treaties. Obviously, this depends chiefly on the applicable legal system in the country concerned". The reform of the OECD TP Guidelines to incorporate the amendments derived from Actions 8-10 and 13 BEPS was finally approved by the OECD Council on 23 May 2016 (*see* the press note of 15 June 2016, available at http://www.oecd.org/tax/oecd-council-approves-incorporation-of-beps-amendments-into-the-transfer-pricing-guidelines-for-multinational-enterprises-and-tax-administrations.htm). Whether or not countries accept the immediate application of this new version of the OECD TP Guidelines will also depend on the specific legal system.

or the multilateral framework for automatic exchange of country-by-country reporting (CbCR)); and, above all, that taxpayers engaged in empty tax planning (tax planning without substance) – and countries favouring these types of structures – may suffer considerably in the post-BEPS international context unless they adapt to the new world. The main effect of BEPS may, therefore, be that it reaches a certain degree of (still) nascent harmonization of some desirable principles or delimits a certain concept of substance.

The remainder of this chapter will concentrate on the weaknesses of the new standards (once some of their common features have been identified). It should be clear from the beginning that the rejection of the single-tax principle is one of the consequences of BEPS. This is probably controversial for some sectors[15] and may be welcomed by others. If we are speaking about admitted BEPS and reproachable BEPS, that is because the single-tax principle has not been accepted and double non-taxation/low taxation has not been fully prohibited.[16] In this context, the nexus requirements (in Actions 5 and 8-10 BEPS) with the country applying special tax regimes are rather weak in terms of substance, and this opens up considerable opportunities for tax planning (BEPS within BEPS). The new nexus standards (closely connected with reproachable and permitted BEPS) also mark the limits between permitted and prohibited avoidance. This feature, linked with the fact that BEPS, with limited exceptions, does not represent an exercise of harmonization of the structure of income taxes (e.g. there is no minimum

15. Y. Brauner, *BEPS: An Interim Evaluation*, 6 World Tax Journal 1 (2014), Journals IBFD, p. 28.
16. *See*, for a similar argument, A. Wardzynski, *The Limitation on Benefits Article in the OECD Model: Closing Abusive (Undesired) Conduit Gateways*, 68 Bulletin for International Taxation 9 (2014), Journals IBFD, p. 472; and M. Stewart, *Abuse and Economic Substance in a Digital BEPS World*, 69 Bulletin for International Taxation 6/7 (2015), Journals IBFD, p. 405. F. Vanistendael, *Is Tax Avoidance the Same Thing under the OECD Base Erosion and Profit Shifting Action Plan, National Tax Law and EU Law*?, 70 Bulletin for International Taxation 3 (2016), Journals IBFD, seems to make the assumption that BEPS fights any kind of double non taxation. As will be shown below, this does not hold true in a post-BEPS context. This also means that BEPS may be less problematic in terms of EU law than Vanistendael seems to assume. On the single tax principle, *see* R. Avi-Yonah, *Who Invented the Single Tax Principle? An Essay on the History of US Tax Treaty Policy*, 59 New York Law School Law Review 2 (2015), p. 305 ff., available at http://repository.law.umich.edu/cgi/viewcontent.cgi?article=2662&context=articles. This author does not share, however, Avi-Yonah's assumption that, in the foundational period of the League of Nations, the single tax principle was a policy goal behind the first tax treaty models of the 1920s. It was probably the idea defended by Thomas Adams as the US delegate, but it was not shared by other countries. This is very clear from the positions of other delegates, especially, for instance, when the works on Article 23 of the OECD MC started in the 1950s and 1960s).

level of taxation requirement in terms of rates or configuration of tax bases), is important to the new forms of tax planning.

To explore these points further, it is necessary to reflect on the core of BEPS, on the pillars, if any, of the new minimum standards. A holistic view of the BEPS Actions is needed to know what the new standards are. For this view, it is crucial to understand Action 6 (tax treaty avoidance), Action 7 (permanent establishment (PE)), Actions 8-10 (transfer pricing (TP)) and the connections between them. (Reference will also be made, when appropriate, to Action 5 (harmful tax competition) and its links with Actions 8-10.) The new standards derived from BEPS also entail considerable steps in terms of transparency (Actions 12 and 13 BEPS, although these Actions reinforce Actions 8-10), of limiting – or rather advising limitations on – a number of behaviours that are considered reproachable (in regard to hybrid mismatch arrangements in Action 2 and company debt in Action 4) and of strengthening traditional SAARs, such as controlled foreign company (CFC) rules (Action 3), but the remainder of this chapter will concentrate on those BEPS Actions (6, 7 and 8-10) that are, from the author's standpoint, the most relevant in terms of contributing to set anti-avoidance standards. (Again, reference to other Actions will be made when considered warranted.)

2.3. The core of the new international standards of tax avoidance: Actions 8-10 BEPS (transfer pricing) and their effects upon traditional anti-avoidance instruments

As explained above (*see* section 2.2.), the leitmotif of the BEPS project is that double non-taxation or low taxation is a cause of concern "when it is associated with practices that artificially segregate taxable income from the activities that generate it". The BEPS project was initiated (mainly, although not exclusively) as a reaction against the behaviour of (especially, but again not exclusively, US) MNLs and as a response to the need to adapt international norms to new business models. For MNLs, transfer pricing is a major concern, but it has also been the main (or at least a central) tool for segregating value and tax bases. In this context, a central part of the BEPS project had to do with tax planning techniques of MNLs that revolve around principal company models that combine commissionaires, contract manufacturers and the licensing of intangibles.[17] These models of organization typically

17. *See*, on these structures, J. Andrus and M. Durst, *Standing on "principal": Transfer pricing structures using limited risk manufactures and distributors*, in PwC Transfer Pricing

(even if not in all cases) use legal forms to segregate activity and tax bases in order to make profits arrive in low or no-tax jurisdictions. A main target of BEPS was entities that do not really carry on relevant business functions (or engage in a substantial business activity) but are attributed a substantial part of the profits of an MNL (so-called cash boxes).

Actions 8-10 BEPS are directly linked with the BEPS guiding principle, because they try to (i) reduce the effects of using (formalistic) legal techniques or intermediaries to achieve BEPS outcomes; (ii) define source in a negative (shell companies/cash boxes are given a risk-free rate of return or are even not recognized) and a positive (where value is added to the value chain of the MNE group) form;[18] and (iii) define the economic attributes that act as the main value drivers to which profits should be attached (significant people who control risks and intangibles and contributions to intangible creation).

If considered in connection with other Actions, as will be shown, Actions 8-10 are the "stars of the show", the central concepts to which the other Actions are subordinated. Even in their form and effects, Actions 8-10 take precedence over other Actions through, as mentioned above, their incorporation in the OECD TP Guidelines, which many countries either apply directly or use as interpretative tools. Quite another issue is whether the legal/tax order of most countries is ready to accept the changes that will be brought into the OECD TP Guidelines by Actions 8-10 BEPS. Most countries are probably not prepared for the new standards, and some legislative action needs to be taken (for instance, to recognize the new transfer pricing model they represent and the new forms of intangibles in chapter 6 of the Guidelines and how they are transferred or used by parts of a group that do not really "own" them).

Even if it appears that there is an emphasis on economic reality, it can also be said that the Actions 8-10 BEPS reaffirm legal substance, as a concept opposed to formalistic legal constructions.[19] This is an extremely rel-

Perspectives (2006), pp. 56-64, available at https://www.pwc.com/us/en/transfer-pricing-strategies/assets/transfer-pricing-perspectives.pdf (accessed 1 Apr. 2016).

18. S. Wilkie, *Transfer Pricing Aspects of "Intangibles," "The" License Model and "BEPS" – Appearances May Be Deceiving: "You Don't Do What You Can't Do"*, draft paper presented in Vienna in February 2016 (forthcoming), points out that these actions define a "negative source rule". In this author's view, they also embody a positive formulation of source linked with value creation, control of risk and financial capacity to assume it, and value added to the intangibles of the group.

19. Wilkie, *supra* n. 18, at sec. 3, argues that changes in chapter 1 of the OECD TP Guidelines not only seek to find the economic substance of transactions within an MNL

evant innovation, since structures without the required substance are more clearly than before treated as not attracting any – or a very limited amount of – income (a negative source rule).

The new paradigm that these actions represent has the following features:

– *Limitation of legal forms/intermediaries that add no value and legal risk shifting*: The main change in chapter 1 of the OECD TP Guidelines that Actions 8-10 have brought about is limiting the effects of risk shifting if the "contracts" through which this takes place are not in line with legal reality (identified as the capacity to bear risk and control it). This limits the ability of MNLs to shift risks legally without changing the capacity to control those risks and the people who factually can take decisions on risks (that is to say, without changing the relevant people functions which control the risks and assets). This is a change in paradigm: from transactions, the arm's length principle is now focusing on the "contributions" by the different parts of the MNL to its global business,[20] the effective control of risks (the ability to take decisions on risks) and the capacity to bear them.[21] In this new model, there is considerable uncertainty regarding the relationship between risk control and legal relations, and whether the new model of attribution of profits to parts of the MNL group is really in line with what happens in the marketplace or in some respects produces disproportionate or arbitrary results.[22] With this change, however, transfer pricing rules are not only

but also – and mainly – try to evidence the legal, as opposed to the formal, substance of the relations between members of that MNL.

20. Id.

21. As W. Schön, *International Taxation of Risk*, 68 Bulletin for International Taxation 6/7 (2014), Journals IBFD, especially at pp. 288-290, notes, the focus by the OECD on risk control and the ability of people to oversee activities is controversial, since there are many examples in the market of people contracting without controlling risks and simply relying on the ability of third parties to perform a job (e.g. the relationship of a patient with a doctor or a client with a lawyer, insurance, and corporations in which risk is born by the shareholders but relevant decisions are taken by the managers). J. G. Ballentine, *Ownership, Control, and the Arm's-Length Standard*, 82 Tax Notes International 12 (2016) also emphasizes that the premises of the new model are simply false and the attribution of tax bases to "control", besides not corresponding to the arm's length principle, simply opens up new avenues for tax planning. *See also*, on some of the controversial aspects of risk in the BEPS works, I. Verlinden, D. Ledure and M. Dessy, *The Risky Side of Transfer Pricing: The OECD Base Erosion and Profit Shifting Reports Sharpen the Rules on Risk Allocation under the Arm's Length Standard*, 23 International Transfer Pricing Journal 2 (2016), Journals IBFD.

22. *See* the criticism of Schön, *supra* n. 21, at sec. 3, pp. 288-289, who defends the argument that control of risk cannot be a crucial element in a sound tax policy on "risks", since "a great deal of contractual instruments between independent parties are meant to shift risks away from the person closest to the risk in order to reach efficiency". In this

defining the source of income, they are also occupying the ground of other anti-avoidance rules that have traditionally been used to recharacterize transactions, deny deductions, look through intermediaries that add no or low value, find the real substance of transactions (either real legal or other substance), or regard certain transactions as abusive or artificial.[23] Before anything is done, the initial step is delineation of the transactions – finding where value is added in the group, where risks are actually controlled and where there is capacity to bear them.[24] If that is not enough, the anti-abuse flavour of the delineation of transactions is reinforced by a second tool, the non-recognition (old disregard) principle, which acts as a safety net (a second SAAR) for tax administrations when delineation may not be of help in specific cases (mainly where no comparable transactions are identified and the transactions lack commercial rationality).[25]

– *Intangibles in the value chain, limitation of the legal property of intangibles as a criterion for attributing profits and the overvaluation of*

context, he rightly defended the argument that the notion of control should be limited to safeguards usually established between independent parties. *See also*, for instance, on the effects of the new approach, Verlinden et al., *supra* n. 21, at sec. 3, p. 113, who explain the differences between special purpose vehicles (SPVs) investing in real estate before and after BEPS, where, as is usual, control of risks is not in the SPVs. The classic approach would attribute most of the rent of exploiting the real estate to the SPV, whereas, under the new approach, the investors will be attributed that return. They also criticized the fact that, despite the attention initially given by the BEPS project to cash boxes, the OECD has not developed much guidance on how to treat them.

23. There are considerable differences in the scope, procedure and techniques of applying transfer pricing rules and traditional anti-avoidance standards. While most of those differences still exist, transfer pricing rules are entering a ground that was previously reserved to traditional anti-avoidance devices and, therefore, they reduce their scope and field of application. This has the interesting and probably sought-after effect of easing access to mutual agreement procedures (MAPs) in tax treaties, since, as is known, many countries deny access to MAPs where anti-avoidance rules or doctrines are applied at the domestic level.

24. This effect is, somehow, recognized by Action 4 BEPS, since, before the “interest barrier” defined as good practice in that Action is applicable, the transaction must be characterized as a “loan”. If it is not – because it is regarded as equity contribution under transfer pricing legislation – then the interest barrier will not apply. Another example is that if “inventory or product” risks are not in fact factually controlled by a foreign affiliate that has the capacity to bear those risks, there is no need to apply anti-avoidance doctrines to “disregard” the legal attribution of risks to that subsidiary. This effect can be achieved with transfer pricing rules.

25. *See* para. 1.119 ff., especially paras. 1.122 and 1.123 of ch. 1 OECD TP Guidelines, as reformed by Actions 8-10 BEPS. This principle has already a tradition in the (old) OECD TP Guidelines, and especially chapter IX, on business restructurings, added in 2010. The substance-over-form prong of the old disregard has now been turned into the “delineation of the transaction”.

intangibles as a profit driver:[26] In a world of global value chains, the OECD's first BEPS Report, *Addressing Base Erosion and Profit Shifting*, remarked that, "[f]rom an economic point of view, most of the value of a good or service is typically created in upstream activities where product design, R&D or production of core components occur, or in the tail-end of downstream activities where marketing or branding occur. Knowledge-based assets, such as intellectual property, software or organizational skills, have become increasingly important for competitiveness and for economic growth and employment".[27] It is not surprising, therefore, that Actions 8-10 BEPS recognized the importance of intangibles in the reform of chapter 6 of the OECD TP Guidelines, gave a broad definition of intangibles (broader than the definition of royalties in Article 12 of the OECD Model Convention (OECD MC) and encompassing not only legally protected intangibles or those included on balance sheets for accountancy purposes but also intangibles that have none of those features) and attributed to them "value within the group value chain". Correct delineation of the value chain is, therefore, linked to identification of intangibles within the group and exercise of development, enhancement, maintenance, protection and exploitation (DEMPE) functions in connection with intangibles. But, as in the case of risks, intangible DEMPE functions must be real – not legal, paper – functions that are in reality carried on by other parts of the MNL. Real (not simply legal) DEMPE functions in respect of intangibles will mean attribution of (especially residual) profits to those parts of the MNL that develop, control and add value to the intangible, in proportion to the value added or contributed, and less attribution of profits to those parts that exercise routine functions without having real control over the central valuable elements of the value chain (e.g. contract manufacturers and low-risk distributors, unless an intangible or unique contribution can be attributed to them)[28] or to the formal legal owners of the intangible or to those entities that only contribute to fund

26. On intangibles in the BEPS project (Actions 8-10), *see* Wilkie, *supra* n. 18, at sec. 3.
27. BEPS Action Plan 2013, p. 27.
28. This point has been confirmed by M. De Ruiter, at that time head of the tax treaty, transfer pricing, and financial transactions division of the OECD, who was quoted as follows: "If you have a very routine distribution activity, but for whatever reason you don't have a comparable for that country or region, why would you go to a profit Split? I think the method is still that you would go to either a resale minus or TNMM, but not to a profit Split". *See* R. Finley, *No Global Consensus on Profit Splits*, 81 Tax Notes International 12 (21 Mar. 2016), p. 1011. As is known, the Chinese approach is to consider local distribution subsidiaries the economic owners of marketing intangibles and, therefore, a profit split is needed to recognize the value of their contributions (*see also* Finley, *supra*, p. 1011).

the projects without having real material resources to add value. That issue is central in BEPS, since it seems that intangibles absorb a good part of the residual profits of an MNL, reducing the value of, for instance, labour and capital.[29] This clearly produces a bias in favour of more technologically advanced countries and against less-developed countries (where "low value adding labour" – i.e. labour not connected with intangibles – is used or routine functions are undertaken) and market states (although the final distribution of tax bases between countries may depend on the final works of the OECD on profit splits[30] and the attribution of profits to PEs as a consequence of Action 7 BEPS, which are not yet finished).[31] It may also create new forms of BEPS in combination with the special regimes for intellectual property under Action 5 BEPS or others that may be created.[32] The fact that payments for use of intangibles are usually deductible by the payer and there are no withholding taxes for royalties and services in the OECD MC certainly helps (the concept of royalties has evolved so as to reduce its impor-

29. *See* on this issue, for instance, R. Tavares and J. Owens, *Human Capital in Value Creation and Post-BEPS Tax Policy: An Outlook*, 69 Bulletin for International Taxation 10 (2015), Journals IBFD, who emphasize the functions of capital, labour and even tangible assets, as well as other factors not taken into account in the BEPS project. *See also*, for instance, M. Kane, *Labour Rents, Arm's Length Transfer Pricing and Intangibles: Still Searching for a Solution to the BEPS*, 69 Bulletin for International Taxation 6/7 (2016), Journals IBFD, who argues that the treatment of location savings as comparability factors rather than as intangibles may have the effect of reducing the weight of labour in the multinational structure and the attribution of profits to labour in favour of intangibles, which attract most of the residual value of MNE groups. Kane also concludes that "[a]s so-defined [in the OECD TP Guidelines] intangibles exclude location savings as a technical matter but, nonetheless, have the odd characteristic of likely reflecting location savings to the extent that any residual value ends up being attributed to them. The unhappy result is the likely under taxation of the labour rents".

30. Contrary to common assumptions, profit splits can also operate to the detriment of countries and be used to redistribute losses even in cases in which principal-commissionaire/licence models are implemented, provided that the companies to which they are applied are not purely "routine" ones; *see* P. De Homont and A. Voegele, *From Principal to Profit-Split*, International Tax Review (9 Mar. 2016) (on-line version); and T. Braukmann, P. De Homont, and A. Voegele, *Implementation of Profit Splits*, International Tax Review (30 Mar. 2016).

31. *See* Draft on Action 7 BEPS: *Additional Guidance on the Attribution of Profits to PEs*; and Draft on Actions 8-10 BEPS: *Revised Guidance on Profit-Splits*, both released by the OECD for comments on 4 July 2016.

32. For instance, the Swiss 3rd Corporate Tax Reform combines, among other incentives, a patent box, a super deduction for R&D (up to 150% of expenses) and a step-up and amortization for hidden reserves and goodwill created when the company was abroad or which relates to reallocation of assets or functions into Switzerland. *See* T. Boitelle and A. Kanani, *Memo Bonnard Lawson Law Firm on "3rd Swiss Corporate Tax Law Reform"* (16 June 2016), available at http://www.ilf.ch/wp-content/uploads/3rd-Swiss-Corporate-Tax-Reform-Update-8-June-2015.pdf. (accessed 15 July 2016).

tance in the OECD MC, with the effect of eliminating the risk of withholding taxes when the source country insists on having withholding taxes for royalties by transferring concepts to the category of business profits).[33]

– *The relevance of functions and effective control of risks and intangibles reduces the relevance of law, increases the importance of subjective economic judgements and, in the end, may facilitate tax planning*: The emphasis in Actions 8-10 BEPS on effective control of risks and, therefore, significant people functions, and the broad concept of intangibles that covers categories that are not traditionally recognized in tax, legal or accounting systems may introduce tensions within the BEPS minimum standards, since, in the end, an emphasis on economic factors at the expense of legal definitions and concepts may facilitate tax planning of MNLs (or, more generally, companies doing business internationally). Taxable events usually depend on legal definitions, and, in the system arising out of Actions 8-10 BEPS, it seems that reallocation of functions and people and, with them, some of the new categories of intangibles and risks (also with regard to intangibles) may dramatically facilitate tax planning.[34] In the context of paragraph 118 of Action 11 BEPS, it is recognized that if economic functions, assets and risks are effectively relocated to another country to take advantage of a low tax rate or tax credit, this is not (reproachable) BEPS. Business restructurings of this kind are, obviously, not opposed by the OECD, even if tax reasons are one of their main drivers.[35] From that, it seems that, in the post-BEPS order, it will be easy to have substance in a jurisdiction, because this concept is identified with control of (as well as capacity to bear) risks and intangibles, that is to say, with significant people who

33. *See*, on the concept of royalties in Art. 12 OECD MC, A. Martín Jiménez, *Article 12: Royalties*, in R. Vann (ed.), Global Tax Treaty Commentaries, Amsterdam: IBFD (online publication).

34. On this, J. Wittendorff, *BEPS Actions 8-10: Birth of a New Arm's Length Principle*, Tax Notes International (25 Jan. 2016), p. 332, in connection with the new approach rightly explains: "Hence, the trend of transfer pricing planning could be decentralization of decision-making to ensure value creation in low-taxed enterprises. Even better would be decentralization of decision-making in low-taxed enterprises, because intangible profits may now be shifted to a low-tax country without a transfer of intangibles – that is, without exit taxation. From a tax planning perspective, the new arm's-length principle offers the best of all worlds". *See also* S. Picciotto, *Taxing Multinational Enterprises as Unitary Entities*, Tax Notes International (30 May 2016), p. 905; and *see* Ballentine, *supra* n. 21, at sec. 3, for similar remarks.

35. *See* ch. 9 OECD TP Guidelines (2010-2016) on those business restructurings; and the OECD Draft on *Conforming Amendments to Chapter IX of the Transfer Pricing Guidelines*, released for comments on 4 July 2016.

control risks or are attributed relevant intangible functions and risks. Therefore, a few significant people can be the *situs* of the main valuable parts of the global value chain so that they attract a substantial amount of income (nexus in Action 5 has a relatively stronger definition of substance by virtue of its focus on expenditures).[36] It will be relatively easy, therefore, to move risks, their control and valuable contributions to intangible value from one jurisdiction to another without triggering taxation, unless there is effective legislation in the relevant states on how to tax the shifting of risks (though changes in control of risks) and contributions to intangible value. In order, therefore, to really mitigate this form of tax planning, countries should make efforts to accommodate their tax and legal systems to the new reality (value chains, intangible overvaluation and attraction of profits, recognition of the transfer of intangibles even if not registered for legal or accounting purposes, exit and entry of functions that control risks or are connected with the value of intangibles etc.); otherwise, they will suffer the consequences from competition of jurisdictions that may try to attract the profit-driving activities of the new BEPS model. The new context, together with Action 5 BEPS, and the possibility of giving preferential regimes to intangibles (patent boxes) if certain requirements are met or other special regimes that states may design[37] will give MNLs considerable room to manoeuvre to achieve low or no taxation. Therefore, special emphasis on significant people who control risks and intangibles at the expense of capital and labour is the main weakness in the system and may have the consequence that global value chains will concentrate their profit-attracting assets (intangibles) and functions (controls of risks) in

36. In fact, one of the issues in the new standard is that it does not clarify how much outsourcing of activities is permitted. For instance, as D. Wright, H. Keates, J. Lewis and L. Auten, *The BEPS Action 8 Final Report: Comments from Economists*, 23 International Transfer Pricing Journal 2 (2016), Journals IBFD, at p. 102, wonder: "Can a shell company with only one (active) director outsource all the functions needed to manage the intangibles that it legally owns? If the answer is 'no', how much can be outsourced and still justify intangible income in such an entity?" The focus on the control of risk without really setting the standard of substance facilitates outsourcing to related or unrelated parties and profit attribution to jurisdictions where the principal employees that "control" risk are located or simply exercise control, even if not much is going on in that jurisdiction. *See*, for a similar argument, Schön, *supra* n. 23, at sec. 3, p. 289-290; and Ballentine, *supra* n. 21, at sec. 3 (at p. 1180, he explains that "the concept of control is not precise and open to wide interpretation. The OECD should be concerned by the army of tax advisers in the private sector ready to help taxpayers with new arrangements for control. They can plan to set up oversight panels, management committees, review boards, and lines of reporting anywhere in the world to establish where control is actually exercised").

37. As mentioned above, *supra* n. 32, the new 3rd Swiss Corporate Tax Reform clearly "understands" this reality, with the combination of patent boxes, super R+D deductions, step up and amortization of hidden reserves and goodwill.

> low-tax jurisdictions to avoid relevant presence in others. Exposure to high-tax countries may be limited by outsourcing or by using low value adding subsidiaries there while locating significant people/functions in low-tax jurisdictions.[38] The subjectivity of the economic analysis behind transfer pricing also provides MNLs considerable room for bargaining and negotiation with tax authorities (and tax authorities considerable room for bargaining and negotiation with each other), which also incurs risks of over-attribution of income to the most powerful and dominant players (either MNLs or states) and of generating conflicts.[39]

In terms of fighting avoidance, the reform of the OECD TP Guidelines and its emphasis on economic reality and substance (represented by delineation of the real transactions, factual control of/capacity to bear risks and the concept of intangibles) over legal form clearly, in the author's view, seeks to turn transfer pricing norms into the main anti-avoidance rule applicable to MNLs. Transfer pricing rules are conceived of now as a sort of SAAR that will displace the use of GAARs against MNLs in the context of related-party transactions.[40] This centrality of transfer pricing rules as an anti-avoidance norm has advantages: it avoids discussions on whether there is "avoidance" – with all the attendant problems of different standards, dif-

38. *See* Tavares and Owens, *supra* n. 29, at sec. 3, p. 599. The new trend of outsourcing to third parties, as they show, will have the effect of also creating third-party comparables that MNLs could use. In this respect, in the author's opinion, it is quite likely that, due to the force of attraction of intangibles in the post-BEPs world, they will not even need outsourcing to third parties, and it will be enough to simply keep some subsidiaries as low-risk, low-margin entities that do not contribute, as such and by themselves, to value creation of the intangibles within the group. The author, however, agrees with Tavares and Owens (*loc. cit.*) that, in the post-BEPS world, "the lion's share of the tax base would remain attributed to low-tax intermediaries operating under BEPS-compliant 'knowledge boxes'", probably combined with other incentives (like the 3rd Swiss Corporate Tax Reform). The structure of the OECD MC will continue to facilitate this outcome, with no taxation at source, if the recipient in the residence country meets the requirements of Action 5 (*see* section 2.5.3. on the special tax regimes provisions that derive from Action 6 BEPS). *See* Martín Jiménez, *supra* n. 33, at sec. 3. This, as Tavares and Owens, *supra* n. 29, at sec. 3, p. 600 note, leads to a world in which accumulation of residual knowledge-based capital in low-tax countries will continue to be the rule, "albeit in some case, perhaps, in different countries or with added personnel … capital-rich 'knowledge boxes' that meet minimum activity requirements would become the norm".

39. *See*, for a similar opinion, R. Avi-Yonah and H. Xu, *Evaluating BEPS*, 6 Harvard Business Law Review (2016), p. 181 at 224-227.

40. The anti-avoidance nature of transfer pricing rules in the OECD materials is stressed by Saint-Amans and Russo (the two persons mainly responsible for the BEPS project), *supra* n. 14, at sec. 3. When referring to the reform of the OECD TP Guidelines, they explain the following: "In the area of transfer pricing, the guidance on the arm's-length principle has been updated to ensure that what dictates the results is the economic rather than the purely legal reality. What is, in effect, an anti-avoidance principle cannot and should not be applied to achieve the very results it is intended to prevent".

ferent institutional and procedural rules, and the reputational risks of labelling a structure or transaction as abuse in different countries[41] – by transferring technical points to the more familiar and technical transfer pricing area. But this is also the Achilles heel of the BEPS project, since, as shown, by using real control of risks, defining intangibles and intangible-related significant people functions so broadly and placing intangibles at the centre of the value drivers of a MNL, the new standard may facilitate the tax planning work of MNLs within the new parameters defined by BEPS.[42] This can also have devastating effects for countries (mainly, but not exclusively, developing countries) that do not have the capacity to administer what is indeed a very complex model. For them, alternative standards, or at least a temporary regime until they achieve further stages of development and administrative capacity, are probably desirable. It also remains to be seen whether other, more developed, countries will accept the BEPS core idea of placing transfer pricing at the centre of anti-avoidance norms and standards and will adapt their legislation accordingly.

Even if the central features of the new anti-avoidance standard can be found in Actions 8-10 BEPS, it is important to consider their interaction with other Actions to develop a full picture of the minimum standards derived from the BEPS project.

2.4. The PE definition as an instrument for enforcing the BEPS anti-avoidance standards (or to avoid taxation at source): Action 7 BEPS

The PE concept/threshold in Article 5 of the OECD MC has been recognized as one of the principal factors that causes BEPS, since, in the end, it permits ready disaggregation of economic activity in a given jurisdiction from taxation there.[43] It has always been easy to avoid having a PE (a

41. For a summary of the main problems of different GAAR standards, *see* Stewart, *supra* n. 16, at sec. 2, pp. 407-408.
42. It may also have the effect of increasing conflicts, since, in the end, the contours of the new concept of risk or the broad concept of intangibles and their valuation and valuation methods are not clearly defined. Confusion also increases the risk of deals between taxpayers and auditors that simply seek a satisfactory solution for both parties (on this last point, *see*, for instance, Verlinden, et al., *supra* n. 21, at sec. 3; and Wright et al., *supra* n. 36, at sec. 3).
43. *See* A. Martín Jiménez, *Preventing Avoidance of Permanent Establishment Status*, in A. Trepelkov, H. Tonino and D. Halka (eds.), *UN Handbook on Selected Issues in Protecting the Tax Base of Developing Countries*, New York: UN (2015), and the bibliography there cited.

fixed place of business or dependent agent PE, as defined in Article 5 of the OECD MC) in a jurisdiction and still conduct significant activity there: it is enough to avoid having a fixed place PE to fragment activities in that jurisdiction (in different forms) in order to invoke Article 5(3) (the less than 12 months' threshold) or Article 5(4) of the OECD MC, or to avoid a dependent agent PE under Article 5(5) of the OECD MC. By being applied to a stream of income linked to a fixed place of business or dependent agent PE, not to a taxpayer; by attributing a strict configuration to the commercial and geographical coherence test in Articles 5(1) and 5(3) to avoid "accumulation" of different fixed places of business as PEs; by setting a high threshold for dependent agents to become PEs (a person who habitually concludes contracts in the name of the non-resident taxpayer); and by recognizing the legal independence of companies of the same group, the PE concept has given taxpayers and MNLs the tools to legally avoid having taxable presence (PE) in a jurisdiction.[44] The PE threshold is even easier to avoid with new business forms and the digital economy.

Due to how the PE concept was defined – its function and configuration – it is difficult to say that it is against the spirit of the PE concept to avoid taxable presence in a jurisdiction, since that is the precise goal that the concept is meant to achieve: taxation at source will only occur when a very substantive threshold – that of Article 5 of the OECD MC – is met (the cliffs effect of the PE concept). Article 5 of the OECD MC is there to facilitate free trade, not to protect source countries. It is not strange, therefore, that, historically, the OECD has also been inclined to limit the effects of anti-avoidance theories and norms in the context of Articles 5 and 7 of the OECD MC as instruments in the hands of source countries to attack those taxpayers avoiding a PE in their territory (e.g. commissionaires and contract-manufacturer models, remote activities supported by local subsidiaries, fragmentation of activities and contracts etc.).[45] In the context of Article 5 of the OECD MC, the threshold to find avoidance has been rather high, and the OECD, instead of resorting to "a" or "one principal" purpose test, has tended to defend the position that only artificial avoidance of PE status for purely tax-driven reasons can be attacked with anti-avoidance norms.[46] The recognition of

44. On this issue, *see* Martín Jiménez, *supra* n. 43, at sec. 4.
45. That the drafters of Art. 5 OECD MC preferred to protect free trade at the expense of permitting tax-motivated fragmentation of activities to avoid source country taxation is clear from the 1958 *OEEC Report on the Allocation of Profits to PEs and Subsidiary Companies*, FC/WP 7 (58) 1, 4 Sept. 1958. Only the most problematic cases of fragmentation could be attacked with anti-avoidance norms; *see* Martín Jiménez, *supra* n. 43, at sec. 4, p. 349.
46. On this issue, *see* Martín Jiménez, *supra* n. 43, at sec. 4, especially pp. 356 ff. A couple of examples are enough to understand the anti-avoidance test that the OECD applied

the legal personality of the companies within a group has worked in the direction of solving conflicts with transfer pricing norms, the application of which has traditionally been preferred over classical GAARs in this context.

The BEPS minimum standards have changed this reality in a very limited form: Action 1 BEPS (digital economy) had no concrete outcomes, whereas Action 7 BEPS (preventing the artificial avoidance of PE status) has lowered, with limited effects, the PE threshold of Article 5 of the OECD MC (it has included commissionaires within the concept of PE by reforming Article 5(5) and 5(6); it has limited the effects of Article 5(4) and the concept of preliminary and auxiliary activities; it has proposed an anti-fragmentation clause in the context of Article 5(4); and it has addressed the fragmentation of contracts that try to avoid the construction work PE of Article 5(3)). But by lowering the threshold of Article 5 in a very limited (and unclear) manner that permits the conduct of considerable activities within a jurisdiction without having a PE and by maintaining the legal independence of subsidiaries of an MNL in Article 5(7), Action 7 BEPS, in connection with Actions 8-10, renders it enough to have only limited functions and control of risks within a jurisdiction and the most valuable intangibles outside that jurisdiction to be able to conduct business activities there without being taxed, or being taxed in a limited form (for example, as long as a subsidiary in a given jurisdiction only undertakes limited or "routine" functions – such as a contract manufacturing or low-risk distribution activities – there, profits attributable to that jurisdiction will remain low). In the post-BEPS world, the OECD continues to prefer transfer pricing rules for attributing income to source countries to lowering the PE threshold, since it contends that the changes to the OECD TP Guidelines deriving from Actions 8-10 BEPS will permit attributing sufficient income in source country jurisdictions where subsidiaries of MNLs operate. This is probably true where real functions

in this context. The OECD document *Issues Arising under Art. 5 (Permanent Establishment) of the Model Tax Convention*, in *Issues in International Taxation: 2002 Reports related to the OECD Model Tax Convention*, OECD: Paris (2002), at para. 100, admitted that, in a case of business restructuring with an evident tax planning flavour, the transaction could only be attacked if it was "exclusively tax motivated". Similar conclusions can be inferred from the reform, in 2010, of chapter 9 of the OECD TP Guidelines, on business restructurings, where principal-commissionaire models and fragmentation of activities were similarly viewed as only attackable from a transfer pricing perspective, which, in fact, limited the application of GAARs in these cases (*see*, for instance, para. 9.182 and Example A in para. 9.188 OECD TP Guidelines). The new OECD Draft on *Conforming Amendments to Chapter IX of the Transfer Pricing Guidelines*, released for comments on 4 July 2016, also endorses these ideas, especially with its strong support for the arm's length standard in para. 9.6. and the exclusion from within its scope of anti-abuse rules in paras. 9.6 and 9.8; it seems to forget that the anti-abuse nature of the transaction is already assessed under the new transfer pricing principles.

(and therefore risks) and intangibles are kept within a jurisdiction and risks, functions and intangibles are only moved via legal contracts. However, the new standard also gives a wide margin to locate in source jurisdictions activities that attract less profits (e.g. contract manufacturers, limited risk distributors and some service companies) without having a PE and permits conducting activities in jurisdictions without any relevant presence (e.g. through outsourcing activities to third parties to avoid the PE threshold or using digital-economy models). In sum, it will still be easy to avoid having a PE in a jurisdiction. In this context, Action 7 BEPS reinforces the outcomes of Actions 8-10 BEPS and the model they propose: it strengthens and enhances the tax planning avenues that those Actions open up. The OECD's (flawed) *Public Discussion Draft BEPS Action 7: Additional Guidance on the Attribution of Profits to Permanent Establishments* (2016) reinforces these conclusions and renders meaningless the (limited) outcomes of Action 7 BEPS.

Action 1 BEPS (digital economy) reveals that the current situation is unsatisfactory. It considers new possible thresholds, below the PE concept of Article 5 of the OECD MC, for countries of destination of services or goods (this includes equalization levies and withholding taxes), but none of them has been really used or supported to change one of the tenets of the OECD MC, the PE principle. Discontent with this situation has lead some countries to try to supersede the PE threshold by means of new forms of taxation – the diverted profits tax in the United Kingdom, the Australian multinational anti-avoidance law,[47] the Indian equalization levy on internet advertising[48] and the Turkish virtual PE tax[49] – or by heterodox interpretation of the

47. For an official explanation of the new Australian provision that is designed to counter the schemes adopted by multinational enterprises (MNEs) to limit their taxable presence in Australian, *see* the official guide to how the Australian Tax Office (ATO) intends to apply the multinational anti-avoidance law (MAAL), available at www.ato.gov.au/law/view/pdf/psr/lcg2015-002.pdf (accessed 15 July 2016).

48. *See* D.P. Sengupta, *The Indian Equalisation Levy*, taxindiainternational.com (2016), available at http://www.taxindiainternational.com/columnDesc.php?qwer43fcxzt=MjQ1(last access 15 July 2016); and A. Mehta, *"Equalization Levy" Proposal in Indian Finance Bill 2016: Is It Legitimate Tax Policy or an Attempt of Treaty Dodging?*, 22 Asia-Pacific Tax Bulletin 2 (2016), Journals IBFD.

49. *See* A. Devranoglu, *Turkey Introduces Electronic Place of Business Concept*, International Tax Review (25 Apr. 2016), available at www.internationaltaxreview.com/Article/3548543/Turkey-introduces-electronic-place-of-business-concept.html?utm_source=Compliance%20Management&utm_medium=email%20editorial&utm_content=Editorial&utm_campaign=635968432652711823&utm_term=Turkey%20introduces%20%u2018electronic%20place%20of%20business%u2019%20concept (accessed 15 July 2016).

concept of PE – in Israeli[50] and Spanish administrative decisions and case law.[51] In the end, all of these innovations, with their differences, represent forms of circumventing the BEPS minimum standard (threshold for source country taxation) represented by Actions 1, 7 and 8-10. The same can be said of the new technical services article in the UN MC (and the royalty withholding tax in Article12 of the UN MC).

In the context of this work, what Action 7 BEPS really proves is that transfer pricing, with its reinvigorated anti-tax avoidance purpose after Actions 8-10 BEPS, is the preferred standard for the OECD to fight cases of avoidance for source countries, reducing the effects of GAARs from the source country perspective in respect of attacking structures that try to avoid taxation there. It can even be argued that, by admitting a limited reduction of the PE threshold, the OECD has reinforced the status quo – the preference for transfer pricing rules and the limited application of GAARs in this context to attack only purely or exclusively tax-motivated cases (which, as argued, is in contrast with the "one principal purpose" test that derives from Action 6).

What is really surprising in Actions 1 and 7 BEPS is that, in a world of legal (or economic) substance, as defended in the BEPS Action Plan in general and, in particular, in Actions 8-10, the PE threshold is still an empty form that really does not reflect the activities carried on within a jurisdiction and even permits taxpayers to avoid taxation there based on tests that are in fact formal and do not see through those forms to actually take into account the substance of what is going on in a jurisdiction.

50. *See* EY Alert: *Israeli Tax Authorities publish official circular on internet activity of foreign companies in Israel* (15 Apr. 2016), available at http://www.ey.com/Publication/vwLUAssets/Israeli_Tax_Authorities_publish_official_circular_on_internet_activity_of_foreign_companies_in_Israel/$FILE/2016G_00570-161Gbl_Israeli%20TAs%20publish%20official%20circular%20on%20internet%20activity%20of%20foreign%20companies%20in%20Israel.pdf (accessed 15 July 2016).

51. *See*, on this, A. Martín Jiménez, *The Spanish Position on the Concept of Permanent Establishment: Anticipating BEPS, Beyond BEPS or Simply a Wrong Interpretation of Art. 5 OECD Model*?, 70 Bulletin for International Taxation 8 (2016), Journals IBFD, in which the *Borax*, *Roche* and *Dell* decisions of Spanish Courts are studied in the context of Action 7 BEPS.

2.5. The residual nature of Action 6 BEPS in the definition of the new anti-avoidance standards

2.5.1. The anti-avoidance standards proposed by Action 6 BEPS

The interaction of Action 6 BEPS (preventing the granting of treaty benefits in inappropriate circumstances) with (mainly) Actions 8-10 BEPS has interesting features: in fact, it can be said that it really is the same relationship a GAAR (Action 6) has with a SAAR (Actions 8-10); or, rather, that Action 6 confirms the pre-eminence of transfer pricing as a central anti-avoidance tool in the (new) international context.

Action 6 BEPS is not yet finished, because the United States did not release its updated model tax treaty (the US MC) until February 2016. The final deliverable on this Action by the OECD is still expected. Action 6 is addressed at avoidance of tax treaties, even though it was impossible to define a valid and universal solution for tax treaty avoidance because of the diverging views of the United States (mainly) and other countries (including the European Union).[52] It has proposed minimum standards that are based on the following:

- a clarification (title, preamble) on the part of the contracting states that treaties wish to prevent tax avoidance and treaty shopping;
- an LOB clause;
- an LOB clause complemented by a PPT rule (which, in reality is a lower standard, since the OECD refers to a "one" principle purpose test and not to "a" principal purpose test); and
- the possibility that some states may want to use only the (one) PPT rule and not an LOB clause.[53]

The main goal of this Action is to limit access to treaty benefits for those that do not have sufficient "allegiance" with the two contracting states that are parties to a treaty. It seeks, therefore, in coherence with the BEPS guiding principle, to eliminate "double non-taxation or reduced taxation through tax evasion and avoidance, including treaty shopping in this category".[54]

52. On 19 November 2015, the European Commission announced that it had opened an infringement procedure regarding the LOB clause of the tax treaty between the Netherlands and Japan (European Commission Fact Sheet, *November Infringements Package: Key Decisions*, Memo 15-6006, available at http://europa.eu/rapid/press-release_MEMO-15-6006_en.htm).
53. Paras. 19-20 Action 6 BEPS.
54. Para. 22 Action 6 BEPS.

Not all forms of double non-taxation are, therefore, prohibited – only those characterized as tax avoidance and evasion with the standard defined by Action 6 BEPS.

There are two issues that stand out in this Action: (i) the relationship of the prohibition rules (LOB and PPT) to other Actions of the BEPS Action Plan; and (ii) the clarifications as to what type of double non-taxation is permitted or prohibited. Both of them are helpful for understanding the new minimum standards derived from BEPS in terms of legal and illegal tax avoidance.

2.5.2. Action 6 BEPS as a standard subordinated to that defined in Actions 8-10 BEPS

This is not the place to describe the main features of LOB clauses or the one principal purpose test, so this chapter will focus on how Actions 8-10 BEPS are connected with Action 6. In LOB clauses, which are designed to deal with triangular situations, it is not enough to be a resident of a contracting state to have access to a double tax treaty: that resident must also be a qualified person (as defined in the LOB clause); must actively conduct a business in a contracting State (for certain items of income); must be an equivalent beneficiary; or must go to the residual clause on competent authority granted access to the tax treaty.[55]

The effects of the active-conduct-of-business test ("active trade or business" in the US MC) are the most interesting ones for the purposes of this chapter. Under this test, a resident of one of the contracting states that is not a "qualified person", as defined in the LOB clause, can still have access to the benefits of the treaty if (a) that resident carries on a business in that state (other than making and managing investments) and the item of income derived from the other state is connected, or is incidental, to that business; and (b) the income is derived by that resident or from a related person in the other contracting State – the condition is met if the business carried on in the state of residence of the party deriving the income is substantial in relation to the business carried on in the other state (this will be determined on the basis of facts and circumstances). The detailed version of

55. *See*, for instance, G. Cooper, *Preventing Tax Treaty Abuse*, in A. Trepelkov, H. Tonino and D. Halka (eds.), *UN Handbook on Selected Issues in Protecting the Tax Base of Developing Countries*, New York: UN (2015), for a good explanation of LOB clauses and Action 6 in general; *see also* C. Fleming, *Searching for the Uncertain Rationale Underlying the US Treasury's Anti-Treaty Shopping Policy*, 40 Intertax 4 (2012), for an explanation from the perspective of the United States as a source country.

the active-conduct-of-business clause, however, adds a letter (c) to the test, whereby the activities conducted by persons connected to a person shall be conducted by such a person (a connected person is defined in terms of common control of at least 50% of the beneficial ownership). It is important to remark that, under this test, no general access to a treaty is granted to the taxpayer, but only access with regard to the items of income that qualify under the conduct of business test.

The conduct of business test gives a broad margin for tax planning.[56] It is true that headquarters are excluded from this test (although this is more nuanced in the US MC (2016), and this exclusion will probably be modified in the final version of Action 6 BEPS), but, in other situations, there is considerable room to manoeuvre:

– From the examples the OECD gives (R+D activity in connection with royalties received from other related companies (paragraph 50 of Action 6 BEPS, example 2)) a no or low-taxation situation can arise if, for instance, a patent box in the state of residence is combined with royalties derived from the other states. This means that, by placing an R+D centre in that state, a resident of a third state may gain access to the treaties of the state in which the R+D centre is located. As explained below, the R+D centre may have less substance than it may at first appear. It should obviously respect the modified nexus approach proposed by Action 5 BEPS to have a preferential tax treatment, but some countries may decide not to apply that approach in order to make the most of the margin that the nexus approach attributes, to take advantage of the grandfathering periods for old R+D reductions or to give other (for instance, regional) tax base or credit incentives that are not subject to conditions.

– The conditions of the active trade of business test are also laxer if income from the active conduct of trade is derived from non-related parties (e.g. services to consumers or unrelated companies provided remotely in the other contracting state).[57]

– The active trade of business test does not have a base erosion condition, which may mean that the state in which the trade is conducted may not

56. This has been traditionally pointed out by tax scholars in the United States; *see*, for instance, Fleming, *supra* n. 55, at sec. 5.2 (although, in this case, from the perspective of the United States as a source country).
57. *See*, for instance, the example in para. 56 Action 6 BEPS.

be able to tax a considerable tax base if payments are made to other (related or unrelated) parties.[58]

– But what really stands out is the accumulation clause for connected parties in the detailed version of the active business test clause: it does not require meeting the test that the activities of connected persons (defined in terms of control) are carried on within the same state in which the entity claiming the treaty benefits is a resident. This leaves a considerable margin for the resident entity to outsource or fragment activities to related persons in a third state while still taking advantage of the tax treaties of the state in which the trade or business is carried on.[59] Action 6 BEPS defines the term "business" by reference to domestic law, but it clarifies that "[a]n entity generally will be considered to be engaged in the active conduct of a business only if persons through whom the entity is acting (such as officers or employees of a company) conduct substantial managerial and operational activities". This may mean that, as in US LOB clauses, an entity acting as a principal that outsources its activities is entitled to treaty relief for activities connected with its main line of business.[60] This fits perfectly with the new framework of Actions 8-10 BEPS, in which substantial economic activity is identified with factual control over risks, the capacity to bear them or significant people functions in connection with risks, which also admits outsourcing models where an entity oversees, manages or controls the activities of other controlled parties, as long as all of them are remunerated at arm's length. This will mean that, as long as enough substance, in terms of functions and control over risks and the capacity to bear them, is located in a country, it will be possible for third-country groups to have access to treaties signed with third states where the entity controlling the business is located, which gives a lot of leeway in terms of tax planning.

– The link between the item of income derived from the state of source and the activity conducted in the state of residence is also rather broad in paragraphs 50-51 of the commentary on the LOB clause in Action 6 BEPS once it is permitted that "parallel" (not only downstream and

58. Cooper, *supra* n. 55, at sec. 5.2, p. 307.
59. This point is made by R. Tavares, *The "Active Trade or Business" Exception of the Limitation on Benefits Clause*, in M. Lang, et al. (eds.), *Base Erosion and Profit Shifting (BEPS)*, Wien: Linde (2016), at p. 145: "[T]he interposed legal entity in residence state R could seek benefits under a bilateral treaty with source state S, and justify entitlement to such benefits with 'business activities' entirely outsourced (or fragmented) to related persons in a third state X with which source state S does not have a treaty in force."
60. Id., at sec. 5.2, p. 148.

> upstream) activities are included within the concept. Parallel – or even complementary – activities may not necessarily be connected with the activity in the state of residence where trade is conducted; still, they seem to qualify for treaty benefits.[61]

Therefore, as it stands now, it seems that the active-conduct-of-business clause only affects rather passive activities and permits considerable room to manoeuvre for MNLs[62] (provided, of course, that they meet the requirements of Actions 8-10 BEPS).[63]

The analysis above demonstrates a fundamental connection between Actions 8-10 BEPS and LOB clauses, since, where the requirements of transfer pricing legislation are met in terms of functions, assets and risks in the country that has signed a treaty with another country, it is easy to gain access to LOB clauses. Given that, as noted in section 2.3., control of risks and the capacity to bear them or exercise DEMPE functions provides a sufficient nexus with a jurisdiction, it is enough to place a few of those significant people in a country that acts as a platform to gain access to the treaties of that country with other states, even if those people outsource

61. Id., at sec. 5.2, p. 161.

62. Id., at sec. 5.2, pp. 162-163. As Tavares puts it there, the LOB clause with the "business exception" "could serve as a shelter for artificial arrangements that 'free-ride' on horizontal operating models or insubstantial restructuring that attempts to demonstrate vertical integration. As it stands, the business exception significantly undermines the effectiveness of the limitation on benefits rule, and could turn into a mere limitation on benefits for non-operating and rather 'passive' headquarter entities".

63. The new US MC (2016) has added some changes that will probably affect the final drafting of Action 6 BEPS and the LOB model clause to be included in the OECD MC/Multilateral Treaty. In the modified active trade and business test, income derived from the source state must "emanate from" or be incidental to that business carried on in the state of residence (Art. 22(3)(a) US MC (2016)). This change seeks a factual connection between active trade or business in the residence country and the item of income for which benefits are sought. It seems that some types of dividends and interest will be included within this rule and that this test will introduce some changes with respect to the one that existed before ("derived in connection"; *see* preamble US MC (2016)). Some entities and activities are also excluded from that test: (i) holding companies; (ii) providing overall supervision or administration of a group of companies; and (iii) providing financing (including cash pooling); in addition to the traditional making or managing of an investment. Article 22(3)(b) emphasizes that the income derived from the source state from a related party must be connected with the business carried out in the source state. A new and complex headquarters rule has also be added for "active headquarters" that provide management and control functions (and not only supervision and administration). Even if this tightens the requirements of the active trade or business test, and these requirements may be transferred to the LOB clause in the OECD MC once the report on Action 6 BEPS becomes final, it still permits a considerable margin for tax planning of corporate groups, as explained in this section. The Technical Explanation to the US MC (2016), yet to be released, will finally explain the scope of the changes.

most activities to parties located in other territories. In cases of patent boxes in that intermediate country, the modified nexus approach requires a bit more substance (expenses), but this is only required to gain access to patent boxes, not to qualify for LOB clauses in treaties signed with third countries or to take advantage of other regimes or incentives. This facilitates treaty shopping and permits structures very similar to those used in the pre-BEPS world that enable erosion of tax bases in source countries with limited substance (control of risk and the capacity to bear it) in the country used as an intermediate platform.

The same issue may arise with PPT clauses. From the new commentary on the PPT clause in Action 6 BEPS, there is no reason to conclude that it will be interpreted very differently than the active-conduct-of-business clause in the LOB provisions. For instance, in example F,[64] a publicly traded company of State T purchases the shares of a holding company in State R, which also has patents that are licensed to other subsidiaries of R located in countries with which R has treaties that provide for no or low withholding taxes for dividends and royalties. The example concludes that the principal purpose of the acquisition is the expansion of the company resident in State T and not gaining access to the low withholding taxes in treaties between State R and S. In fact, if a group decided to carry on activities to develop patents in State R that are further licensed to subsidiaries, even if outsourcing reduces the presence in country R to a minimum but sufficient requirement to meet the new substance standards defined by Actions 8-10 BEPS, the conclusion should be the same, since the treaty advantages can be regarded as accessory in connection with the business environment in which the patents are developed (even the patent box in country R could have an effect on the decision). Example G[65] is even clearer. In this case, a company T decides to set up a regional headquarters (RCO) for the purpose of providing group services to subsidiaries located in a region, including management services such as accounting, legal advice, human resources, financing and treasury services (managing currency risks and arranging hedging transactions), as well as some other non-financing-related services. It is assumed that, if the decision is driven by the economic conditions of the country in which the regional headquarters is finally established, even if tax treaties of that country may have had an impact on it, the structure is covered by those treaties, provided that the intragroup business constitutes a real business through which RCO exercises "substantive economic functions, using real assets and assuming real risks and that business is carried on by RCO through its own personnel

64. Action 6 BEPS, pp. 61-62.
65. Id., p. 62.

located in State R" (the state of residence). Again, the substance requirement of Actions 8-10 BEPS permits meeting the PPT of Action 6 even if not much may be going on in the country in which the headquarters is set up. Some of the examples given as non-conduit arrangements are similar (e.g. example F, where a finance/treasury centre is established).[66]

In the end, it seems that if the substance required for transfer pricing purposes (control of risks and the capacity to bear them, and DEMPE functions with regard to intangibles) is located in the residence country, the source country will not be able to use the PPT to refuse treaty benefits. Since, as noted above, substance in transfer pricing terms permits a broad margin for outsourcing as long as real functions (and, therefore, risks) are carried on in a state, it may be easy to avoid the application of the PPT by means of a few people who control risks but outsource most tasks to third or related parties, as long as they can demonstrate that control of risks (as well as the financial capacity to bear them) is in their hands.

This understanding is also confirmed by the fact that the reform of the Commentary on Article 1 of the OECD MC that Action 6 BEPS proposes is in line with the PPT clause that will be added to the OECD MC, so that domestic doctrines and treaty anti-avoidance clauses are also interpreted in a parallel form.[67] It is not strange, therefore, that the new Commentary on Article 1 of the OECD MC recognizes that transfer pricing rules must apply

66. Id., p. 68.
67. Id., especially paras. 58-59, at pp. 79-80:
58. As indicated in subsection A.1, a new general anti-abuse rule that will incorporate the principle already recognised in paragraph 9.5 of the Commentary on Article 1 will be included in the OECD Model. The incorporation of that principle into tax treaties will provide a clear statement that the Contracting States want to deny the application of the provisions of their treaty when transactions or arrangements are entered into in order to obtain the benefits of these provisions in inappropriate circumstances. The incorporation of that principle into a specific treaty provision does not modify, however, the conclusions already reflected in the Commentary on Article 1 concerning the interaction between treaties and domestic anti-abuse rules; such conclusions remain applicable, in particular with respect to treaties that do not incorporate the new general anti-abuse rule.
59. The following revised version of the section on "Improper use of the Convention" currently found in the Commentary on Article 1 will reflect that conclusion and will better articulate the relationship between domestic anti-abuse rules and tax treaties.
It appears, therefore, that the new Commentary on Article 1 of the OECD MC is designed to produce "retroactive effects" with regard to existing treaties.

with priority over GAARs and general domestic anti-abuse rules,[68] which produces a sort of circularity: The Commentary permits the application of domestic anti-avoidance rules, but transfer pricing rules have priority, and they have to be interpreted in line with the standard the OECD has fixed under Actions 8-10 BEPS. This in fact reduces the scope for domestic anti-abuse provisions or doctrines where transfer pricing rules apply and substance requirements in terms of transfer pricing actions are met.

Therefore, interpretation of the PPT (and even domestic law doctrines) may be close to the active-conduct-of-business clause in LOB rules. Thus, Actions 8-10 BEPS create a sort of exception for Action 6 (either LOB or PPT clauses): when MNLs comply with the standard in terms of transfer pricing, it seems that the OECD wants to exclude the application of other anti-avoidance rules at treaty level. This gives a broad margin to MNLs for tax planning (if combined with special tax regimes such as those identified in Action 5 BEPS or defined in domestic legislation).

2.5.3. The concepts of permitted and prohibited double non-taxation in Action 6 BEPS and the definition of special tax regimes

The second main issue identified in section 2.5.1., the definition of undesirable double non-taxation (reproachable BEPS), confirms the hypothesis advanced in section 2.5.2. (and in previous sections in this chapter) that some types of double non-taxation (or low taxation) are admitted and others are not. Apart from changes to the title, the proposed changes to the preamble of double tax treaties proposed by Action 6 BEPS already stress that undesirable double non-taxation is that linked with tax evasion and

68. In the author's view, this effect is clear from the new paras. 21 ff. of the Commentary on Article 1 of the OECD MC, as proposed by Action 6 BEPS:

> 21. Tax authorities seeking to address the improper use of a tax treaty may first consider the application of specific anti-abuse rules included in their domestic tax law.
>
> 22. Many specific anti-abuse rules found in domestic law apply primarily in cross-border situations and may be relevant for the application of tax treaties. For instance, thin capitalisation rules may apply to restrict the deduction of base eroding interest payments to residents of treaty countries; *transfer pricing rules (even if not designed primarily as anti-abuse rules) may prevent the artificial shifting of income from a resident enterprise to an enterprise that is resident of a treaty country* [...]
>
> 25. *First, a treaty may specifically allow the application of certain types of specific domestic anti-abuse rules. For example, Article 9 specifically authorises the application of domestic rules in the circumstances defined by that Article* [emphasis added].

avoidance,[69] which basically means that special regimes that permit double non-taxation are admitted in the post-BEPS context. Because of that, Action 6 BEPS has defined special tax regimes and the actions that a contracting state may take to protect its tax base against those regimes that permit reproachable double non-taxation. For those purposes, in line with the US Draft Model (2015), it proposes using a definition of special tax regimes so that when one of these regimes is identified as applicable to the taxpayer in the state of residence, Articles 11 (interest), 12 (royalties) and 21 (other income) of the OECD MC will not apply, the state of source is not limited by the treaty, and it can apply its domestic withholding taxes.[70]

The definition of special tax regimes[71] to be included in Article 3 of the OECD MC leaves out of its scope two types of potential structures: (i) those

69. The changes to the preamble that Action 6 BEPS, p. 92, proposes consist in the addition of the following sentence: “Intending to conclude a Convention for the elimination of double taxation with respect to taxes on income and on capital without creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance (including through treaty-shopping arrangements aimed at obtaining reliefs provided in this Convention for the indirect benefit of residents of third States).” In line with the new preamble, the Introduction to the OECD MC, as proposed by Action 6 BEPS, p. 93, also explains that the type of prohibited double non-taxation is the one caused by tax evasion and avoidance (*see* the new para. 16.1).

70. Action 6 BEPS, para. 81, at p. 98.

71. Id., para. 81, at p. 96:

New definition of “special tax regime” to be included in Article 3 (General Definitions)

X) … the term “special tax regime” with respect to an item of income or profit means any legislation, regulation or administrative practice that provides a preferential effective rate of taxation to such income or profit, including through reductions in the tax rate or the tax base. With regard to financing income, the term special tax regime includes notional interest deductions that are allowed without regard to liabilities for such interest. However, the term shall not include any legislation, regulation or administrative practice:

i) the application of which does not disproportionately benefit interest, royalties or other income, or any combination thereof;

ii) except with regard to financing income, that satisfies a substantial activity requirement;

iii) that is designed to prevent double taxation;

iv) that implements the principles of Article 7 (Business Profits) or Article 9 (Associated Enterprises);

v) that applies to persons which exclusively promote religious, charitable, scientific, artistic, cultural or educational activities;

vi) that applies to persons substantially all of the activity of which is to provide or administer pension or retirement benefits;

vii) that facilitates investment in widely-held entities that hold real property (immovable property), a diversified portfolio of securities, or any combination thereof, and that are subject to investor-protection regulation in the Contracting State in which the investment entity is established; or

that benefit from a patent box as defined in Action 5 BEPS; and (ii) those hat are based on transfer pricing principles and lead to results consistent with them, for instance with regard to services that do not fall within the scope of Articles 11, 12 or 21 of the OECD MC. In those cases, as well as in others (e.g. incentives in the tax base or payable amount that are not linked to income or profit but to assets or investments and special tax zones),[72] double non-taxation outcomes are accepted as legitimate, which clearly shows the way to states and tax planners regarding how to structure source state tax-efficient structures: by combining the effects of Articles 7, 9, 11, 12 or 21 of the OECD MC with regimes that are not tagged as "special" under the new definition of Article 3, while at the same time not falling within the scope of LOB or PPT clauses.

The new US MC (2016) definition of special tax regimes has relevant differences with the one proposed in Action 6 BEPS in terms of (i) the concept of special tax regimes;[73] and (ii) the scope of the reaction, since Articles 11, 12 and 21 of the US MC (2016) will not apply only if payments are made to

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viii) that the Contracting States have agreed shall not constitute a special tax regime because it does not result in a low effective rate of taxation.

72. A. Laukkanen, *The Development Aspects of Special Tax Zones*, 70 Bulletin for International Taxation 3 (2016), Journals IBFD, p. 159, notes that special tax zones are outside the definition of special regime and also that "jurisdictions with an active business requirement and the application of the principles in Art. 7 (Business profits) and article 9 (Associated enterprises) may stay out of the special tax regime classification".

73. New Art. 3(1)(l) US Model (2016) defines special regimes as follows:

l) the term "special tax regime" means any statute, regulation or administrative practice in a Contracting State with respect to a tax described in Article 2 (Taxes Covered) that meets all of the following conditions:
  (i) results in some or more of the following:
    (A) a preferential rate of taxation for interest, royalties, guarantee fees or any combination thereof as compared to income from sales of goods or services;
    (B) a permanent reduction in the tax base with respect to interest, royalties, guarantee fees or any combination thereof, without a comparable reduction for income from sales of goods or services, by allowing:
      (1) an exclusion from gross receipts;
      (2) a deduction without regard to any corresponding payment or obligation to make a payment;
      (3) a deduction for dividends paid or accrued; or
      (4) taxation that is inconsistent with the principles of Article 7 (business profits) or Article 9 (associated enterprises); or
    (C) a preferential rate of taxation or a permanent reduction in the tax base of the type described in part (1), (2), (3) or (4) of subclause (B) of this clause with respect to substantially all of a company's income or substantially all of a company's foreign source income, for companies that do not engage in the active conduct of a trade or business in that Contracting State;

"connected persons" (as defined in Article 3(1)(m) of the US MC (2016)). But, essentially, the outcome is very similar that of the rules proposed in Action 6 BEPS (which will presumably be adapted to the US changes in 2016): it permits double non-taxation that either is not regarded as undesirable (patent boxes and those structures that are compliant with transfer pricing principles) or that does not fall within the definition of special tax regime (although the definition of special tax regime basically tries to make more objective the definition of undesirable or reproachable double non-taxation), with the result that there are some types of double non-taxation that will be permitted and others that will not. It should be stressed that the active-conduct-of-business exception also appears in the US definition of special tax regimes (for those that give general reductions in connection

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(ii) in the case of any preferential rate of taxation or permanent reduction in the tax base for royalties, does not condition such benefits on the extent of research and development activities that take place in the Contracting State;

(iii) is generally expected to result in a rate of taxation that is less than the lesser of either:
- (a) 15 per cent; or
- (b) 60 per cent of the general statutory rate of company tax applicable in the other Contracting State;

(iv) does not apply principally to:
- (A) pension funds;
- (B) organizations that are established and maintained exclusively for religious, charitable, scientific, artistic, cultural or educational purposes;
- (C) persons the taxation of which achieves a single level of taxation either in the hands of the person or the person's shareholders (with at most one year deferral) that hold a diversified portfolio of securities, that are subject to investor-protection regulation in the Contracting State and the interest in which are marketed primarily to retail investors; or,
- (D) persons the taxation of which achieves a single level of taxation either in the hands of the person or the person's shareholders (with at most one year deferral) and that hold predominantly real estate assets; and

(v) after consultation with the first-mentioned Contracting State, has been identified by the other Contracting State through diplomatic channels to the first-mentioned Contracting State as satisfying clauses (i) through (iv) of this subparagraph.

No statute, regulation or administrative practice shall be treated as a special tax regime until 30 days after the date when the other Contracting State issues a written public notification identifying the regime as satisfying clauses (i) through (v) of this subparagraph.

with all the income of a company or foreign-source income) and will presumably be interpreted similarly to the LOB clause, thus producing similar effects.[74]

The definition of special tax regimes also shows that the desire to harmonize the structural elements of taxes covered by tax treaties is indeed limited in the BEPS context (involving only those that permit an agreement on what substance is), but it remains important, since some forms of taxation and forms of tax systems are no longer permitted or are perceived as reproachable.[75]

2.6. Conclusions

This chapter has aimed at answering, first, the question of whether ATP is the new international anti-avoidance standard. The answer is that, in the OECD context, ATP is not the standard. In fact, the standard of what is permitted or prohibited in terms of tax planning has been defined in BEPS Actions. Since ATP was not the standard to give content to the concepts of legal or illegal avoidance or abuse, the second question this contribution has tried to answer is whether central elements or features of a standard could be identified in the BEPS Actions. Even if the BEPS project can be seen as a conglomerate of 15 Actions that are not guided by a single principle, the work is not yet finished and the contours and connection of the different Actions are not fully clear or defined, there are some indications about what the kernel of a new standard might be.

The core of the new standards is represented by the transfer pricing Actions (8-10) of the BEPS project, whose (arguably new) transfer pricing rules are not only intended to be immediately applicable but have also been attributed a reinvigorated anti-avoidance function. Transfer pricing rules act in

74. Action 6 BEPS, para. 81, at p. 98, also includes a new provision that would permit excluding the benefits of Arts. 10-12 and 21 if, after the signing of the treaty, a contracting state provides for an exemption from taxation to resident companies or individuals for substantially all foreign-source income. A similar (with some relevant differences) provision is included in Art. 28 US MC (2016).

75. In this context, this issue overlaps with one of the structural elements of tax treaties and one of their main weaknesses, namely the fact that their objective scope (Art. 2 OECD MC, on the concepts of tax and tax on income or capital) is not clear, which contributes to creating a context of very weak international obligations, whereby states can easily (on purpose or as an effect of their policy choices) avoid their treaty obligations by (i) enacting taxes that they pretend are outside the scope of tax treaties; and (ii) moulding elements of taxes to make them fall within the scope of tax treaties, so that they are credited in the state of residence.

this new context as SAARs in relation to other anti-avoidance or anti-abuse norms; it can even be argued that those rules are conceived of as exceptions to what are regarded as GAARs in the new system (LOB clauses and the PPT derived from Action 6 BEPS). The new standard is far from perfect, since, by defining weak substance requirements (even weaker than those in Action 5 BEPS) and attributing the residual profits of MNLs to control of risks and intangibles within a group, it facilitates tax planning via simply placing or moving significant people (risks and control over risks, the capacity to assume risks and DEMPE functions) in or to low-tax countries. In fact, in some respects, it can even be said that "BEPS admits BEPS outcomes", since, in the end, not all types of double non-taxation are prohibited, and there is a considerable margin within the new system for tax planning without placing much substance in low-tax countries (risks and control of risks and intangibles is too weak a nexus with a country). The importance of intangibles in the new context – as elements that attract residual profits of MNLs – is also extremely relevant, given that this not only permits shifting tax bases from non-technologically advanced countries to technologically advanced ones but also introduces a relevant factor for competition between states and opportunities for MNLs that, combined with relatively weak substance requirements, still permit achieving double non-taxation or low taxation rather easily – all that in a context in which significant people attract the benefits attributed to their DEMPE functions, even if they outsource relevant tasks (in Action 5 BEPS, there are some limitations to outsourcing to related parties). In this new scenario, the PE threshold, as redefined in Action 7 BEPS, acts as a perfect companion to reinforce the new standard and achieve within it no or low taxation in source countries, and Action 6 acts as subordinate to the new transfer pricing standard. In this context, the author would also like to stress the fact that the BEPS Actions are not a legal standard as such, and their principles, ideas and consequences must be regulated within domestic tax systems so that they can have full effect (anti-avoidance standards are defined, or at least should be, in domestic law).

With all their flaws, the new international standards derived from the BEPS project, pragmatic and unprincipled as they may be, also have undeniable virtues. First, purely passive activities, empty and shell company structures are seriously wounded in the post BEPS world. That there is international agreement (an international principle, it may even be said) on this is already an asset and a significant step forward in a world in which not all countries would recognize that the use of formal/empty structures may be abusive. BEPS does not fully harmonize the international tax scene; it does not even attempt to do so, with the exception of this very basic rule that forms its core. Second, placing transfer pricing (with all the flaws of the arm's length

principle) at the centre of the scene has permitted reaching a common language regarding and understanding of "substance" that was very difficult to achieve with traditional GAARs. True, the substance threshold in transfer pricing norms is weak, easily malleable and improvable, but it is stronger than it was pre-BEPS. This too is a virtue of the project, and it has the side effect of facilitating access to procedures on resolution of conflicts, thereby bypassing the obstacles that some countries create to access to mutual agreement procedures (MAPs) or arbitration in cases of avoidance (i.e. what previously would have been abuse conflicts are transformed into transfer pricing disputes, which find their natural field of resolution in the context of MAPs or arbitration). There is no revolution with BEPS, but there is a significant leap forward, one that calls for relevant (more coordinated) action by domestic legislatures and one that may not be a valid standard for all countries (i.e. in the case of developing countries) due to its complexity.

Therefore, the answer to the question – posed at the beginning of this chapter – of what the international standards of avoidance are would probably be that, as yet, there is no robust international standard. It seems that only the seeds of such a standard are already present. Rather than the end of the road, the BEPS project seems to represent the beginning of a new path along which those seeds of the new standards will need to grow, be perfected, be reinforced or even, eventually, be replaced. Where that path leads is a matter for another day, but it seems that the issues of greater recognition of source country taxation (which the BEPS project fended off almost completely) and a more balanced treatment of intangibles, capital and labour are topics that will resurface along the road in one form (division of tax bases or source rules) or another (a definition of acceptable anti-avoidance standards, more robust substance requirements or commonly accepted international principles).

Chapter 3

Transfer Pricing and Tax Avoidance

Yariv Brauner

3.1. Introduction

Transfer pricing is undoubtedly a key, fundamental weapon in the arsenal of any modern tax planner. During the last two decades, most of the countries extensively (and even those less extensively) involved in international trade have adopted transfer pricing laws to combat this otherwise most simple of tax minimization techniques. Essentially all of them followed the almost universal arm's length standard, and a large majority of them also expressed commitment (though to various extents) to the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations (TPG). Transfer pricing abuse has also featured centrally among the most prominent issues dealt with by the base erosion and profit shifting (BEPS) Project, and has now long been declared as the most concerning challenge for MNE tax compliance.

For the purposes of this book, one therefore must consider transfer pricing, its regulation, practice and enforcement in the more general context of tax avoidance and laws attempting to limit it. This chapter considers, first, the conceptual relationship between transfer pricing and tax avoidance through tax planning. Second, it examines the appropriateness of viewing transfer pricing laws as general anti-avoidance rules (GAARs), and, finally, it explores the role of transfer pricing rules as specific anti-avoidance rules (SAARs) and their interaction, as such, with other common SAARs.

3.2. Transfer pricing and tax avoidance

Transfer pricing laws are a necessary product of two seemingly independent developments: economic globalization and the legal fiction of separate corporate personality. The opportunity that globalization presented to multinational enterprises (MNEs) to exploit (primarily) intangibles[1] has not only been an economic opportunity. Since essentially all countries legally

1. One may argue that such opportunities serve as the primary justification for MNEs to operate in that form.

adhere to the fiction (or metaphor) of separate corporate personality for tax law purposes, they also essentially view intra-firm transfers as real, cross-border transfers. Such cross-border transfers, even if not "real" for the firm in economic terms, are deemed real for tax law purposes, since typically there are competing claims of multiple jurisdictions to tax them regardless of economic realities. The point, for our purposes, is that transfer pricing planning at its core is not a tax planning technique in the sense of tax minimization but simply a mechanism to comply with the legal reality of jurisdictions claiming taxing rights over activities of MNEs, regardless of the real economics of these activities.[2] It is first and foremost an allocation norm.

As such, transfer pricing rules and compliance have obviously been a significant burden on MNEs. Yet, they also presented obvious opportunities. The separate corporate personality fiction permitted intra-firm, cross-border transactions that are easy, cheap and, by definition, unreal and fully in control of taxpayers. There can be no simpler profit shifting technique. Transfer pricing rules and the arm's length standard have been the solution, imposing supposed market discipline on this "too easy" planning. At a very general level, it would still be difficult to view the transfer pricing rules (and arm's length) as serving an anti-abuse role, since they primarily set the "rules of the game". In the absence of such rules, it would be difficult to view regular transfer pricing planning as abusive,[3] as MNEs are required (by law) to maximize profits, etc.

Yet, the application of the arm's length standard is difficult and far from perfect. Despite the supposed universal application, adherence to the TPG and the attention of governments to the matter, transfer pricing is at the forefront of the war over so-called aggressive tax planning by MNEs, as demonstrated by the BEPS Project. "Arm's length" rules require related parties to charge the prices they would have charged unrelated parties in comparable transactions and circumstances. This approach fortifies rather than counters the separate corporate personality fiction, since it mandates taxpayers to act (for tax purposes) according to that fiction, despite the fact that they explicitly chose to arrange their economic affairs hierarchically rather than contract with unrelated parties. This was done presumably because they believed that they would gain an economic advantage; however, this advantage is decidedly and consciously ignored by current transfer pricing rules worldwide.

2. Indeed, this basic approach was reflected in several reports. *See*, for example, Austria.
3. Assuming, for these purposes, behaviour that is not too aggressive, such as the creation of losses in a jurisdiction where a firm is clearly profitable.

Moreover, tax authorities and the OECD militantly and religiously protect and strengthen the dominance of arm's length-based transfer pricing, despite the ample criticism. It is easy to observe that the complexity of the rules, their strong political flavour and the general competitive framework of the international tax regime makes the identification of abuse in transfer pricing planning very difficult. Yet, aggressive transfer pricing planning clearly fails the "smell test" and, therefore, requires the same kind of scrutiny that other abusive tax planning techniques face, especially since transfer pricing planning is typically combined with other tax planning techniques that are subject to the scrutiny of anti-abuse norms as a matter of course.

To deal with this challenge, one must first establish a baseline, or zone of acceptability, the deviation from which would be considered abusive. Yet, despite the appeal of arm's length or "market behaviour" as a baseline, it is far from very useful in reality. First, due to the impossibility of generating accurate, pinpoint transfer prices, the practice requires flexibility and often uses an arm's length range rather than price. This very sensible practice introduces an inherent advantage to MNEs, especially intangible-heavy MNEs. Note that this bias is universal to arm's length transfer pricing, even when a range is not established, since the taxpayer is at the helm and has the opportunity to establish the facts, comparables, etc. of the case. Second, countries differ significantly in their interpretation and application of arm's length, and taxpayers have notoriously exploited the opportunities presented by these differences (more than they have suffered from them). Third, the lack of cooperation among countries has further blurred any potential baseline. Countries do not even consistently require consistent reporting by taxpayers. Transfer pricing compliance is essentially unilateral. This observation was made by the BEPS Project and work is being done that would make coordination more feasible, especially in the context of Action 13 of the BEPS Action Plan, yet one must wait and see how successful this work would be. Consequently, an application of the transfer pricing rules as anti-abuse norms would necessarily both over and under-regulate intra-firm transactions. A fictional baseline based on some unattainable arm's length price would have to serve as a benchmark for abuse. However, it must be noted that such an analysis would differ from the application of other anti-abuse rules, since deviation from the baseline would then automatically mean "abuse". There would not be an independent analysis of abuse, per se. The above-mentioned lack of a true international baseline makes it a moving target that would be a very poor and undesirable measure of abuse in the normal legal sense.

In what sense, then, may transfer pricing planning be abusive? Well, functionally, one may engage in abusive behaviour independent of the mere

deviation from arm's length pricing. This seems to be the approach of most of the country reports in this book, yet, in reality, it is very difficult to distinguish abusive tax planning from mere aggressive transfer pricing positions. This difficulty may be resolved with an intent-based approach to the notion of abusive tax planning; however, as demonstrated in this book, such an approach is far from dominant in today's world. Only one country report has expressed an approach close to the latter intent-based analysis: the Netherlands. Other countries have also reported on the relationship between transfer pricing enforcement and doctrines such as *fraus legis*, yet none of them resembles the rather direct reliance on behaviour and intent of the Netherlands. Nonetheless, it is notable that even Dutch law does not rely solely on intent, which makes the analysis more complex.

The general approach to the concept of abuse and tax avoidance is further clarified in the next section, where the report analyses transfer pricing laws as GAARs.

3.3. Transfer pricing laws as GAARs

The debate during the congress has demonstrated the lack of consensus over the precise definition of GAARs and their appropriate use. One approach is functional, which one may call political, viewing GAARs as rules that transfer the power to set exact legal boundaries from legislators to governments (or tax authorities). Under this approach, a GAAR may be necessary or useful when the legislator cannot set exact boundaries or is not in the best position to do so efficiently. This approach tolerates different forms of GAARs, depending on the legal and business cultures of the relevant jurisdictions. Some countries' GAARs are rather expansive, shifting the discretion to the tax authorities,[4] and some are designed more narrowly, such as the newly enacted UK GAAR.

It may also generate resistance to GAARS, as best demonstrated by the United States report. However, that report also demonstrates that political resistance to GAARs does not make the challenges typically managed by GAARs simply disappear. The United States alternatively uses a large number of supposed SAARs and what may be viewed as a hidden GAAR: the US transfer pricing norm in section 482[5] of the US Internal Revenue

4. Which may still use it sparingly, such as in Sweden, where the GAAR is considered a tool of last resort.
5. All references are to the US Internal Revenue Code and Treasury Regulations, unless otherwise provided.

Code. Section 482 operates as a GAAR-like rule in that it provides the Internal Revenue Service (IRS) with significant discretion to intervene in the characterization of income from related-party transactions. This power is translated into a complex arm's length-based regime through detailed regulations.[6] While the transfer pricing rules target some of the same abuses as various SAARs, these rules apply separately and concurrently, and are not specifically coordinated within the US tax system. Although the transfer pricing rules provide the IRS with significant power to intervene in the pricing of intercompany transactions, the US government has struggled to enforce the transfer pricing rules. Both the government itself and the courts have clearly interpreted section 482 as a limited transfer pricing provision. Therefore, it would still be difficult to discuss section 482 in the same category as traditional GAARs.

A second approach to GAARs, already mentioned above, focuses on the intent of taxpayers. A few country reports mention the use of such GAARs in parallel or complementary to the transfer pricing rules,[7] yet none of them report a distinct transfer pricing rule with such GAAR features. Eventually, most countries view their transfer pricing rules as SAARs, as discussed in the next section.

3.4. Transfer pricing and SAARs

Most of the reports express an inherent understanding of their transfer pricing as SAARs, and are not concerned with their particular distinctive features.[8] The Turkish report mentions an explicit categorization as such, and the German report explains that the transfer pricing rules constitute a "closed system" within Germany's anti-abuse legislation. This system substantively conforms with OECD standards, but its administrative and compliance aspects are uniquely domestic (German), with "a number of national particularities and inefficiencies".[9]

The Brazilian report reflects a similar approach, despite the substantive deviation of the Brazilian rules from the universal norms reflected in the TPG. The anti-avoidance intent of Brazilian transfer pricing legislation is clear, according to the reporters, from their application to both controlled

6. US Treas. Reg. 1.482-1 to -9.
7. E.g. the Dutch report.
8. *See*, for example, the reports of Denmark, the Czech Republic, the Netherlands and Norway.
9. The French and Russian reports demonstrate similar approaches and distinctions.

and uncontrolled transactions (although the application to the latter is more limited).

The US rules all appear in regulations; even the arm's length standard, chosen by the Treasury and the IRS as the most appropriate for income allocation among related parties, appears only in the regulations. However, the evolution of the transfer pricing regime in the United States resulted in the near abandonment of the original purpose of the rules in favour of the implementation and instrumentality of the mechanism chosen for its application. First the government and then the courts limited the regime to a literal application of the arm's length standard in complete disregard of the object and purpose of the regime. It was all about the comparability of market and non-market transactions in the most straightforward and literal manner. The application of the detailed arm's length rules in the regulations combats much of the tax avoidance attempted by related parties, but it does so indirectly and only through the prism of the literal arm's length and prescribed regulations. There is no direct targeting of abuse or tax avoidance.

Yet, as mentioned before, some countries still struggle with automatically viewing transfer pricing as an anti-avoidance regime. The Polish report, for example, indicates a transition from this approach, where current law does not examine transfer pricing cases from an anti-avoidance perspective. Still, the reporters expect that recent reforms would result in more consistent interpretation of transfer pricing rules, interpretation that should also increasingly resemble that of other applicable SAARs.

The report of Portugal indicates that the anti-abuse nature of transfer pricing rules is apparent in practice, despite the obviation of the original purpose of allocation. The reporter reaches this conclusion based on the mandatory penalties regime that is typical for SAARs.[10]

The Italian report indicates that Italian courts have also struggled with this point. The Italian Supreme Court originally classified transfer pricing among other anti-avoidance rules, supported by scholars and other experts. However, the Court was criticized that this approach had been at odds with the wording of the transfer pricing law indicating solely allocation functions. This led the Supreme Court to change its position, recognizing that transfer pricing primarily represents an allocation rule. The report mentions a recent case, which stated: "The manipulation of transfer prices applied in transactions between related parties... is prosecuted, at international level,

10. The report for Portugal, fn. 35.

not so much because it is aimed at achieving an undue tax saving... but because it distorts the proper allocation between States of tax bases generated by cross-border transactions". Therefore, "[w]hile an anti-avoidance purpose exists, it does not exhaust the goals of this rule".

3.5. Application and interaction with other anti-avoidance rules

At present, it can be easily observed that jurisdictions generally prefer to package their transfer pricing rules as SAARs, despite the universality of arm's length and the unclear anti-avoidance origins of transfer pricing. However, the supposed abuse targeted by transfer pricing (leaving aside the question of whether it is directly or only incidentally targeted by them), is typically addressed by many other traditional SAARs as well. All of the country reports included refer to several SAARs that operate alongside the transfer pricing rules, often with very similar goals. Essentially all of the countries have, for example, rules that regulate or limit interest deductions, all of which are based on a presumption of non-market debt structures that are also regulated by the transfer pricing rules. Similarly, many countries employ controlled foreign companies (CFC) rules that try to prevent the artificial shifting of profits (especially to low-tax jurisdictions), which, again, is also the goal of transfer pricing rules, most definitely where such rules are framed as SAARs. The picture portrayed by the reports is quite uniformly one of preference for multi-layered anti-avoidance regimes. The different components usually operate in parallel, with little to no coordination or hierarchy.[11] Apparently, none of these regimes are accepted as sufficiently effective. A few reports, however, indicate a more complex legal situation where, although some coordination norms exist, their application is challenging. This is the situation in the Netherlands, for example, and also in Denmark, where the report indicates that real issues have arisen in the difficult interaction between the transfer pricing, thin capitalization and CFC rules. France reports coordination rules among SAARs, but with no specific ones for transfer pricing.

The interaction of the transfer pricing rules (as SAARs) with GAARs is more complex. In some countries, the GAAR operates as another anti-avoidance rule with no superiority or inferiority to SAARs, including transfer pricing rules.[12] In other countries, the GAAR is viewed differently

11. *See*, for example, Norway, Greece, Russia and the United States
12. *See*, for example, Norway and the Netherlands.

from SAARs even if not in terms of explicit hierarchy. For example, the Russian report indicates the importance of *lex specialis* in the application of anti-avoidance rules, effectively giving the GAAR a supportive and perhaps residual role to SAARs, which includes transfer pricing.[13] The Russian report mentions case no. A40-111951/12, where the transfer pricing rules (which were in force before the adoption of 227-FZ of 18 July 2011) have been applied and the court was requested to analyse their relations with the GAAR. The court focused in its decision on the application of transfer pricing rules to the facts of the case. It further referred to the GAAR, posing it as an abstract principle in service of the transfer pricing rules, helping to clarify their purpose and their proper use.

The German report indicates a very interesting aspect of the existence of a GAAR. The reporter explains that the GAAR is used as a weapon or a threat to taxpayers in cases where they cannot clearly establish their position. The important context of valuations is specifically mentioned in the report. This is a good example of the importance of the conceptual question of transfer pricing's place among the SAARs, since if it does not belong to this category, it would be difficult to justify such threats by the tax authorities (that said in general without reference to German law specifically). This is particularly relevant in the context of the valuation of intangibles, which is a very controversial matter.[14] Prudent taxpayers clearly may deviate in their positions from those of the tax authorities, making the desirability of harsh consequences very questionable. Is it reasonable to trigger a GAAR each time that taxpayers and tax authorities reach materially different conclusions in valuation studies? What penalty regimes should apply in these cases? Would typical penalty structures that depend on the extent of the deviation be appropriate in these cases? It does not seem that legislators and tax authorities have considered these issues carefully enough, if at all.

3.6. Conclusion

In conclusion, the almost universal arm's length-based transfer pricing rules are viewed by most countries as serving anti-avoidance purposes, primarily or in conjunction with their role as allocation rules of tax bases among competing jurisdictions. As such, they are generally included among other

13. Quite a similar situation seems to exist in Portugal and Turkey. The RSA report indicates a similar situation, where there is no explicit hierarchy, yet the tax authorities apply the GAAR as a tool of last resort.
14. *See*, for example, Y. Brauner, *Value in the Eye of the Beholder: The Valuation of Intangibles for Transfer Pricing Purposes*, 28 Va. Tax Rev. 79 (Summer, 2008).

SAARs. The basic application of the rules as SAARs and their interaction with other SAARs are also fundamentally similar in most countries. Where a GAAR exists, differences arise but interaction between transfer pricing rules and GAARs seem to be rare or practically non-existent, whether de facto or de jure.

However, once the details have been considered, it becomes difficult to reach conclusions about similarity of application of these rules worldwide. Domestic idiosyncrasies seem to feature prominently. Finally, despite the essential universality of the presumptive view of transfer pricing as a SAAR, such presumption leans on weak intellectual foundations, which in some countries lead to challenges in the application of the rules or deviations from international practices, and in others to a lack of clarity regarding the application of the rules, especially in difficult cases, such as the transfer of intangibles.

Chapter 4

The Meaning of Tax Avoidance and Aggressive Tax Planning in European Union Tax Law: Some thoughts in connection with the reaction to such practices by the European Union

Pasquale Pistone

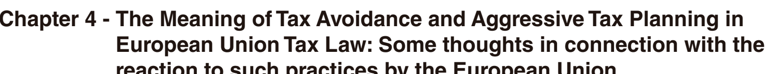
4.1. Introduction

2016 will be remembered as the year in which the European Union relaunched the issuing of its secondary legislation on direct taxes. This is mainly due to unprecedented circumstances, at least in tax matters: in a single year, the European Commission successfully managed to propose and have the Council approve the Directive that counters tax avoidance practices that directly affect the functioning of the internal market.

This Directive, better known as the Anti-Tax Avoidance Directive (ATAD),[1] in fact includes the implementation of the BEPS Project in the European Union in the framework of a broader package,[2] and puts forward additional rules that establish a comprehensive framework against this phenomenon.

The studies conducted by the OECD in the framework of the BEPS Project and the Recommendation issued in 2012 by the European Commission[3] include a specific reference to aggressive tax planning, which indicates the intention to narrow down the limits within which international tax planning across borders should be tolerated. It also reflects a new approach to base erosion and profit shifting practices of multinational enterprises, which

1. Directive 2016/1164 of 12 July 2016.
2. The main components of this anti-tax avoidance (ATA) package were announced in the documents released by the European Commission on 28 Jan. 2016 and include COM(2016) 24 on the External Strategy for Effective Taxation, COM(2016) 25 amending the Directive on mandatory automatic exchange of information and the Recommendation C(2016) 271 final on the implementation of measures against tax treaty abuse.
3. C(2012) 8806 final of 6 Dec. 2012. Commission Recommendation on Aggressive Tax Planning. An express reference to aggressive tax planning is also included in the third preliminary remarks to the Anti-Tax Avoidance Directive, which indicates that "it is necessary to lay down rules in order to strengthen the average level of protection against aggressive tax planning in the internal market" and adds that "this objective can be achieved by creating a minimum level of protection for national corporate tax systems against tax avoidance practices across the Union".



strengthens international tax coordination in order to establish a new cross-border consistent framework for the exercise of taxing powers.

Whilst tax avoidance has been the object of considerable attention by tax literature over the years, aggressive tax planning is a completely new entry in international taxation, which requires dedicated study to single out its structural features and lay down a proper framework for its relations with tax avoidance. Our thoughts in this contribution are devoted to addressing such issues within the framework of European tax law, with a view to determining the correct characterization of both for European law purposes.

The qualitative research methodology adopted by our analysis aims at developing a comprehensive interpretative reconstruction of the relations between tax avoidance and aggressive tax planning, after identifying their respective essential elements in the light of the relevant provisions of primary and secondary tax law of the European Union. Such elements will be identified on the basis of the significant contributions provided by the case law of the Court of Justice of the European Union, especially on fundamental freedoms, but also on anti-avoidance and similar rules contained in tax directives.

Three main factors will drive our analysis. First, legal pluralism driven by the supremacy of EU law presents peculiar features in tax matters that are connected with establishing limits on the exercise of taxing powers at the national level of EU Member States. Second, supranational law requires autonomous characterization also of tax categories in line with the ultimate goals of European integration. Third, supranational institutions should produce secondary legislation of the European Union to the extent that a given integration result is not possible on the sole basis of the interpretation of primary law of the European Union.

Besides implying a general idea of subsidiarity connected with the issuing of secondary legislation of the European Union in tax matters, this framework also requires that any act of supranational legislation by the European Union must fit within the overall framework and conceptual categories established by primary law of the European Union, even when transposing measures reflecting forms of international coordination that were agreed on a broader geographical level (such as the BEPS Project).

4.2. The absence of a common concept of tax avoidance in tax systems

Tax avoidance is arguably one of the most popular topics in tax law. Its blurred boundaries have triggered the attention of at least five groups, namely: taxpayers, seeking to minimize their tax burden without giving rise to forms of open conflict with tax legislation; legislators, wishing to avoid the circumvention of taxing rules and the undue application of the ones providing for tax benefits; tax authorities, pursuing an effective enforcement of both types of rules; courts, facing in common and civil law countries the challenges connected with the implementation of tax statutes in line with the respectively applicable principles; and scholars, trying to reconcile the positive dimensions established within each legal system with the elements that are structurally intrinsic to this phenomenon.

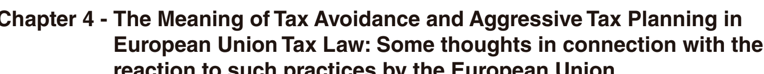
The core concept of tax avoidance is linked to the tax advantage that may be obtained by circumventing the application of tax rules. In other words, taxpayers obtain a tax advantage by exploiting the friction between the form, which they choose from those that do not trigger the liability to tax, and the substance, which is akin to events that would otherwise trigger the liability to tax. Along similar lines, one could describe the features that tax avoidance presents in connection with the undue application of tax benefits.

Within such a general framework, tax systems generally identify the positive dimension of tax avoidance in connection with the reconstruction of the purpose of avoiding the payment of tax through an act, scheme, or series of coordinated acts, often reversing the burden of proof on the taxpayer, who is requested to justify his behaviour on the basis of main non-tax reasons.

The actual positive dimension of tax avoidance varies considerably across tax systems in connection with the boundaries of the three main types – namely general, targeted and specific – of rules that are used to counter this phenomenon either unilaterally, i.e. in domestic legislation, or bilaterally, i.e. in tax treaties.

GAARs give tax authorities fairly broad powers to re-characterize the actual facts in a way that re-establishes the payment of tax under the circumvented norm. Such rules are generally the object of statutory provisions,[4] but may also be the outcome of interpretative reconstruction by the judiciary.

4. Although such provisions are usually contained in domestic tax law, more recently they have also been included in the framework of tax treaties.



Their presence has become a common feature of almost all European systems. Their application frequently generates fairly complex litigation and, depending on how tax authorities exercise their powers, may in fact give them a last resort weapon to handle cases of tax minimization that are close to the exploitation of loopholes, or to overcome the failure of otherwise enforcing the applicable tax rules.

Targeted anti-avoidance rules (TAARs) give tax authorities similar powers of re-characterizing the facts, but within a narrower set of transactions, generally defined within the framework of a statutory provision. They are less frequently components of national tax systems, which commonly adopt them to address some of the issues raised by the application of GAARs. Their application is often easier to circumvent, mainly when a taxpayer manages to act outside of their scope.

SAARs are in principle the easiest for tax authorities to handle, since they lead to an (almost) automatic consequence in the presence of their conditions and generate more limited litigation, but also the easiest to circumvent. However, the way in which such clauses operate – in domestic law (for instance in the case of CFC legislation) or bilateral tax treaties (for instance in the case of LOB clauses) – may raise problems of compatibility with European Union law.

The application of GAARs, TAARs and SAARs is generally combined in the domestic tax law approach of EU Member States to tax avoidance, but the different conditions set for their application, as well as their interaction across borders, often creates two main types of problems for European tax law.

In particular, these problems can be described as disproportionate restrictions on the exercise of fundamental freedoms – which occur when such rules effectively counter tax avoidance, but go beyond what is strictly needed for achieving their goal – and disparities, which create biases that may alter competition within the internal market.

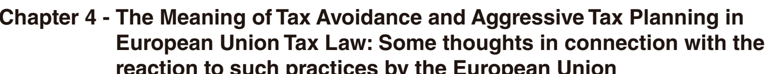
The first type of problem has repeatedly triggered the intervention of the Court of Justice, which brought the exercise of taxing powers by EU Member States back in line with the supremacy of supranational law and its principles over national law, by requiring a case-by-case analysis of the compatibility of such rules with the fundamental freedoms. In the framework of such actions, irrefutable, and sometimes also refutable, presumptions were struck down by the Court, but the same destiny also affected the

parts of such rules that were not suitable indicators of tax avoidance or that could unnecessarily discourage EU nationals from exercising the freedoms.[5]

The second type of problem has not yet been addressed by the Court of Justice, which currently regards tax disparities to be in line with the fundamental freedoms and as the natural consequence of limited harmonization. However, the application of different standards of reaction to tax avoidance within the European Union has an impact on the exercise of economic activities across borders, which has generated intervention by the European Commission with the ATAD and raises further issues that will be addressed in this chapter.

Further issues arise in connection with domestic anti-tax avoidance rules of EU Member States in the presence of double taxation conventions that do not specifically preserve the application of such rules. Such issues are addressed by the internationally accepted practice – reflecting the interpretation provided since 2003 by the OECD[6] in its Commentary on Art. 1 of the

5. The problems raised by the use of presumptions in tax matters were addressed by the Court of Justice of the European Union in respect of direct taxes and value added tax. In particular, on the one hand, it excluded in the *Garage Molenheide* decision (BE: CJEU, 18 Dec. 1997, C-286/94, C-340/95, C-401/95 and C-47/96, *Garage Molenheide* et aa., para. 52) that irrefutable presumptions are compatible with the European VAT system, and, on the other hand, in the *Leur-Bloem* decision (NL: CJEU, 17 July 1997, C-28/95, *Leur-Bloem*, paras. 43-44), the Court indicated that "the competent national authorities must carry out a general examination of the operation in each particular case", adding that "it is for the Member States, observing the principle of proportionality, to determine the internal procedures necessary for this purpose. However, the laying down of a general rule automatically excluding certain categories of operations from the tax advantage … whether or not there is actually tax evasion or tax avoidance, would go further than is necessary for preventing such tax evasion or such tax avoidance…".
In the *Bent Vestergaard* decision (DK: CJEU, 28 Oct. 1999, C-55/98, *Bent Vestergaard*) the Court then questioned the validity of the refutable presumption on the non-deduction from direct tax for training courses performed in other countries, for not being based on a valid background. In the *SGI* case (BE: CJEU, 21 Jan. 2010, C-311/08, *SGI*) the Court, when addressing an interest-free loan between related parties, added that it is proportional that tax authorities bear the initial burden of proof concerning the possible abusive nature of this arrangement and fulfil it on the basis of objective and verifiable elements. In this and further decisions (*see*, in particular, UK: CJEU, 13 Mar. 2007, C-524/04, *Thin Cap Litigation*, para. 82; UK: CJEU, 23 Apr. 2008, C-201/05, *CFC and Dividend Group Litigation*, para. 84) the Court then also added that, even when the reversal of the burden of proof operates, the taxpayer should be given the opportunity, without being subject to undue administrative constraints, to provide evidence of any commercial justification that may have existed for a given transaction. Furthermore, in the *Cadbury Schweppes* decision (UK: CJEU, 12 Sept. 2006, C-196/04, *Cadbury Schweppes*, para. 67), the Court indicated that the objective factors should be ascertainable by third parties in terms of premises, staff and equipment.
6. *See* OECD, Commentary on Art. 1, para. 9.5.



OECD Model Convention – that acknowledges the right of Member States to prevent entitlement to the benefits of a bilateral treaty in cases where the main purpose for entering into certain transactions or arrangements was to secure a more favourable tax position and where obtaining that more favourable treatment under these circumstances would be contrary to the object and purpose of the relevant provisions.

Another relevant issue arises where tax avoidance is neutralized as a mere consequence of the application of measures that do not require the actual identification of an abusive practice. A good example of such measures would be the beneficial ownership clauses contained in most general double taxation conventions. The application of such clauses structurally reduces the exposure to treaty shopping practices, insofar as it limits the application of reduced or zero withholding taxes under the treaty provisions on passive income only to those recipients which, at the time of the payment, can freely dispose of income without any contractual or otherwise equivalent factual obligation to pass it on to another (non-resident) person. In our view, these types of measures should not be regarded as equivalent to SAARs for the purposes of applying EU law.

This complex framework shows that, beyond a common core concept, the concrete meaning of tax avoidance depends on the actual measures through which tax systems react to this form of circumvention of its taxing rules.

4.3. The meaning of tax avoidance in European tax law

4.3.1. The interpretation of principles and primary law in tax matters

The existence of relevant discrepancies in the boundaries of tax avoidance across national tax systems of EU Member States is a possible reason for the Court of Justice to develop an autonomous characterization of this concept when applying supranational law of the European Union.

The three main sources for this concept are the principles of EU law, their interpretation and application by the Court of Justice, as well as secondary legislation in tax matters.

The Court of Justice has addressed the principles of EU law in the context of assessing the compatibility of the exercise of taxing powers by EU Member States with fundamental freedoms, seeking whether possible violations

could be justified on imperative grounds, additional to the ones specifically indicated in European treaties, along the lines of the so-called rule of reason.

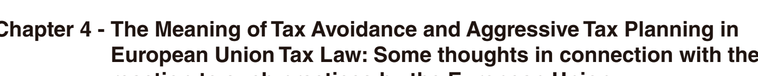
The prohibition of abuse – a legal principle with fairly deep roots in the foundations of EU law and, more recently, also reflected in Art. 54 of the EU Charter of Fundamental Rights – gave the Court the opportunity to shape its case law on anti-tax avoidance as a specification of its more general line of reasoning, in which entitlement to the protection of EU law is precluded in connection with abusive and fraudulent practices.[7]

Tax avoidance has therefore gradually turned into a synonym for abuse in tax matters,[8] whilst the latter conceptual category did not completely rule out the possibility of including cases of tax evasion.[9] Meanwhile, especially in its case law on VAT carousel frauds, the Court clearly separated the latter category, generally considering it more harmful.

When addressing the limits of the exercise of national taxing powers in connection with abusive and fraudulent practices in tax matters, the Court has consequently reached the conclusion that Member States were not under the obligation of complying with the supremacy of European Union over their national sovereignty, and could therefore freely apply their domestic and treaty legislation. However, one of the corollaries of this interpretation was that the application of such measures should not produce any implications whatsoever for situations that were genuinely entitled to the protection of EU law: a matter that the Court has strictly enforced by assessing the suitability and proportionality of anti-abuse measures.

A separate ground for justification has gradually gained relevance in connection with the need to protect the balanced allocation of taxing powers, although the Court has so far always bundled it together with other

7. *See* DK: CJEU, 9 Mar. 1999, C-212/97, *Centros*, para. 27; GER: CJEU, 14 Dec. 2000, C-110/99, *Emsland Stärke*, para. 51.
8. *See* GER: CJEU, 12 Dec. 2002, C-324/00, *Lankhorst-Hohorst*, para. 38; *Cadbury Schweppes* (C-196/04), para. 55. From the *Cadbury Schweppes* case onwards, the characterization of tax avoidance as the expression of abusive practice in tax matters has become a consistent feature in the judgments of the Court of Justice.
9. For instance, in the *Cadbury Schweppes* case, the Court addresses a case of CFC legislation, which for its own structural features clearly represents a SAAR, though also using some arguments connected with letterbox companies (*see Cadbury Schweppes* (C-196/04), para. 66), which could also fit in a context of tax evasion. This conceptual bundling of tax categories for EU law characterization purposes is also evident in other judgments, such as CJEU, *Lankhorst-Hohorst* (C-324/00), paras. 37 (referring to tax evasion) and 38 (referring to abuse in connection with the application of thin capitalization rules).



grounds,[10] not applying it on a standalone basis. The rationale for this justification is that, in principle, EU law should not interfere with the way in which EU Member States allocate taxing powers among each other. Interestingly, when applying this ground for justification not in connection with the prohibition of abusive practices, the Court has generally shown a looser approach to the control of proportionality. In general terms, the fact that the Court has never applied this justification on a standalone basis and that it has rejected this in at least one specific case[11] do not necessarily imply that the Court is against this possibility, but merely that the factual patterns in which this matter was brought to its attention have not yet given the Court such an opportunity. We shall get back to this separate justification later in our analysis, when addressing the concept of aggressive tax planning and the limits within which it may constitute a ground for justification.

Although the Court has managed to steer the conceptual boundaries of the prohibition of abusive practices in a fairly uniform and consistent manner, there are occasions in which such consistency, at least apparently, was missing. This occurred in its case law on the anti-abuse clauses contained in tax directives that preserve the rights of EU Member States to apply the domestic anti-abuse legislation on matters regulated by secondary law of the European Union. In particular, in the absence of domestic anti-avoidance provisions implementing the anti-abuse provision contained in the EU Tax Merger Directive, the Court of Justice ended up endorsing the application of this Directive, i.e. of secondary law of the European Union, in connection with possible cases of abusive practices.[12]

10. The bundling of the balanced allocation of taxing powers with other justifications (namely with tax avoidance and the prohibition of double deductions) was first used by the Court in UK: CJEU, 13 Dec. 2005, C-446/03, *Marks and Spencer*, para. 51, and then also applied in several other judgments, sometimes also in connection with only one justification. *See further* GER: CJEU, 29 Mar. 2007, C-347/04, *Rewe*, paras. 41-42; GER: CJEU, 15 May 2008, C-414/06, *Lidl Belgium*, para. 33; NL: CJEU, 29 Nov. 2011, C-371/10, *National Grid Indus*, para. 45. For a comprehensive overview of balanced allocation of taxing powers as a justification, *see further* M. Schaper, *The Structure and Organization of EU Law in the Field of Direct Taxes* (IBFD 2013), in particular in chs. 6 and 7.

11. *See* UK: CJEU, 6 Sept. 2012, C-18/11, *Philips Electronics*.

12. In particular (*see* DK: CJEU, 5 July 2007, C-321/05, *Kofoed*), the Court allowed the application of the Merger Tax Directive, despite the second preliminary question referred by the Danish national Court having raised the possible existence of an abusive practice in connection with an exchange of shares; furthermore (*see* NL: CJEU, 20 May 2010, C-352-08, *Zwijnenburg*), the Court refused the application of the national approach implementing the anti-abuse provision of the Merger Tax Directive to a factual pattern involving the avoidance of another tax, thus in fact allowing the use of such secondary EU legislation as a tool for tax avoidance.

Furthermore, the Court also excluded that its interpretation of the tax implications of the EU principle of the prohibition of abusive practices could apply to another case concerning a factual pattern in which the application of EU law was not evidently triggered,[13] thus leading to the potential implication that, in a case simultaneously raising VAT and direct taxes, the implications could in fact be different.

Generally speaking, although the application of general principles to tax matters has not led the Court to reach an overall concept of the prohibition of abusive practices in tax matters applicable within the internal market, its interpretation within this framework has developed certain important criteria for defining the boundaries of such a phenomenon to the extent that the application of EU law is triggered for a given reason.

Two landmark cases can be mentioned in this respect, namely the *Halifax* case (C-255/02),[14] concerning value added tax, and the *Cadbury Schweppes* case (C-196/04),[15] on the limits to the application of CFC legislation in the field of direct taxes. Despite concerning different taxes, both judgments contribute to a unitary reconstruction of the conceptual category of abusive tax practices, i.e. tax avoidance, under EU law.[16]

In particular, in the *Halifax* case, the Court first defined the boundaries of abusive tax practices as "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"[17] and then put forward the elements to define such practices in cases where "notwithstanding formal application of the conditions laid down by the relevant provisions… [there is the] accrual of a tax advantage…[that is] contrary to the purpose of those provisions", adding that such a situation should be "apparent from… objective factors".[18]

Besides quoting this precedent, in the *Cadbury Schweppes* case, the Court concluded that abusive tax practices were "wholly artificial transactions

13. *See* IT: CJEU, 29 Mar. 2012, C-417/10, *3M Italia*, para. 31.
14. *See* UK: CJEU, 21 Feb. 2006, C-255/02, *Halifax*.
15. *See Cadbury Schweppes* (C-196/04).
16. For a thorough reconstruction of the concept of tax avoidance in line with case law of the Court of Justice, *see* K. Lenaerts, *The Concept of 'Abuse of Law' in Case Law of the European Court of Justice on Direct Taxation*, 22(3) Maastricht Journal of European and Comparative Law (2015), pp. 329 et seq.
17. *Halifax* (C-255/02), para. 74.
18. *Halifax* (C-255/02), para. 75.

aimed at circumventing the legislation”,[19] which could be detected in the absence of objective factors reflecting an actual substance, such as – in the case of controlled foreign companies – staff, premises and equipment suitable to carry out the corresponding activities.[20]

The expressions “wrongfully obtaining advantages” and “wholly artificial transactions” more specifically characterize the concept of obtaining tax advantages in a way that is contrary to the object and purpose of tax legislation, which is in essence the circumvention of the legislation that is a typical effect of tax avoidance schemes.

The Court clarified its interpretation in later cases, indicating that operations with the essential aim of obtaining undue tax advantages were also to be regarded as abusive tax practices[21] and that the economic substance would have to be measured against the functions performed, including acceptance of the arm’s length principle as safe harbour for non-abusive tax practices.[22]

The case-by-case analysis required to comply with the principle of proportionality has in fact taken the intervention of the Court of Justice to produce a fairly high impact on the application of anti-tax avoidance measures, which have gradually lost part of their deterrent function and turned into measures for securing a legal environment in which different boundaries for the existing definitions of tax avoidance could gradually converge, in connection with the need to comply with the same standard required by EU law.

On the one hand, this framework significantly facilitates the task of the European Commission, but, on the other hand, it also narrows the boundaries within which positive integration is required and admissible. The latter perspective becomes particularly evident insofar as one considers secondary law as a tool to allow primary law to achieve the goals of integration that it cannot otherwise reach by means of the interpretation of its own rules. In line with this interpretation, the primacy of primary over secondary Union should also imply that the latter may not include rules that are in conflict with the principles and rules established by the former.

In line with this reasoning, we shall now elaborate on the contribution provided by secondary EU tax law to the definition of the meaning of tax avoidance and draw a conclusion on whether this contribution results in a

19. *Cadbury Schweppes* (C-196/04), para. 51.
20. *Cadbury Schweppes* (C-196/04), para. 67.
21. *See* IT: CJEU, 21 Feb. 2008, C-425/06, *Part Service*, para. 42.
22. *See* SGI (C-311/08), para. 71.

consistent conceptual framework for the category of abusive tax practices under EU law. Our focus will be on direct taxes, since the interpretation given by the Court on VAT cases makes further analysis of this domain of limited relevance for the purposes of our study.

Whilst such rules present a non-uniform reference to tax avoidance, abuse, evasion and fraud, we shall consider them all as applicable to cases of tax avoidance for the purposes of our analysis without deriving any significant conclusion in connection with their different wording.

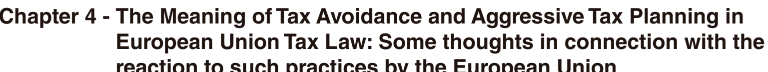
4.3.2. Secondary law in direct tax matters

The original drafting of the Merger and Parent-Subsidiary Tax Directives provided for a fairly soft approach to the matter, since the clauses contained in these Directives[23] for such purposes only ensured that EU Member States would keep their right to apply their own measures against tax avoidance and evasion. Besides the introduction of further anti-avoidance rules in the Interest-Royalty Directive,[24] a significant change in secondary tax legislation occurred as of 1 January 2016, when, in addition to the right to counter tax evasion, fraud and abuse in line with the domestic provisions applicable in each Member State, the Parent-Subsidiary Directive introduced an actual obligation to preclude the application of the Directive to abusive tax practices, together with a definition of such practices.

In particular, according to the current wording of Art. 1(2), the prohibition to apply the Parent-Subsidiary Directive covers any "arrangement or series of arrangements which, having been put into place for the main purpose or one of the main purposes of obtaining a tax advantage that defeats the object or purpose of this Directive, are not genuine having regard to all relevant facts and circumstances". This provision further specifies that an "arrangement may comprise more than one step or part" and Art. 1(3) adds that "arrangements shall be regarded as not genuine to the extent that they are not put into place for valid commercial reasons which reflect economic reality".

In broad terms, the substance of the GAAR contained in the Parent-Subsidiary Directive does not present major differences from the elaboration

23. Namely, Art. 11(1) of the Merger Tax Directive (the clause was later renumbered as Art. 15(1), though without major implications for the purposes of our analysis) and 1(2) of the Parent-Subsidiary Directive.
24. *See*, for instance, the GAAR contained in Art. 5 of the Interest-Royalty Directive.



of the conceptual category provided by the EU principles through its interpretation of how the fundamental principles of EU law apply to tax matters. This certainly facilitates the interpretation of the GAAR in line with the existing case law of the Court on tax avoidance, leaving ample room to the Court to weigh up the existence of valid commercial reasons and providing the Court with an additional benchmark for defining their content in a way that reflects economic reality.

However, it is not entirely clear what actual implications may be derived in connection with the reference to the economic reality. In principle, such a criterion could postulate the application of a substance over form approach, but it would be easier to reconcile with the criteria so far used by the Court a possible evaluation by the Court about the consistency with the economic goals pursued by the transaction.

More recently, the ATAD has added further content to this framework with the introduction of a GAAR and four SAARs.

Since the wording of the GAAR entirely reflects that of the one included in the Parent-Subsidiary Directive, it facilitates a conceptual convergence at the level of interpretation by the Court of Justice, which will now also have a broad jurisdiction over national GAARs in the field of corporate direct taxes, as well as of the four SAARs.

Three SAARs among those included in the ATAD reflect its overall goal of providing for a common implementation framework of the corresponding BEPS actions, which are included among the best practices, with a view to achieving a level playing field in this respect within the European Union.

However, in line with the indication in its Art. 3, the ATAD only sets a minimum level of protection and allows EU Member States to apply stricter domestic or agreement-based provisions. In this context, at least two undesirable consequences may arise. First, by legitimating such different national standards, the ATAD is structurally unsuitable to achieve an EU-wide level playing field and turns into the source of possible legal biases within the European Union. Second, the application of stricter anti-avoidance standards by an EU Member State in conformity with the requirements set by the ATAD can lead to cases of double taxation in the presence of secondary legislation. In line with the methodology described earlier, such cases are to be addressed by reading also Art. 3 in the light of primary law of the European Union, thus excluding that EU Member States have carte blanche as to the implementation of such a provision.

Furthermore, the ATAD also goes beyond the BEPS project by applying some measures, such as CFC legislation to permanent establishments, beyond the boundaries contemplated in the BEPS project, and by introducing further measures that are not contained in this project, namely a common GAAR and the rules on exit taxation. The introduction of the latter measure is to be evaluated positively, since it removes the existing potential for cross-border inconsistencies in the treatment of gains and losses within the internal market in connection with changes of jurisdiction for persons or assets within the European Union in line with the framework established by EU primary law.

The ATAD is rather to be regarded as the first bulk of the broad coordination of corporate tax policies in the European Union that shifts competences to the supranational level in connection with the reaction to tax avoidance, which – for almost all of the ATAD measures[25] – is scheduled to be implemented by 31 December 2018.

A thorough analysis of the measures contained in the ATAD is unnecessary for reconstructing the meaning of tax avoidance under EU tax law. However, some selected issues from the ATAD allow our analysis to reach some interesting conclusions.

The major implications of the ATAD can be summarized briefly as follows. The existence of a common minimum framework for anti-tax avoidance measures at the level of the European Union partly shifts competences away from the national level; widens the obligation for EU Member States to counter international tax avoidance; forces some of them – e.g. Ireland, Luxembourg Malta and the Netherlands – to adopt anti-avoidance measures, such as for instance CFC legislation, that were not in line with their own national tax policy (and to apply them, also in exemption countries, on income attributable to foreign permanent establishments); obliges States to further adapt their existing anti-avoidance measures to the new EU standards; and, most importantly, activates the jurisdiction of the Court of Justice on the interpretation of the rules of the ATAD, as well as on those that implement it, or take it as their reference framework.[26]

Further insight on Art. 7 of the ATAD and its standard for CFC legislation could be interesting for the purposes of our analysis. The identification of the exact implications of this provision is difficult to determine, due to its

25. *See* the exceptions contained in Art. 11(4), (5) and (6).
26. *See* the criteria put forward by the Court of Justice in *Leur-Bloem* (C-28/95).

poor drafting and the complexity related to the numerous variables connected with its application.

Art. 7 of the ATAD stretches the nexus with income of the controlled foreign entity or foreign permanent establishment on the basis of two alternative modalities, namely the designated-income (Art. 7(2)(a)) and the overall approach (Art. 7(2)(b)).

The designated-income approach incorporates the fairly tight limits developed by primary EU/EEA law with limited difference,[27] leaving EU Member States the right not to apply it in two cases, namely (i) when such income only represents one third of the total income of the entity's income;[28] and (ii) in respect of EEA subsidiaries.[29] The latter option creates a potential bias against the investment in non-EEA subsidiaries, whose compatibility will have to be addressed in the light of Art. 63 of the TFEU, to the extent that the free movement of capital is indeed applicable to a given case.[30] The said option can be combined with the former one, whose rationale is to allow for the exemption of cases with a less significant risk of profit shifting in cases where a core activity of such companies is not connected with the designated types of income. However, neither of these options should prevent, on the one hand, Member States from applying more restrictive CFC rules

27. In particular, Art. 7(2) (a) does not apply "where the controlled foreign company carries on a substantive economic activity supported by staff, equipment, *assets* [emphasis added] and premises, as evidenced by relevant facts and circumstances". Accordingly, the carve-out sets a stricter standard than that applicable under the settled interpretation by the Court of Justice on CFC legislation, which could therefore give rise to some potential conflict for not allowing the exercise of a fundamental freedom at the conditions admitted by the Court. Furthermore, the fact that such a context does not specifically include a reference to permanent establishments may affect the neutral exercise of the secondary right of establishment, for setting stricter conditions in connection with the exercise of this right through CFCs as compared to the conditions that would apply to a person who operates with a permanent establishment.

28. *See* Art. 7(3) ATAD, which does not include in this case a specific reference to permanent establishment. Since a specific separate reference to permanent establishments is elsewhere always included, the wording of this carve-out suggests that it only applies to CFCs and not to permanent establishments. One may therefore wonder whether the bias connected with the application of this carve-out is compatible with the neutrality in the exercise of the secondary right of establishment.

29. This is how we interpret the unclear reference to "the preceding paragraph", contained in the third indent of Art. 7(2)(a) ATAD.

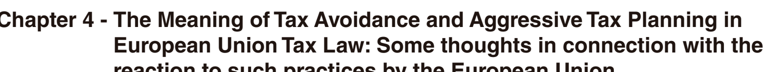
30. *See* UK: CJEU, 13 Nov. 2014, C-112/14, *Commission v. United Kingdom*; PT: CJEU, 3 Oct. 2013, C-282/13, *Itelcar*, and, for my own views on such issues, P. Pistone, *BEPS, Capital Export Neutrality and the Risk of Hidden Tax Protectionism. Selected Remarks from an EU Perspective*, in *Base Erosion and Profit Shifting* (*BEPS*)*. Impact for European and international tax policy* (R. Danon ed., Schulthess Verlag 2016), pp. 319 et seq.

in conformity with Art. 3, and, on the other hand, the Court of Justice from assessing that a CFC in line with the requirements of Art. 7(3) of the ATAD may still be incompatible with primary law, for being an artificial arrangement. Accordingly, Art. 7(3) of the ATAD should not be regarded as establishing a safe harbour, limiting the jurisdiction of the Court of Justice or making a case-by-case assessment of tax avoidance unnecessary, but rather constitute an indicator that, in the situations indicated in this provision, it is more difficult to conceive of the existence of tax avoidance.[31]

The overall approach does not contain a specific waiver for EEA subsidiaries and is shaped along the features of a TAAR, since such a provision incorporates the content of a GAAR, whose content is more specific than that of the one contained in Art. 6 of the ATAD.

The TAAR of Art. 7(2)(b) includes its own definition of non-genuine arrangements, which are identified by reference to the assets and risks of the controlled foreign company and permanent establishment, and their connection with key people functions exercised by the parent company or head office in respect of income generated by the controlled foreign company or permanent establishment. Besides its poor formulation, the substance of this definition looks at key elements in order to draw a dividing line between genuine and non-genuine arrangements,[32] which should minimize the risk for conflict with the overall criteria established by the Court of Justice for detecting the existence of wholly artificial arrangements. However, insofar as such situations fall under the scope of the fundamental freedoms and have staff, premises and equipment that are in line with the standards set by the Court of Justice in the *Cadbury Schweppes* decision for the admissibility of CFC legislation, one should not exclude the possibility of the Court questioning the validity of the TAAR in respect of specific circumstances. In other words (and even more so in cases where States overimplement the standards of the TAAR in line with the provision of Art. 3), the application of the TAAR may not entirely exclude that the Court of Justice regards situations that could be regarded as non-genuine arrangements under its settled case law, as genuine exercise of the right of establishment. Nevertheless, it is reasonable to expect that States will refrain from making in such context an undue use of refutable and irrefutable presumptions.

31. In our view, such result could have also reached directly by the Court of Justice at the level of interpretation, avoiding the issuing of the complex set of rules of Art. 7.
32. We expect that the factual assessment of such situations increases disputes connected with the meaning of tax avoidance and its application to specific cases, which the judiciary will have to resolve.



Also Art. 7(4) gives EU Member States the right to apply a carve-out to the application of the overall approach established by Art. 7(2)(b). The two alternative modalities for this carve-out look to include a minimum threshold defined by reference to the situations in which either the controlled foreign companies and permanent establishments have accounting profits not exceeding EUR 750,000 and non-trading income within EUR 75,000, or have accounting profits of no more than 10% of their operating costs for the tax period.

Insofar as an EU Member State decides to limit the application of its CFC rules in conformity with this threshold, it could be viewed in two ways. First, this threshold is the expression of the need to keep within reasonable boundaries the application of rules that in fact limit the exercise of the right of establishment. Second, this threshold does not prevent the Court of Justice from striking down wholly artificial arrangements set up to circumvent the liability to tax in an EU Member State, when the controlled foreign company or permanent establishment lacks staff, premises and equipment that are in line with the criteria established by the Court.

Supporting the first view should not produce actual consequences for the meaning of tax avoidance, but rather act as a criterion for indicating that, in such circumstances, the EU standard of CFC legislation does not in fact oblige States to take action. By contrast, a relevant element in favour of the second view should be found in the case where the threshold is set by Art. 7(4) of the ATAD at fairly high values and that it is rather unreasonable to deem that tax avoidance should only exist for EU tax law purposes above them. In connection with the issuing of ATAD, the regulation of this domain has become in principle relevant for EU law. Therefore, even if one considers that the TAAR of Art. 7(2)(b) has created a micro-environment for the reaction to tax avoidance in the specific cases that it regulates, the wording of Art. 6(1) requires Member States to ignore “arrangements, which having been put into place for the main purpose or one of the main purposes of obtaining a tax advantage that defeats the object and purpose of the applicable tax law, are not genuine having regard to all relevant facts and circumstances”, adding in Art. 6(2) that, for the purpose of the previous clause, an “arrangement shall be regarded as non-genuine to the extent that it is not put in place for valid commercial reasons which reflect economic reality”. The effect of the obligation of the Court to take into account Art. 6 in cases in which a Member State has exercised its option to carve-out Art. 7(2)(b), in fulfilment of the rights enshrined in Art. 7(4), would therefore, in our view, be that the Court of Justice is still obliged to make sure that the obligation

of the GAAR keeps its full meaning and value, thus striking down all cases of controlled foreign companies that are expressions of abusive practices.

In the absence of a clause regulating the relations between the *general* AAR of Art. 6 and the *targeted* AAR of Art. 7(2)(b), one could consider that the principle of *lex specialis* could make the latter preventing the application of the *lex generalis*. However, the consequence of this interpretation would be to allow the application of secondary law in respect of abusive practice of a non-negligible value.

In the light of our analysis, the ATAD appears in fact as the source of unnecessary complication in the interpretative reconstruction of the conceptual categories of tax avoidance, as well as of additional biases (including, in particular, in the relations with non-EEA countries) and specifications, whose validity should still be tested against primary law of the European Union. To the extent that such specifications are compatible, the meaning of tax avoidance in the areas covered by the ATAD may be adjusted, but without departing from the boundaries established through the interpretation of the basic principles of EU law.

Our criticism of the ATAD should not necessarily be interpreted as an opposition to its content being regulated by secondary law, but rather for the unsatisfactory outcome of a text that suffers from the repeated amendments to its wording over a very limited period of time to satisfy the different conditions put forward by the various EU Member States and reach the unanimous consent required for approval in the framework of the EU Council.

Whilst failing to achieve its goal of establishing a level playing field within the European Union,[33] the ATAD has the merit of shifting the reaction to tax avoidance in most areas of direct taxation from the national to the supranational level within the European Union. This development gives the Court of Justice jurisdiction to apply its settled interpretation on abusive tax practices within a broader area of direct taxation and further refine this concept

33. Various tax directives have applied this technique, but never in a similar context. In particular, since their original formulation, the Tax Merger Directive and Parent-Subsidiary Directive allowed EU Member States to apply their anti-abuse rules clauses and in such cases prevent the application of rules that had removed the existing cross-border tax obstacles. Likewise, in the field of VAT, minimum thresholds were established in different contexts (for instance as to the rates), in all of which any departure from such standards would have in fact have gone against the national interest of the State applying them.

in the near future, together with the new challenges arising from proposed legislation.[34]

In line with the arguments that have been put forward in the framework of this section, the core concept of tax avoidance, also known as abusive practices, can be derived on the basis of settled case law of the European Court of Justice on the fundamental freedoms. Accordingly, we consider its existence in the presence of a causal link between tax advantages and the friction between form and substance, producing artificial arrangements, which may not be justified on the basis of main business, i.e. non-tax, grounds. In line with the requirements of EU law, the identification of such practices always requires a case-by-case analysis, with a view to excluding disproportionate effects on genuine practices entitled to the protection of EU law. The presence of TAARs and SAARs may steer the application of such rules in connection with the application of specific requirements, but not depart from this overall framework.

4.4. The meaning of aggressive tax planning

A much more limited number of elements become available in the framework of an empirical search for the meaning of aggressive tax planning.

This phenomenon was only recently singled out from international tax planning in connection with the plans to enhance international tax coordination and narrow down the boundaries within which States tolerate international tax planning. For that purpose, studies were conducted by the OECD since 2010, then also in the framework of the BEPS project, and the European Commission undertook a coordinated action that produced the 2012 Recommendation.[35]

This recommendation could serve as the actual starting point of our analysis. Interestingly, it defines aggressive tax planning in the preliminary remarks, but not in the actual content of the recommendation, despite the fact that

34. In particular, the proposed CCTB Directive, in its formulation of COM(2016) 685, 25 Oct. 2016, indicates the potential for new anti-avoidance supplementing the GAAR of ATAD. Art. 11(6) of such proposal indicates that the Council may empower the Commission to adopt delegated acts laying down more detailed rules against tax avoidance in connection with the allowance for growth and investment (AGI). Furthermore, Art. 53 of the same proposal include a SAAR along the mechanism of switchover clauses.
35. C(2012) 8806 final of 6 Dec. 2012, Commission Recommendation on Aggressive Tax Planning.

the Commission does recommend the introduction of various measures in domestic tax law and treaties for the purpose of effectively countering this undesirable phenomenon. Among others, such measures include suggested amendments to the existing national anti-avoidance rules of EU Member States.

In particular, the second preliminary remark to the 2012 Recommendation indicates that "aggressive tax planning consists in taking advantage of the technicalities of a tax system or of mismatches between two or more systems for the purpose of reducing tax liability", adding that its "consequences include double deductions and double non-taxation". In line with this reconstruction, aggressive tax planning should be characterized as the outcome of unintended tax advantages within one single system, or across borders.

The content of the 2012 Recommendation suggests two main types of action against aggressive tax planning, to be included respectively in double taxation conventions and in domestic tax law. As for the first type of action, it recommends the introduction of subject-to-tax clauses in tax treaties and indicates that the requirements of such criteria are not met in the presence of exemption, full tax credit, or zero-rate taxation. As for the second one, it invites EU Member States to apply a comprehensive GAAR.

Despite affirming that aggressive tax planning may also occur inside one tax system, the preliminary remarks to the recommendation acknowledge that "national provisions…are often not fully effective, especially due to the cross-border dimension of many tax planning structures" and that "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)".

Before and after the EU recommendation, work conducted by the OECD has proved that aggressive tax planning thrives across borders, especially by exploiting the inconsistencies and mismatches between tax systems and the way in which the systems apply their respective taxing rules and deductions. In fact, the bulk of cases of aggressive tax planning arise in connection with the cross-border utilization of losses,[36] other forms of double deductions in respect of one single payment, as well as equivalent combinations of deduction in the hands of the payer coupled with non-taxation in the hands of the recipient, or a negative conflict of tax jurisdiction that generates.

36. OECD, *Corporate Loss Utilisation through Aggressive Tax Planning* (OECD Publishing, Paris 2011), available at http://dx.doi.org/10.1787/9789264119222-en

From a conceptual perspective, the question arises as to whether it is correct to consider unintended tax advantages connected with the exploitation of technicalities within one single tax system as forms of aggressive tax planning.

This question should be answered in the negative. The exploitation of technicalities within one tax system may not give rise to an intermediate category between tax avoidance and legitimate tax savings. Each tax system has an internal consistency to its rules and allows tax minimization to the extent that this does not conflict with these rules, or their interpretation. The exploitation of technicalities within one tax system may be due to the absence, or ineffectiveness, of GAARs and other anti-avoidance rules. However, unless the interpretation of a tax rule, or the application of an anti-avoidance provision actually prohibits the exploitation of technicalities, any tax advantage arising in such a context should be regarded as the legitimate result of the exercise of the right of taxpayers to arrange their affairs in a way that reduces the overall tax burden connected with such activities. After the EU recommendation, GAARs have come to constitute a common feature of all tax systems within the European Union.[37]

However, aggressive tax planning raises problems structurally different from tax avoidance and is therefore unsuitable to be addressed as a subcategory of the latter, for its very existence presupposes a cross-border scenario in which the exploitation of differences between tax systems creates the potential for the tax advantage that a taxpayer exploits. Such a situation differs structurally from tax avoidance even when the latter phenomenon occurs at the international level, such as in the case of treaty shopping, where the taxpayer seeks a tax advantage by circumventing the application of tax rules of one single tax system.

It should therefore come as no surprise that anti-tax avoidance measures are fairly ineffective in respect of aggressive tax planning, since such measures target practices that allow tax advantages to be obtained by exploiting internal inconsistencies between the rules of a given tax system, rather than those in which such an advantage is the outcome of an exploitation of the tax differences between two or more systems.

37. After the introduction of GAARs in 2013 in Greece and the United Kingdom, and in 2015 in Denmark and Italy, all EU Member States except for Latvia, Lithuania and Slovenia currently include statutory GAARs or equivalent measures developed by the judiciary in their tax systems.

The focus of our analysis will now shift to how taxpayers may obtain tax advantages by exploiting such differences, with a view to identifying the essential elements of aggressive tax planning and understanding the boundaries of this phenomenon.

In general terms, each tax system keeps its own internal consistency, with the underlying policy goals and the boundaries within which law allows the exercise of taxing powers. Therefore, different policy goals and rules may result in positive and negative conflicts of taxation in respect of cross-border situations. Such conflicts are the natural outcome of the exercise in parallel of taxing jurisdiction in two or more countries and, for European tax law purposes, the source of cross-border tax disparities.

The limited harmonization of direct taxes across systems has contributed to the increased relevance of tax disparities over the past decades, triggering the attention of the Court of Justice on several occasions.

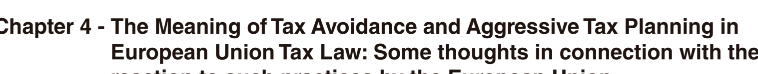
In the case of disparities arising from positive conflicts of tax jurisdiction, the Court had concluded that any less favourable treatment is the consequence of the lack of tax harmonization and results from the exercise in parallel of taxing jurisdiction of two or more Member States. On the basis of such arguments, unlike discriminations and restrictions, tax disparities are regarded as compatible with the exercise of a fundamental freedom.[38] At present, the Court has put such situations in a juridical limbo, leaving it up to other EU institutions and/or EU Member States to address their problems by means of positive integration.

The Court has taken a different approach to disparities arising from negative conflicts of tax jurisdiction, considering their impact on State aid within the internal market. In the *Gibraltar* case, it quashed tax rules that systematically gave rise to selective tax advantages from the exploitation of cross-border tax disparities, regarding such rules as incompatible with Art. 87 of the TFEU.[39]

Case law on fundamental freedoms contains further relevant elements for our interpretative reconstruction. In particular, EU Member States are allowed to apply their domestic provisions in order to prevent double tax

38. BE: CJEU, 14 Nov. 2006, C-513/04, *Kerckhaert-Morres*; GER: CJEU, 12 Feb. 2009, C-67/08, *Block*; BE: CJEU, 16 July 2009, C-128-08, *Damseaux*; AT: CJEU, 10 Feb. 2011, C-436 and 437/08, *Haribo*; IT: CJEU, 4 Feb. 2016, C-194/15, *Baudinet*.

39. *See* CJEU, 15 Nov. 2011, C-106 and 107/09, *Commission and Kingdom of Spain v. Government of Gibraltar and United Kingdom of Great Britain and Northern Ireland*.



deductions, since the Court admits this circumstance as a ground for justification, which it has bundled together with the need to preserve the balanced allocation of taxing powers and to counter tax avoidance.[40]

Seen from the perspective of EU law, the exploitation of such cross-border tax disparities may affect the internal market and the exercise of tax sovereignty in a way that is totally disconnected from the existence of an actual abusive practice.

This gives us one more reason to affirm that, insofar as aggressive tax planning is connected with the exploitation of tax technicalities and mismatches for the purposes of obtaining an unintended tax advantage within such a framework, it should be regarded as a completely different phenomenon from tax avoidance for the purposes of EU law.

Accordingly, when reacting to such practices, States should be allowed to preserve the integrity of their tax sovereignty and the allocation of taxing powers in a way that does not require all the steps for applying the justification based on the need to counter abusive practice. A standalone justification based on the need to preserve the allocation of taxing powers, or, in some cases, its bundling with the prohibition of double dips would in our view also best serve the need to secure a level playing field within the internal market, preventing possible unintended tax biases akin to forms of harmful tax competition.

Our analysis will now be rounded off by a more precise indication of the elements that characterize aggressive tax planning.

First, aggressive tax planning is connected with tax advantages, often arising in the form of double non-taxation, that must be connected with the exploitation of cross-border tax disparities. In other words, there should be a causal link between the tax advantage and the exploitation of the external inconsistency, or the disparity, between two tax systems. A good indicator of this situation is that such tax advantages would not be available in either tax jurisdiction involved, due to the internal consistency of the rules applicable within such tax systems.

Except in certain cases – such as the ones connected with double deductions in respect of a single payment or double benefits that are connected with the external inconsistency between tax systems – the interpretation

40. *See*, for instance, *Marks and Spencer* (C-446/03).

of this element should not lead to the conclusion that all tax advantages connected with the exploitation of cross-border tax disparities qualify for possible cases of aggressive tax planning by themselves, since otherwise this phenomenon could only disappear in the presence of a complete tax harmonization.

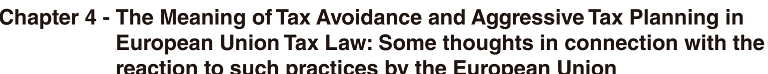
A second element could therefore prove particularly helpful in singling out most cases of aggressive tax planning. In line with studies conducted by the OECD in the framework of the BEPS project, such an element could be described as the "misalignment effect". Its core is represented by the attempt to produce a misalignment, or a disconnect, between the tax jurisdiction of value creation and that to which the taxpayer seeks to shift profits in a way that is instrumental to obtaining the tax advantage.

For the purpose of better understanding the relevance of this element, we may imagine that tax incentives for a given activity may render a tax jurisdiction particularly attractive for business, leading a taxpayer to seek to have its profits taxed under this jurisdiction, regardless of whether value creation has occurred elsewhere. This is, for instance, the case with the so-called IP box regimes that are being faded out in various European countries, including the United Kingdom, by 2021. Insofar as the tax rules of the jurisdiction that applies this favourable tax regime allow taxpayers to establish a nexus within such a jurisdiction on the basis of rules that do not necessarily take into account the place of value creation, the taxpayer could exploit the cross-border tax disparity in a way that allows him to produce the desired misalignment effect and shift the profits where they are taxed less without giving rise to an actual abusive practice.

Certainly, the profit shifting effects can be magnified by forms of transfer pricing that are connected with cases of tax avoidance and evasion, or fraud. However, for the purposes of European tax law, this constitutes a separate issue that has to be addressed in the light of the requirements for countering abusive and fraudulent practices.

Finally, a third element is essential for the existence of aggressive tax planning and requires that the granting of a tax advantage should not be intended by the States involved.

When the same payment of income is regarded in the country of the payer as debt (as such eligible to deduction from income) and in that of the recipient as remuneration for an equity investment (as such entitled to a participation exemption in line with the requirements of the EU Parent-Subsidiary



Directive), the double non-taxation of such income resulting across borders should be regarded as unintended, since it would not have been achieved had the rules of either system consistently been applied, either coupling deduction with taxation, or exemption based on the assumption of a previous taxation.

Various forms of cross-border tax mismatches can give rise to unintended cross-border tax advantages, including the ones connected with hybrid mismatches, addressed by Art. 9 of the ATAD.

Furthermore, also in the example of profit shifting connected with the application of a preferential tax regime, the effect of an unintended tax advantage occurs insofar as one considers that the nexus requirements allow for a connection with tax jurisdiction that is disconnected from the place of value creation.

For the purpose of more precisely identifying the boundaries of this third element, we shall now also consider the case of two States that have reached an agreement on the allocation of taxing powers in cross-border situations that prevents them from interfering with how either of them exercises its own tax jurisdiction. A clear example of this situation is given when countries include a tax sparing clause in the applicable double taxation convention. Since the function of this type of clause is to allow either country to remain the master of its own international tax policy decisions, the entitlement to any tax advantage granted by either country is held as intended by both and therefore clearly does not meet the third criterion of aggressive tax planning. Accordingly, neither State may offset lower taxation in the other State by unilaterally applying compensatory taxes, nor would tax sparing be compatible with the unilateral application of subject-to-tax clauses, as suggested by the 2012 Recommendation of the EU Commission. These conclusions apply in our view in intra-EEA relations, as well as in those with non-EEA countries.

Nevertheless, neither Contracting State should be considered to have carte blanche as to the way in which it exercises its tax jurisdiction. In particular, the presence of tax rules that are shaped in a way that systematically allows taxpayers to derive actual tax advantages from the exploitation of the misalignment effect connected with cross-border disparities would be enough to give rise to a case of aggressive tax planning and be treated accordingly.

In the light of such arguments, the issue arises of whether and to what extent compensatory taxes can apply as a tool to react to actual cases of aggressive

tax planning. The Court of Justice regards these taxes as potentially in conflict with the principles and dynamics of the internal market, thus admitting their application in the sole cases in which Member States proportionately react to actual abusive and fraudulent practices.[41] In our view, since EU Member States have introduced measures of international tax coordination for narrowing the limits of tolerance for international tax planning, nothing should prevent the application of compensatory taxes to aggressive tax planning, properly identified in the light of the requirements indicated above.

In our reconstruction of the conceptual category of aggressive tax planning, it is now important to focus on how this phenomenon should be approached from the perspective of EU law.

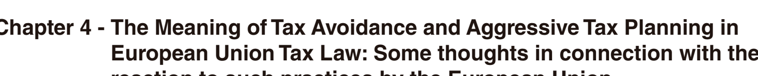
In general terms, the answer to such a question is that various techniques should be used to achieve an effective reaction to aggressive tax planning. However, all of them require a coordinated approach among the States to achieve the cross-border or external consistency that is required in respect of the tax treatment applicable to each specific situation to effectively react to the potential for obtaining unintended tax advantages by exploiting cross-border tax disparities and shifting profits to a different tax jurisdiction.

In particular, such measures may include the introduction of common rules at the supranational level for the tax treatment of mismatches, such as the one provided for by Art. 9 of the ATAD, which will become applicable within the European Union by 31 December 2018. The European Commission has already proposed for its extension to the relations with third countries by means of an amendment to the ATAD that was presented in 2016.[42]

The interpretation of primary law can also be a particularly important tool to achieve an effective reaction to aggressive tax planning. In particular, we consider that the development of the justification based on the need to preserve the balanced allocation of taxing powers – bundled together with the need to preserve double deduction and as a possible standalone justification – could give Member States the opportunity to preserve their tax sovereignty from the attempt of its erosion through aggressive tax planning.

For this purpose, the interpretation of this justification should necessarily look at the applicable overall tax treatment to each specific situation in two

41. *See* GER: CJEU, 26 Oct. 1999, C-294/97, *Eurowings*, paras. 38-42; *Cadbury Schweppes* (C-196/04).
42. *See* COM(2016) 687 final of 25 Oct. 2016, Proposal for a Council Directive amending Directive (EU) 2016/1164 as regards hybrid mismatches with third countries.



or more countries, taking into account the rules of either State involved, to determine whether the tax advantage could truly be considered as unintended by the States.

The position developed by the Court of Justice on the exercise in parallel of the taxing jurisdiction of two States should, in our view, no longer constitute a major obstacle to approach such matters, since the developments of international tax coordination connected with the implementation of the BEPS project in the European Union and the additional measures introduced by the ATAD and the related package show considerable progress in respect of an approximation of the connecting factors with tax jurisdiction.[43]

Furthermore, the interpretation of the Court of Justice on State aid matters will also facilitate an effective reaction to aggressive tax planning, since it will prevent Member States from endorsing the attempts of taxpayers to obtain tax advantages from the exploitation of cross-border tax disparities that can be regarded as incompatible with the rules of the internal market and as unintended from an overall assessment of the taxing jurisdiction of the States involved.

In line with the methodology proposed for tax avoidance, the reaction to aggressive tax planning within the internal market as well should, in our view, mainly be based on an interpretation of the existing rules of primary law.[44] Furthermore, it should take advantage of the progress in international tax coordination gathered in the framework of measures implementing the BEPS project, as well as in the harmonization of direct taxes within the European Commission, which was revitalized by the significant efforts started by the EU Commission in 2016.

43. Accordingly, we also submit that, in the areas covered by a significant degree of international tax coordination – which specifically subordinate the application of tax measures in EU Member States to a due consideration of the rules applicable to the same situation in one or more other EU Member States – the Court could also reconsider its interpretation on juridical double taxation as the outcome of the exercise in parallel of taxing jurisdiction in two or more EU Member States. A possible starting point for reconsidering this interpretation could be in connection with those cases in which the effect of juridical double taxation could be derived from the overimplementation of the ATAD, such as for instance of its Art. 9, which, on the one hand, addresses cases of hybrid mismatches by creating a common standard, but, on the other hand, does not prevent EU Member States from applying stricter standards in conformity with the requirements of Art. 3 ATAD.

44. *See*, further on this, P. Pistone, *La planificación fiscal agresiva y las categorías conceptuales del Derecho tributario global*, Revista española de Derecho Financiero, n. 170 (Abril-Junio 2016), sec. V.

4.5. Summary and conclusions

Our empirical reconstruction of tax avoidance and aggressive tax planning in European tax law has shown that the latter phenomenon is not to be regarded as a subcategory of the former, but rather as a separate category.

The core of tax avoidance is that abusive practices alter the internal consistency within a tax system by exploiting the friction between form and substance of domestic or treaty rules and obtaining an otherwise undue tax advantage. Accordingly, tax avoidance schemes are wholly artificial arrangements, set up for the main purpose of circumventing the liability to tax and cannot otherwise be justified in the light of valid commercial purposes other than obtaining such tax advantages.

In particular, aggressive tax planning represents the latest expression of international tax coordination among States, which reflects the global attempt to limit the tolerance of international tax planning put forward in the framework of the BEPS project.

The core of aggressive tax planning comes close to that of tax avoidance insofar as it also aims at obtaining tax advantages that were not intended by the States involved. However, aggressive tax planning is a phenomenon that requires two jurisdictions, since it derives tax advantages from the external inconsistency between two or more tax systems and the exploitation of the potential cross-border disparities that may arise in such a context.

Seen from the perspective of EU tax law, both phenomena have a fairly significant impact on the internal market and therefore need to be addressed in the light of the principles that regulate the latter, taking into account the application of such principles to direct taxes in the interpretation and settled case law of the Court of Justice.

Secondary law recently issued in this framework has several merits, but also shortcomings.

The structural merit of the ATAD shifting competences from the national to the supranational level allows for a more coordinated approach to phenomena that cannot be properly addressed by means of uni- or bilateral action and for a more comprehensive approach by the Court of Justice in line with its settled case law on tax avoidance.

A possible deficiency of the ATAD arises in connection with the abundance and complexity of its rules and the conditions for their application, which make it difficult to reach satisfactory solutions at the level of interpretation and therefore may soon require possible interventions in the form of amendments of such rules.

Nevertheless, several open questions remain in connection with the reaction to tax avoidance and aggressive tax planning in the relations of the European Union with third countries. In principle, the European Union has a legitimate concern in this context about the absence of suitable international legal countermeasures to aggressive tax planning, harmful tax competition and abusive practices. However, the ATAD contains several measures – and further were announced by the EU in the framework of the EU ATA Package – that unilaterally create the potential for a systematic tax bias against third countries. We suggest that the European Union should refrain from the temptation of turning its current competitive tax disadvantages into an excuse for establishing, also in the framework of bilateral agreements with third countries, a structural competitive tax advantage through forms of tax protectionism[45] that would be incompatible with the very essence of the internal market, of the entire legal system of the European Union and its integration into WTO law, as well as in some cases run against the core goals of taxation in line with the place of value creation, which are boosting international tax coordination worldwide in the post-BEPS era.

45. *See*, further on this, P. Pistone, *supra* n. 30, at sec. III.II., pp. 319 et seq.

Chapter 5

Consistency and Hierarchy among the BEPS Actions

María Teresa Soler Roch*

5.1. Introduction

This chapter deals with two fundamental questions relating to the Base Erosion Profit Shifting (BEPS) Project: (1) Are its actions consistent? (2) Is there a hierarchy among these actions? In my view, neither of these two questions has a clear and definitive answer, and maybe the reason for this lack of clarity is the fact that the Action Plan tries to counteract a kind of polyhedral phenomenon identified by the idea of base erosion and profit shifting in the general framework of international taxation. One opinion in this respect was already expressed by A.P. Dourado along the lines of "there is no clear hierarchy or coordination among the different measures aimed at fighting BEPS".[1]

Moreover, the BEPS Action Plan is an ongoing project. An adequate evaluation of it would have to take into account not only the aims of its Actions when it was launched (2013), but also the recommended measures included in the Reports published in 2015. Despite their name ("Final Reports"), they should not be considered the end of the process because their recommendations will have to be implemented by different means and at different levels (national legislations, revision of the OECD Model Convention and the OECD Transfer Pricing Guidelines, or the multilateral instrument as a result of the implementation of Action 15) and because further documents and discussion are being produced.[2]

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* The author can be contacted at: mt.soler@ua.es.

1. A.P. Dourado, *The role of CFC rules in the BEPS initiative and in the EU*, British Tax Review 3 (2015), p. 353.

2. OECD documents: Public Discussion Draft *Treaty Entitlement of Non CIV Funds* (related to BEPS Action 6) (24 Mar. 2016); Public Discussion Draft *BEPS Action 15 Development of a Multilateral Instrument to Implement the Tax Treaty Related BEPS Measures* (31 May-30 June 2016); *BEPS Action 13 Guidance on the Implementation of Country by Country reporting* (June 2016); Public Discussion Draft *BEPS Action 7 Additional Guidance on the Attribution of Profits to Permanent Establishments* (4 July-5 Sept. 2016); Public Discussion Draft BEPS Actions 8-10 *Revised Guidance on Profit Splits* (4 July-5 Sept. 2016); Public Discussion Draft *BEPS Action 4 Elements of the Design and Operation of the Group Ratio Rule* (11 July 2016); Public Discussion Draft *BEPS*

As already mentioned, concepts such as consistency and hierarchy related to the BEPS Project are unclear. In the case of consistency, the analysis can deal with coherence, with respect to no mismatches or contradictions between the Actions and especially with the recommendations set out in the Final Reports, but also with strength, with respect to the suitability of the recommendations in order to comply with the aim of the Actions. In the case of hierarchy, the preliminary remark may be clearer, as far as the design of the Action Plan does not establish a formal hierarchy among its Actions; in this respect, this concept can be considered to be related to the relative importance of the different Actions, also in this case, according to the aim of the BEPS Project.

In both cases, and especially when dealing with consistency, the answers to the questions above cannot be a simple yes or no. Adequate answers will depend on a further point, which is: consistency and hierarchy with respect to what? The content of this book is structured according to this question, taking into account the concept of the BEPS Project and its main targets and standards.

5.2. The concept

A preliminary question deals with the concept and scope of the BEPS Action Plan: What is this project really about?

At the time when it was launched, Brauner defined BEPS as "an overwhelming project; it seems to be about everything and nothing at the same time".[3] To some extent and at a first glance, this may be the right perception of the BEPS Project; it can be perceived as a polyhedral phenomenon and therefore, the same could be said about the Action Plan aimed to counteract it. However, from a theoretical and legal perspective, the main concern raised by the BEPS Project is not related to its more or less extensive scope, but to the lack of clear and solid conceptual grounds, a weakness that some scholars pointed out from the beginning.[4]

Action 4 Approaches to Address BEPS Involving Interest in the Banking and Insurance Sectors (28 July 2016); Discussion Draft *BEPS Action 2 Branch Mismatches Structures* (22 Aug. 2016).

3. Y. Brauner, *What the BEPS?*, 16 Florida Tax Review 2 (2014), p. 111.

4. Y. Brauner stated that "the BEPS project has very undisciplined and opportunistic roots because it evolved through a political response to media frenzy rather than an educated study of the International Tax Regime", in Y. Brauner, *supra* n. 3, at sec. 2, p. 113. A critical analysis can also be read at: J.M. Calderón Carrero & A.J. Martín Jiménez, *El*

A condition sine qua non for the consistency of an Action Plan is a clear identification of the situation that the Plan is aimed to address; in this case, the BEPS phenomenon. Initially, it seems obvious that BEPS cannot be considered a legal concept, but rather just an expression used to identify a current situation in international taxation that is characterized by an unfair balance between states' taxing rights and taxpayers' tax burdens. The result of this balance would be in favour of the taxpayers, especially those who are active globally (multinational groups) and against tax jurisdictions, especially those applying a high level of taxation.

That is just a simple synthesis of the final result, which could not be achieved without help from other players, such as low or intermediary tax jurisdictions and, foremost, thanks to the traditional rules of the game. Although it may seem paradoxical, BEPS should not be considered an unexpected consequence of traditional international tax standards that have been (and still are) characterized, on the one hand, by an absence of general and clear principles that should have marked out the rules and thus been respected by tax jurisdictions and taxpayers, and on the other hand, by the allocation of taxing rights in tax treaties according to an idea of *laissez-faire* only combined with some compulsory rules acting mainly as limitations to the tax power of the source state.

The relationship between the different tax jurisdictions in an international context has been developed according to the paradigm of tax competition,[5] which reflects the respect for national sovereignty and the autonomy of each state in the exercise of its taxing power. In other words, states are free to design their own tax policies, as well as being free to sign or not sign tax treaties with other states and only when they do will their taxing rights be limited, either with respect to some items of income or by correcting double taxation. One of the roots of BEPS lies in this situation, not in the paradigm of tax competition itself, but in the absence – beyond the bona fide principle in international public law – of a specific principle of fair play that should govern the relationship among tax jurisdictions.

Another root of BEPS lies in the non-binding scope of the allocation rights in tax treaties; it is obvious that "may be taxed" does not mean "shall be taxed", and therefore effective taxation rests in the power of each state and thus the door to non- (or low) taxation is open, but so is the door to double

Plan de Acción de la OCDE para eliminar la erosión de bases imponibles y el traslado de beneficios a otras jurisdicciones ("BEPS"): ¿final, el principio del final o el final del principio?, Quincena Fiscal 1-2 (2014).

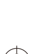
5. *See*, in this respect: Y. Brauner, *supra* n. 3, at sec. 2.

non- (or low) taxation, either in the case where the only state allowed to tax according to the tax treaty does not exercise its right, or, eventually, when both states are allowed to do so but their domestic provisions grant an exemption (or any other benefit).

Those taxpayers locating their capital, developing their economic activities and obtaining their income (either business or passive income) in a global context may benefit from that situation. Also in this case, the roots of BEPS lie in the absence of a general principle that grants that income (and capital) will be effectively taxed, at least in one state. Neither a minimum effective taxation nor the controversial "single tax principle" are properly guaranteed by current international tax standards, and this situation undermines the tax fairness of the whole system. Needless to say, insufficient taxation or no taxation at all can be considered a violation of the ability-to-pay principle, but the problem is that this principle has played a role, so to speak, "within the borders". Whether enshrined in constitutional provisions or not, the ability to pay is considered the main expression of tax justice when determining the taxpayer's burden resulting from tax legislation, and it thus plays its role in the single relationship between the state and its taxpayers; but in cross-border situations, this role may be distorted due to tax competition and the effect of international tax rules.

However, tax treaty rules should not be the only element to be blamed, as far as the risk of double non- (or low) taxation can also arise in the absence of a tax treaty; this situation could simply be due to the gaps, mismatches or asymmetries provoked by tax policy decisions adopted in different tax jurisdictions. It could be, for instance, the effect of tax incentives granted on the same income obtained by the same taxpayer in two different countries (source and residence). Besides that, there is the risk of economic double non-taxation, such as the case of hybrid instruments (deduction in the state of the payer, exemption in the state of the recipient); the taxpayers are different in this case, but the effect on their tax bases is the same, and besides, if both taxpayers are related parties, the effect will mean a substantial reduction on the overall tax burden of the group.

It would be naive to think that this scenario of potential opportunities in order to reduce the tax burden would not have any consequences on taxpayers' behaviour, especially those that operate in a global context. From this perspective, the main consequence has been the development of so-called "aggressive tax planning", a controversial and unclear concept, which can also be considered a root of the BEPS phenomenon. The question which of the two circumstances – tax competition or tax planning – is more dominant,



may be irrelevant to a certain extent, given that there is a feedback effect between them. Or, in other words, "MNE behaviour is only one side of the coin".[6] In respect to the BEPS Project and its consistency, the importance lies in the identification of the targets; in this case, tax competition and tax avoidance, as well as double non- (or low) taxation as a result.

When dealing with the idea of base erosion and profit shifting, some further questions arise. For instance, in the case of related parties within a multinational group, not only should the base erosion of each single company be considered, but also the effect on the group as a whole, moreover taking into account that the economic synergies within this kind of group that is active globally may have a positive effect on their profits. An instrument such as the EU proposal of a common consolidated corporate tax base (CCCTB) might help. However, for the time being, the question is linked to the world of transfer pricing rules, where, for tax purposes, the companies within the group are treated as separate entities notwithstanding the calculation of their tax bases according to the arm's length principle. Needless to say, in this scenario, the question of how to deal with transfer pricing rules becomes a most relevant issue in order to tackle BEPS.

Another question dealing with base erosion in an international context is whether base erosion corresponds to the tax base in the state of residence or to the tax base in the state of source. In this respect, it is well known that the current international tax system is based on the priority of residence over source. As stated by Ault, Schön and Shay: "International tax rules were largely developed under a bilateral paradigm of a well-developed and extensive residence country taxing system".[7] If the concept of a tax base is considered to be focused on the measurement of the taxpayer's global income, this concept will correspond, as a general rule, to the state of residence and from this perspective, BEPS may have a substantial effect on the loss of revenue of this state, especially if this is a high-tax jurisdiction. However, if the tax base in the state of source also has to be considered, taking into account that some BEPS practices are clearly identified may also harm the taxing rights at source (such as for instance, an improper use of the

6. H. Ault, W. Schön & S. Shay, *Base Erosion and Profit Shifting: a Roadmap for Reform*, 68 Bulletin for International Taxation 275 (June/July 2014), Journals IBFD, p. 276. The authors state that "International profit shifting and base erosion envisaged by large business enterprises would be ineffective without countries offering preferential tax rules, including low/no tax regimes for particular taxpayers or income categories and benign provisions on profit measurement".
7. Ault, *supra* n. 6, at sec. 2, p. 276.

Convention aimed to benefit from lower tax rates on dividends or interests at source, or the artificial avoidance of the permanent establishment status).

The latter is related to the idea of profit shifting (where from and where to). In this case, the shifting is not to do with residence vs source, but rather with high- vs low-tax jurisdictions and the latter ones, acting as safe harbours, may play either of those roles.[8] However, in the context of BEPS, the interpretation of a low-tax jurisdiction should be handled with care, because it could give a wrong perception of the problem. In this respect, tax havens could indeed be considered to qualify, but not only tax havens and not even as the main category, as the scope is broader than mere tax evasion and includes international tax planning strategies developed by multinational enterprises (MNEs), where so-called "intermediary" countries play a significant role by using different means, such as specific preferential tax regimes, residence rules, or even by ad hoc tax treatment provided by tax rulings. In this context, some of these countries, rather than fitting in with the traditional idea of low-tax jurisdiction, are considered to be "normal" tax jurisdictions. Included in this group are some EU Member States; a good example in this respect, is the conflict between State aid rules and tax rulings.[9]

The aim underlying the BEPS Action Plan, with respect to the current international tax standards, can be considered according to different approaches, depending on the scope of the changes that may result from the project. In other words: a "revolutionary" vs a "conservative" approach.

Brauner, in his analysis of the BEPS Project at the time when it was launched, stated that three fundamental principles were required in order to tackle the BEPS phenomenon: collaboration (instead of tax competition) among countries, a holistic rather than an ad hoc approach and innovative solutions (as an example of the latter, he referred to "the dramatic acceptance of the need to go beyond arm's length").[10] Dourado identified three possible holistic approaches: minor (a progressive and faster reform of the most problematic regimes that have led to aggressive tax planning); moderate (same reform "and aim at enforcing the single tax principle by eliminating both unintended and intended gaps, without changing the core of the

8. H. Ault, W. Schön & S. Shay refer to situations or non- or reduced taxation "in intermediary countries whether as a source country in relation to potentially deductible payments to intermediary entities or a residence country in relation to income shifted to an intermediary controlled foreign company", in Ault, *supra* n. 6, at sec. 2, p. 277.
9. IRE: European Commission (EC), SA 38373 *Apple*; NL: EC, SA 38374 *Starbucks;* LUX: EC, SA 38375 *Fiat*; LUX: EC, SA 38944 *Amazon*; and LUX: EC, SA 38945 *McDonald's*.
10. Brauner, *supra* n. 3, at sec. 2, pp. 113-114.

current system"); and major, consisting in replacing the current international tax system "by replacing the transfer pricing rules and arm's length method (by an indirect method) or even the corporate tax itself". This author's conclusion, after the Final Reports is that the BEPS Project "reflects a mix of minor and moderate holistic approach".[11]

Certainly, a "revolutionary" approach to the concept of the BEPS Project, along the same lines as a complete change to the core of the current international tax standards is out of the question. Such an approach was surely not the OECD's intention. After reading the Final Reports and also the Action Plan when it was launched, it was quite clear that there would be no changes in the allocation rules: neither the Final Reports nor the action plan resolve the residence vs source dilemma. In this respect, the author shares Dourado's view that "The international fight against BEPS neither aims to adopt a different allocation of taxing rights rules, not to clearly change the balance between capital-exporting and capital-importing countries".[12]

Some glimpses of "new standards" do emerge, such as for example, in Action 6, the express declaration of avoiding double non-taxation as an objective of the Convention, or Action 15 on multilateralism which, although focused on the implementation of the Action Plan, represents a relevant change in the path of the collaborative paradigm. However, other examples related to issues where deeper and more innovative changes would have been required, such as Action 7 related to the PE status or Action 14 about dispute resolution mechanism, show that a replacement of the traditional system is still far off.

Notwithstanding some significant steps forward, a conservative approach to the concept of the BEPS Project seems to be more realistic. In this case, however, "conservative" should not be intended as a kind of "*Gattopardo* effect" (namely changing everything so that everything will remain the same), but rather as setting up rules aimed at restoring and enhancing the traditional principle of priority of the taxing rights of the residence state, meaning in this case the high-tax jurisdictions where the company that ultimately bears the investment risk is located. From this perspective, Actions 8-10, related to transfer pricing issues, trying to prevent "the allocation of profits where no contributions are made to those profits" can be considered the core of the BEPS Project and the first and foremost from a non-formal hierarchy perspective.

11. A.P. Dourado, *May You Live in Interesting Times*, 44 Intertax 1 (2015), pp. 1-2.
12. Dourado, *supra* n. 1, at sec. 1, p. 354.

The Action Plan was conceived as a comprehensive approach to the BEPS phenomenon. However, without ignoring all that has been accomplished, maybe due to its conservative profile, the set of Final Reports has been perceived as a more ad hoc approach, a set of recommendations focused on concrete issues related to that phenomenon. This impression can indeed affect the consistency and strength of the BEPS Project. Section 5.3. discusses the consistency of some of the Actions of the BEPS Project, in respect of its main targets and also taking into account the proposed standards.

5.3. Main targets and new standards

5.3.1. Tax competition

As already mentioned, tax competition is rooted in the BEPS phenomenon and therefore, as Brauner stated, a fundamental analysis of the BEPS Project should be "to rethink the role and intensity of competition in the international tax regime".[13] However, the Action Plan does not seem to be very consistent in this respect, insofar as it does not openly recognize this circumstance, except in the cases when it is linked to illegitimate tax planning. As observed by Dourado in this respect, "residence countries are not mandated to eliminate tax competition in the absence of avoidance (abuse) or aggressive tax planning".[14]

When dealing with the concept of tax competition and its role as an opportunity for developing tax planning strategies, a preliminary distinction should be made between *unintended* and *intended* tax competition.

Unintended tax competition can be considered the simple result of a combination of different elements allocated in different tax jurisdictions or in the combination of those elements with the tax treaty provisions; such as, for instance: tax policy decisions (other than tax incentives), allocation rules in bilateral double tax conventions or different tax provisions (either as a result of domestic legislation or, in the cases of EU Member States, due to the implementation of EU law). This kind of asymmetric situation generates gaps and mismatches that may favour those taxpayers active in an international tax context, and from this perspective, the border between legitimate and illegitimate tax planning may be unclear.

13. Brauner, *supra* n. 3, at sec. 2, p. 76.
14. Dourado, *supra* n. 1, at sec. 1, p. 354.

Intended tax competition is usually identified with the concept of harmful tax competition, mainly based on the idea of the will of some tax jurisdictions to set up a favourable tax regime to attract taxpayers or, in other words, profit shifting; the intention (attracting) and the result (harming) go inevitably together. The kind of intended or harmful tax competition envisaged by the BEPS Project has to do with the idea of attraction rather than with shelter; it is about international tax planning strategies, rather than mere tax evasion. In other words, it concerns taxpayers trying to reduce their overall tax burden without openly violating the rules, rather than taxpayers seeking how to hide their non-declared wealth. From this perspective, any tax jurisdiction can, in principle, incur harmful tax competition practices.

Taxpayers can indeed develop their tax planning strategies, either profiting from intended or unintended tax competition. The relationship between the kind of tax planning (legitimate or aggressive under the form of tax avoidance or abuse) and the kind of tax competition (unintended or harmful) if there is any, may not be clear and probably should be ascertained on a case-by-case basis. To a certain extent, there could be a kind or "reverse proportion", meaning the more aggressive the tax jurisdiction is, the less aggressive the tax planning should be considered (the taxpayer would be "accepting" the "invitation" to benefit from a preferential tax regime). However, there are also cases where there is a direct proportion between harmful tax competition and abusive or artificial tax schemes expressly addressed to benefit from preferential tax regimes.

The main issues addressed by the BEPS Project in this respect, correspond mainly to the latter situation. It is important to note that the scope of the Action Plan is limited, insofar as it does not prohibit tax competition, neither does it clearly set out a general principle of fair play, and moreover it cannot be considered an anti-tax incentive project. In other words, national tax sovereignties and the autonomy of tax policy decisions are still preserved. However, if its recommendations are followed, states are supposed to restrict some undesirable effects of harmful tax competition (a glimpse of fair play?) and also some of the taxpayers' practices could be effectively counteracted. The recommendations set out in the Final Reports on Action 5 (preferential tax regimes) and on Action 3 (CFC rules) are expressly aimed at tackling some of these cases.

Action 5 (Countering Harmful Tax Practices More Effectively, Taking into Account Transparency and Substance) and its content is focused on so-called "preferential tax regimes", although without clearly defining this concept. Certainly, these regimes can deal with different kinds of tax

benefits and even with ad hoc rulings, but all of them may fit in a concept, by means of a general definition combined with some low-tax indicators. This has been the option in the US Model Convention (MC) (2016) which, for treaty purposes, includes in article 3.1.l a general definition of "special tax regimes" related to reductions either in the tax rates or in the tax base.[15]

The main proposal of the Final Report on this Action to draw a border between "good" and "bad" preferential tax regimes is based on the idea of "requiring substantial activity for preferential tax regimes". Thus, the *substantial activity* requirement emerges as a leading concept and a strong and consistent standard in order to tackle harmful tax competition. How this concept should be interpreted is another question, as the Report is not very precise in this respect. In any case, its consistency requires a wider meaning than mere "business activity", as there are preferential tax regimes dealing with passive income; the idea of "substantial" as opposite to "artificial" could also help and from this perspective, the substantial activity requirement should not be considered as a totally new standard, insofar as this kind of analysis has traditionally been at the core of the anti-avoidance provisions. However, a more adequate approach to the concept seems to be focused on the concrete link between the effective activity developed by the taxpayer and the income generated by this activity. With respect to special tax regimes related to royalties, the US MC (2016) grants an exception to those tax benefits linked to research and development activities,[16] in line with a kind of "nexus approach".

The Report is focused on the IP box regimes (patent boxes), which are output tax incentives granting tax allowances or lower tax rates on royalty income. Although aiming at fostering R&D activities, these have also been considered a way of attracting highly mobile capital and thus an example of harmful tax competition. In this case, the substantial activity requirement has been expressed by the "nexus approach", which "allows a taxpayer to

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15. United States Model Income Tax Convention (Feb. 2016). According to this provision the term "special tax regime" means "any statute, regulation or administrative practice in a Contracting State" meeting conditions such as: preferential rates of taxation or permanent reductions in the tax base applied to interests and royalties, as compared to income from sales or goods, and the same with respect to all of a company's income or foreign source income not engaged in business activity; also, when it is generally expected to result in a rate of taxation less than 15% or 60% of the general statutory rate of company tax applicable in the other Contracting State.

16. According to art. 3.1.l, one of the conditions of a special tax regime would be that: "ii) in the case of any preferential rate of taxation or permanent reduction in the tax base for royalties, does not condition such benefits on the extent of research and development activities that take place in that Contracting State".

benefit from an IP regime only to the extent that the taxpayer itself incurred qualifying R&D expenditures that give rise to the IP income." As a result, only patent boxes compliant with this standard shall be allowed, and the existing ones shall be adapted accordingly.

Taking into account that BEPS cannot be considered an anti-incentive project, the idea of drawing a line between legitimate and harmful tax policy decisions is not bad and the substantial activity standard is, in principle, a suitable instrument in order to implement this idea. However, some concerns related to the compliant IP box regimes and its consistency with other Actions may still arise.

One of these concerns is the risk of juridical double non- (or low) taxation. This could be the case in those bilateral tax treaties following article 12 of the OECD MC: there would be no taxation of the royalty income at source and low taxation at residence if this state grants a (compliant) IP box regime. This effect may not be consistent with the aim of avoiding double non- (or low) taxation, expressly declared as an objective of the tax treaties in the Final Report of Action 6.

A similar concern is the risk of economic double non- (or low) taxation. This could be the case of a royalty payment deductible in the state of the payer company and the related income benefiting from a (compliant) IP box regime granted to the recipient at residence. However, the inconsistency of this case with the Final Report of Action 4 is even less clear not only because it is doubtful that royalty payments can be considered hybrid instruments, but also because the linking rules proposed in that Report deal with cases of "deduction and no inclusion" and the type of tax incentives granted by a patent box regime could not technically be included in this last concept.

A special report published by the TAXE Special Committee of the European Parliament[17] in respect of the risk of double non-taxation arising from patent boxes, described three possible situations and how to counteract them:

> First, source countries, the most commonly discussed proposals are withholding taxes on royalties and royalty deductions limitations. Second, R&D countries, the application of retroactive price-adjustment clauses in case of intra-group disposal of IP and the application of the profit split method when determining contract R&D fees. Third, the residence countries of the ultimate parent company of a MN group might limit incentive of profit shifting through CFC rules.

17. L.K. Evers, *Intellectual Property Box Regimes – Tax Planning, Effective Tax Burdens and Tax Policy Options,* In-Depth Analysis for the TAXE Special Committee (Oct. 2015) (IP/A/TAXE/2015-03).

Certainly, the risk of double non- (or low) taxation could be counteracted by this type of measure, but in terms of consistency, the question is whether the compliant IP box regimes should be preserved, otherwise the fostering effect of the tax incentive could be jeopardized and legal uncertainty could affect taxpayer's decisions. In a recent Resolution, the European Parliament enhanced the necessary link between patent boxes and "genuine economic activity" by means of binding EU legislation (maybe because these regimes are not included in the Anti Tax Avoidance Directive, ATAD), together with some critical remarks about the BEPS Report.[18]

From the perspective of consistency and strength, the fact that the Final Report on Action 5 is focused on patent boxes raises doubt about the suitability of the substantial activity requirement in order to tackle any other kind of preferential tax regime. In this respect, the Report states that the application of that standard to other regimes "would need to take place in the context of a specific category of regime being considered",[19] even recognizing that some cases, such as the holding companies "may not in fact require much substance in order to exercise their main activity of holding and managing equity participations".[20] The Report also considers that such a case could be better addressed by other Actions (Action 6 or Action 3). Therefore, the substantial activity requirement should be ascertained on a case-by-case basis, and when the income benefiting from a preferential tax regime cannot be proved to be linked to an activity effectively developed by the taxpayer (or, as in the case of some special holding regimes, by the ultimate beneficial owners), the regime should be better tackled by other measures, such as the CFC rules (provided that the residence state of the beneficiaries has implemented these rules, the income qualifies as CFC income, the beneficiaries meet the threshold required and the benefits from the preferential regime fulfil the low tax requirement).

18. Plenary Session 6 July 2016. The Resolution "Calls on the Commission, in order to prohibit the misuse of patent boxes for tax avoidance purposes and ensure that if and when used they are linked to genuine economic activity, to put forward proposals for binding Union Legislation on patent boxes, building on and addressing the weaknesses of the OECD Modified Nexus Approach; stresses that the Commission proposal should apply to all new patent boxes issued by Member States and that all the existing patent boxes still in force must be modified accordingly".

19. The Report mentions in this respect several regimes such as: headquarters, distribution and service, financing or leasing, fund management, banking and insurance, shipping and holding companies.

20. Just as an example: the Spanish ETVE regime (resident companies exclusively dedicated to holding participations in foreign entities). According to this special regime (articles 107-108 of the Corporate Tax Act), neither the dividends obtained by the ETVE from the foreign entities, nor the dividends distributed by the ETVE to their non-residents shareholders will be taxed at all.

In the spirit of "improving transparency", the Final Report on Action 6 also deals with a different type of harmful tax practice that, through a tailored approach, may benefit concrete taxpayers and especially MNEs; this is the case for those tax rulings that might be considered preferential tax regimes. In this respect, the Report refers to "a framework covering all rulings that could give rise to BEPS concerns in the absence of compulsory exchange". Thus, *transparency* should be considered another of the leading standards of the BEPS Project and the core of some other Actions; although in this case, it seems to have an instrumental scope in order to disclose some tax rulings identified as potentially harmful.

Certainly, transparency cannot be considered a totally new standard but it is relevant here insofar as disclosure of the tax rulings is a preliminary step in order to identify them as preferential tax regimes. This Report mentions six categories of rulings: preferential tax regimes, advance pricing agreements (APAs) or any other agreements on transfer pricing, permanent establishments (PEs), conduits and a final catch-all clause for "any other type of ruling where the FHTP agrees in the future that the absence of exchange would give rise to BEPS concerns". The scope of the list may seem too wide, so for the sake of legal certainty and in line with the idea of transparency, this scope should be considered restricted to undisclosed tax rulings that, once identified, should be ascertained as harmful tax practices on a case-by-case basis rather than under general presumptions. There is a difference between preferential tax regimes set up in the tax legislation (such as IP box regimes) and those provided by tax administrations by means of ad hoc tax treatment. Tax rulings before and after the BEPS Project may have been a problem (and they will continue to be), but a general presumption of tax competition in these cases is not the right way to deal with issue.

Action 3 (Designing Effective Controlled Foreign Company Rules) is also aimed at tackling BEPS produced by harmful tax competition, in this case, lower-tax jurisdictions where the controlled company is located. Nothing much new has happened in this regime; as the Final Report recognizes "Since the first CFC rules were enacted in 1962, an increasing number of jurisdictions have implemented these rules". The Report includes recommendations aimed at improving the effectiveness of the usual elements of CFC rules (control by shareholders, exemptions and threshold requirements, definition and computation of income and elimination of double taxation). The compatibility of the CFC rules with the allocation of taxing rights in tax treaties has been controversial, including court decisions in different tax jurisdictions. However, it would be wrong to think that CFC rules enhanced by Action 3 of the BEPS Project may have a far-reaching or radical effect

on those rights; as stated by Dourado in this respect "CFC measures are put forward as one of the tools to fight BEPS and not as *the* tool to address allocation of taxing rights among jurisdictions".[21]

More significant is a prudent approach ("flexibility") to the autonomy of different tax jurisdictions when implementing those rules, also due to the fact that the recommendations "are not minimum standards"; they are designed only to ensure effectiveness in the jurisdictions that choose to implement them. Notwithstanding this flexibility, the Final Report on Action 3 provides some significant guidance; such as, for instance, the recommendation about applying CFC rules only in the case of tax rates "meaningfully lower" than those applied in the parent jurisdiction. Due to the different items that may qualify as CFC income, most of them being passive income (such as dividends or interests), but also some in the border area between passive and business income (such as royalties), the *substantial activity* standard is also mentioned in the Report. In this case, "a substantial analysis looks to whether the CFC engaged substantial activities in determining what income is CFC income", although admitting that this substantial analysis may be combined with a category-based approach.

Also in this case, the substantial activity standard seems to be coherent in order to preserve genuine economic activities and moreover, the consistency with the line drawn between bad and good preferential tax regimes; in other words, the consistency between Actions 3 and 5. Therefore, the royalty income granted with the benefits of a patent box regime compliant with the nexus approach should not qualify as income for CFC purposes, otherwise the tax incentive could be jeopardized. In this respect, Dourado comments that "Given the results under Action 3, it seems that a CFC rule can be applied by jurisdiction A, even if the nexus approach is applied in jurisdiction B".[22] This risk however, could be counteracted following the recommendation provided by the Report, according to which "CFC rules could include a version of the nexus approach as a substance analysis, under which income earned by the CFC that met the requirements of the nexus approach would not be included in CFC income…Under this version of the nexus approach, all IP from qualifying IP assets would be attributed unless the taxpayer could show that the income would qualify for benefits under a nexus compliant IP regime in the CFC jurisdiction".

21. Dourado, *supra* n. 1, at sec. 1, p. 353.
22. Dourado, *supra* n. 11, at sec. 2, p. 5.

At the EU level, a similar provision to preserve royalty income in line with the substantial activity standard, is enacted in article 7.2(a) of the ATAD,[23] which states that when, after including in the CFC income royalties or any other income generated from intellectual property: “This point shall not apply where the controlled foreign company carries on substantive economic activity supported by staff, equipment, assets and premises, as evidenced by relevant facts and circumstances”.

In the end, the substantial activity standard may be perceived as the consistent link between these two Actions, aimed at tackling BEPS resulting from harmful tax competition in cases related to preferential tax regimes or controlled entities located in low-tax jurisdictions.

5.3.2. Tax avoidance

It has become common to link the BEPS phenomenon with the idea of aggressive tax planning. However, this is an unclear concept without a consistent legal basis, which seems intended to draw a kind of grey area between the taxpayers’ legitimate options (tax planning) and tax avoidance, either intended as abuse of law or *fraus legis.*

The only definition known of such a concept was set out in the EU Commission Recommendation of 6 December 2012,[24] according to which: “Aggressive tax planning consists in taking advantage of the technicalities of the tax system or of mismatches between two or more tax systems for the purpose of reducing tax liability”. However, the mere taking advantage of a situation not provoked by the taxpayer refers to tax planning strategies that, in principle, may be considered as legitimate options, unless other aspects of the taxpayer’s behaviour can demonstrate, either according to the facts and circumstances of the case or by means of specific indications or presumptions established by the law, that the behaviour incurs tax avoidance. Moreover, and paradoxically, aggressive tax planning is not a concept used in the context of the Action Plan; however, as far as the BEPS phenomenon is considered, a result of the combination of tax competition (either unintended or harmful) and tax planning strategies, that grey area expressed by the idea of aggressive tax planning fits in the BEPS picture.

23. Council Directive 2016/1164 of 12 July “Laying down rules against tax avoidance practices that directly affect the functioning of the internal market”.
24. EC Recommendation COM(2012) 722 on “Aggressive Tax Planning”.

Notwithstanding the fact that most of the BEPS Project is related to this issue, some of the Actions that focus on tax avoidance schemes related to tax treaties (Actions 6 and 7) deserve discussion and Action 12 relating to the disclosure of tax planning strategies will also be discussed.

The Final Report on Action 6 (Preventing the Granting of Treaty Benefits in Inappropriate Circumstances) is mainly dedicated to treaty abuse by different means. From a programmatic perspective, the first proposal is most relevant insofar as it implies two declarations that intend to put the tax avoidance issue on the front page of tax treaties. The first, replacing the title of the Convention as follows: "Convention between (State A) and (State B) for the elimination of double taxation with respect to taxes on income and on capital *and the prevention of tax avoidance and evasion*" (emphasis supplied). The second, relating to the proposed Title, including in the Preamble of the Convention, an express reference to the parties' intention: "Intending to conclude a Convention for the elimination of double taxation with respect to taxes on income and on capital *without creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance (including through treaty-shopping arrangements aimed at obtaining reliefs provided in this Convention for the indirect benefit of residents of third States*" (emphasis supplied).

It seems obvious that, according to this declaration, the *prevention of tax avoidance (and evasion)* should be considered a guiding principle, although not so new an international tax standard, taking into account that the concept of "improper use of the Convention", under different forms, had already been included in the extensive Commentary on Article 1 of the OECD MC. As mentioned above, the novelty of the Report consists in putting this standard on the front page of the Convention. For the time being, it does not go beyond a statement, and some critical views have already been expressed in respect of its influence – if any – even as interpretative guidance.[25] However, its influence should not be overlooked in the interpretation of those tax treaties that include such a statement. In the end, its scope and effectiveness, as well as its consistency with the objective of avoiding double non- or reduced taxation, remain to be seen.

25. E. Pinetz, *Final Report on Action 6 of the OECD/G20 Base Erosion and Profit Shifting Initiative: Prevention of Treaty Abuse*, 70 Bulletin for International Taxation 1-2 (Jan. 2016), Journals IBFD, about the declaration in the Preamble: "The objective expressed in this statement is simply too vague and general to have a significant influence on the interpretational outcome of a specific provision in a tax treaty".

More novelties come from two other main proposals included in this Report, both intended to address different forms of treaty abuse: the limitation-on-benefits (LOB) rule and the general anti-avoidance rule based on the principal purpose test (PPT).

The LOB can not be considered a new standard either because under different forms, most of them related to a look-through or any other way of disregarding the use of conduit companies for tax treaty purposes mentioned in the Commentary on Article 1 of the OECD MC, this standard has influenced bilateral tax treaties which, more or less extensively, have used this type of anti-treaty shopping rules. In the case of treaties signed with the United States, the LOB clause provided by the US MC[26] has indeed been the rule.

The main outcome of the Final Report on Action 6, rather than delivering the standard itself, lies in the proposal of including a new provision in the OECD MC: "Article X Entitlement to Benefits" based on this standard, together with a related Commentary. According to the Report, the content of this provision, to be specified by the bilateral Conventions, deals with different tests related to the concept of a qualified person, business activity and proportional ownership of the entity, as well as an escape clause. Viewed positively, this kind of provision can be considered to be, in principle, consistent with the target of preventing treaty abuse, at least in the cases addressed by its content. The preliminary remarks to the related Commentary included in the proposal mention the coherence of the provision with the declaration in the aforementioned Preamble. However, the effectiveness of the proposal, inspired in the US LOB rule, which has been controversial, remains to be seen especially from the perspective of its implementation by developing countries.

The Report also recommends including a GAAR that should be added at the end of the proposed article X, aimed at counteracting cases of treaty abuse not properly covered by the specific rules under this provision. According to this proposal, paragraph 7 would read 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, 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 result 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.

26. US MC (2016), art. 22.

The Report states that this provision "incorporates principles already recognized in the Commentary on article 1 of the OECD Model Convention", but the fact that an alternative GAAR has been included in the text of this Model is indeed relevant and has been perceived as a significant, yet controversial step forward. As already mentioned, the standard of this GAAR has been identified with the PPT, rather than with other indicators usually included in this kind of provisions (such as artificiality, circumvention or valid economic purpose). The GAAR in article 6 of the ATAD is also based on the PPT, together with the non-genuine character of the transaction.[27] In the end, and whatever the test may be, the main feature underlying any GAAR is more or less the idea that the only logical explanation why the taxpayer acted that way was to avoid tax (in this case, benefiting from a tax treaty). The problem with the PPT lies in the fact that insofar as the meaning of "purpose" refers to "intention", the implementation of the provision may raise some concerns in respect of its effectiveness and in the light of legal certainty. In Pinetz's view, "the recommendation to implement a GAAR in future tax treaties does not appear capable of effectively preventing treaty abuse and treaty shopping, but rather increases the legal uncertainty".[28]

Without ignoring some critical concerns, the new provision on Entitlement of Benefits recommended by this Report, which combines a SAAR based on specific tests with an alternative GAAR in order to cover any other abusive arrangement, should be considered, in principle, consistent with the aim of preventing treaty abuse. The combination of these two kinds of anti-avoidance rules is common in the national legislation of many tax jurisdictions, so why should it not be an issue in the case of tax treaty abuse? Legal uncertainty is indeed a risk, especially when dealing with a GAAR, whatever the test may be, although in the case of PPT the risk could be higher for the reasons already mentioned (how to prove the "purpose" without any objective indicator), especially in a cross-border scenario. In this respect, paragraph 17 of the Commentary to this provision proposed in the Report states that: "The provision does require, however, that the competent authority must consider the relevant facts and circumstances before reaching a decision and must consult the competent authority of the other Contracting

27. "1. For the purposes of calculating the corporate tax liability, a Member State shall ignore an arrangement or a series of arrangements which, having been put into place for the main purpose or one of the main purposes of obtaining a tax advantage that defeats the object or purpose of the applicable tax law, are not genuine having regard to all relevant facts and circumstances. An arrangement may comprise more than one step or part.
2. For the purposes of paragraph 1, an arrangement or a series thereof shall be regarded as non-genuine to the extent that they are not put into place for valid commercial reasons which reflect economic reality".
28. Pinetz, *supra* n. 25, at sec. 3.2, p. 119.

State before rejecting a request to grant benefits if that request was made by a resident of that other State".

There are other significant voices in favour of a GAAR. The EU Commission, in its "Recommendation on the Implementation of Measures against Tax Treaty Abuse", encourages Member States to include, either in the Conventions concluded among themselves or with third countries, a similar provision, in this case combining the PPT with the "genuine economic activity" test.[29]

The Final Report on Action 6 also deals with some situations of rule shopping, such as splitting up contracts, hiring out labour, dividend characterization or circumvention of article 13.4 of the OECD MC, as well as a special reference to exit taxes. These taxes are a way to counteract the effect of the allocation rights on capital gains in cases of change of residence, as far as the former state of residence may lose its taxing power on the income derived from the alienation of certain assets (i.e. shares), due to the catch-all clause laid down in article 13.5 of the OECD MC, and there is also a risk of tax avoidance if the main purpose of the taxpayer's emigration is to circumvent the taxation of that income in that state. There are two specific anti-avoidance rules that may be included in the bilateral tax treaties in this respect: one is related to shares linked to immovable property, under article 13.4 of that MC; the other is the "substantial participation" clause laid down in article 13.5 of the UN MC, according to which the source state may tax the capital gain (irrespective of the kind of underlying assets) when the alienator of the shares has held a significant participation in the company prior to the transfer.

Taking into account that, in some cases, the combined effect of the catch-all clause and the domestic provisions exempting capital gains may result in double non-taxation, some recommendations in order to counteract rule shopping should have been proposed, thus reinforcing the consistency of Action 6 to tackle tax avoidance by means of tax treaty provisions. A significant step in this direction would have been to propose a substantial participation clause. In spite of the increasing number of tax jurisdictions

29. "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 facts and circumstances, that obtaining that benefit was one of the principal purpose of any arrangement or transaction that result directly or indirectly in the benefit, unless it is established that *it reflects a genuine economic activity or* that granting that benefit in these circumstances would be in accordance with the object and purpose of the relevant provisions of this Convention" C (2016) 271 (28 Jan.) (emphasis supplied).

implementing exit taxation, now enhanced in the European Union by a binding provision included in article 6 of the ATAD, a substantial participation clause could be more effective and less problematic, taking into account that a change of residence does not necessary imply tax avoidance purpose and, if not properly implemented, it may incur double taxation. The Report is aware of this problem and provides for a solution when it recommends that "the new State of residence would provide relief for the departure tax levied by the previous State of residence on income that accrued whilst this person was a resident of that other State, except to the extent that new State of residence would have had source taxation rights at the time when the income was taxed (i.e. as a result of paragraphs 2 or 4 of Article 13)". A step-up clause applied by the source state, such as the one included in article 6.5 of the ATAD, could be another way of correcting double taxation related to exit taxes.

The Final Report on Action 7 (Preventing the Artificial Avoidance of Permanent Establishment Status) deals with one of the most relevant situations related to tax avoidance, profiting from the tax treaty provisions that require that the status for taxing business income be at source (articles 5 and 7 of the OECD MC). Global tax planning developed by MNEs may combine this situation with a more complex strategy linked to the restructuring of business functions, profiting from commissionaire arrangements and the attribution of the main business activity to a company (either the ultimate parent or an intermediary company) located in a favourable tax jurisdiction. In this respect, changing operational functions or a dependent agent's position to that of an independent agent (even including subsidiaries in this concept) to avoid the PE status becomes a highly relevant issue and constitutes a challenge that affects paragraphs 5 and 6 of article of the OECD MC.

For this purpose, that Report recommends changes in these two provisions. In paragraph 5, by means of a more substantive than formal approach to the concept of "dependent agent", which would require concluding contracts "in the name" and "on behalf of" when "in doing so, habitually concludes contracts, or habitually plays the principal role leading to the conclusions of contracts that are routinely concluded without material modifications and these contracts are…b) for the transfer of the ownership of, or for the granting of the right to use, property owned by that enterprise or that the enterprise has the right to use of c) for the provisions of services by that enterprise". The concept of dependent agent would also be reinforced in paragraph 6, according to which, the fact of "acting exclusively or almost

exclusively on behalf of one or more enterprises to which it is closely related" would be incompatible with the status of an independent agent.[30]

The standard used in this case could be identified with the idea of *exclusiveness and substantial dependence* between related parties involved in the commissionaire arrangement, thus disregarding the formal terms of the arrangement and counteracting the artificial distribution of functions within the group. In this case, it could also be said that the standard is not so new, if considered related to the substance-over-form principle. This does not mention the fact that tax planning strategies developed by MNEs such as described above, had already been challenged by the Spanish Supreme Court's decisions (among other courts), according to a substantial interpretation of the commissionaire clause, under the current Commentary to Article 5 of the OECD MC.[31] In any case, one way or another, the standard seems to be consistent in order to counteract the kind of functional restructuring mentioned above, and also able to prevent artificial avoidance of the PE status. This is the perception of the EU Commission, which encourages Member States "in Tax Treaties concluded among themselves or with third countries, to implement and make use of the proposed new provisions of Art. 5 OECD MC, in order to address artificial avoidance of PE status, as drawn up in the Final Report on Action 7 of BEPS Action Plan".[32]

However, and notwithstanding this step forward, it must be pointed out that although these changes may solve part of the problem, they do not probe deeply into the roots of the PE issue. Some unilateral and controversial decisions, even after the launching of the BEPS Project, such as the diverted profits tax (DPT) enacted in the United Kingdom, show that this issue will continue to be a source of conflict for a long time.[33] The reason lies in the link between this concept and the allocation of taxing rights on business profits rather than in the PE concept itself; in other words, in the interaction between articles 5 and 7 of the OECD MC. Brauner already expressed

30. Also, according to the proposed provision, the concept of "closely related" shall be considered: if a person "possesses directly or indirectly more than 50 per cent of the beneficial interest in the other (or, in the case of a company, more than 50 per cent the aggregate vote and value of the company's shares or of the beneficial equity interest in the company)" or if he has the same position as such a person in the enterprise.
31. This is the case of the so-called "Spanish approach to the PE concept". *See*, among others, the decision of SP: Spanish High Supreme Court (*Tribunal supremo*), 20 June 2016, *DELL,* ref. 1275/2016.
32. EC Recommendation COM(2016) 271 on the "Implementation of Measures against Tax Treaty Abuse".
33. "It remains to be seen whether the recommendations under Action 7 or the UK regime will be followed as standards by other jurisdictions", Dourado, *supra* n. 11, at sec. 2, p. 3.

a critical view in this respect when stating that "the OECD identified very specific instances where it saw abuse, but only with respect to the technical elements of article 5. Article 7 and the interaction between articles 5 and 7 – which may perhaps belong to the transfer pricing action items – were completely ignored".[34]

It is obvious that a major change to the allocation rules would not have been in line with the conservative profile of the BEPS Project, and therefore a radical decision, either under the single-tax principle (effective taxation on business income only in one state, either source or residence),[35] or by breaking that link (taxation on business income at source, with or without PE), would have been unthinkable. If the issue was to keep the PE concept as a condition to tax business income at source, maybe other issues such as the "service PE" concept, in line with the approach followed by the UN MC and the ongoing work developed in this respect[36] would have been a better option.

From another perspective, Action 12 (Mandatory Disclosure Rules) also aims at tackling tax avoidance, insofar as it deals with the disclosure of tax planning strategies; an instrument that can be considered suitable, yet controversial, with a deterrent effect on aggressive tax planning. As expressly recognized in the Final Report on this Action, this effect, as well as enhancing information, are the targets and *transparency* is the standard, all with the ultimate goal aimed at tackling tax avoidance.

It could also be said that transparency applied to the disclosure of tax planning schemes is not a new idea. As recognized in the Report, some tax jurisdictions had already implemented disclosure rules, although the measure proposed by this Action "both complement and differ from other types of reporting and disclosure obligations, such as cooperative compliance programmes". Specifically, some tax jurisdictions have done so in the framework of the enhanced relationship.[37] In general, and according to the

34. Brauner, *supra* n. 3, at sec. 2, p. 95.
35. *See*, in this respect, R. Avi-Yonah, *The International Tax Regime: a Centennial Reconsideration*, Michigan Law University of Michigan. Public Law and Legal Theory Research Paper Series. Paper no. 462 (June 2015).
36. Art. 5.3(b) UN MC. *See*, on this topic, A. Baez Moreno, *The Taxation of Technical Services under the United Nations Model Double Taxation Convention: A Rushed – Yet Appropriate Proposal for Developing Countries*? 7 World Tax Journal 3 (2015), Journals IBFD.
37. This is the case of the Spanish Code of Tax Best Practices, implemented by the tax administration since 2011 (*Agencia Estatal de la Administración Tributaria. "Código de Buenas Prácticas Tributarias" Julio 2011).* In this case, the disclosure is voluntary.

existing regimes, the disclosure can be voluntary or mandatory; in both cases, this is an ex ante instrument, a key feature if it pretends to have a deterrent effect ("taxpayers may think twice about entering into scheme if it has to be disclosed"), and more suitable than other types of measures that pretend that linking that effect to tax planning schemes is already declared abusive by the tax administration,[38] rather than due to a previous disclosure by the taxpayer of his own tax planning scheme.

However, the Report has a moderate scope, insofar as its recommendations are not meant to be a minimum standard but rather some guidance addressed to the design of those rules by states that may want to implement them; in other words, "countries are free whether or not to introduce mandatory disclosure regimes". The key design features include disclosure obligations either on the promoter or on the taxpayer or on both, including generic hallmarks (such as confidentiality), tracking disclosures, timeframe and penalties; sharing information between tax administrations is also recommended. This prudent approach to mandatory disclosure rules may be due to the need for consensus in respect of a controversial issue. However, from the perspective of consistency and strength of the measure, this flexibility could jeopardize its effectiveness in a global context. At the EU level, more decisive steps in this direction have been suggested[39] and international coordination on this issue is essential, otherwise, paradoxically, any gaps may create a new scenario of tax competition (between tax jurisdictions with and without mandatory disclosure rules).

In respect of legal certainty, mandatory disclosure rules are somewhat ambiguous. Knowing the tax administration's position beforehand on the transaction planned by the taxpayer may eliminate the risk of a negative tax assessment based on that transaction. However, precisely for this reason and for the sake of legal certainty and taxpayers' legitimate expectation, the "green light" should be given in respect of a tax planning scheme agreed with the tax administration, in any case. Moreover, the consistency between Actions 12 and 5 of the BEPS Project requires those authorized tax planning schemes disclosed by the taxpayers to not be considered as "preferential"

38. According to art. 206 *bis* of the Spanish General Tax Act (*Ley General Tributaria)* after its reform in 2015 (*Ley 34/2015 de 21 de septiembre),* penalties in tax avoidance cases will only apply if the tax planning scheme is similar to another previously declared in violation of art. 15 (GAAR) by the tax administration.

39. "The Commission will work closely with the OECD and other international partners on a possible global approach to greater transparency on advisors' activities, going beyond the recommendations in BEPS (Action 12)". Communication from the Commission to the European Parliament and the Council on "Further measures to enhance transparency and the fight against tax evasion and avoidance" (5 July 2016), COM(2016) 451.

tax rulings under Action 5. The Report on Action 12 is aware of the fact that "Rulings can, at least in part, play a similar role to disclosure regimes in that a taxpayer will typically apply for a ruling in anticipation of entering into a transaction". A safeguard clause in this respect, as well as prevention of retroactive effect on tax planning schemes previously agreed with the tax administration, should be provided by those tax legislations implementing mandatory disclosure rules.

5.3.3. Double non-taxation

As mentioned in section 5.2., double non-taxation may be the result, either from the combination of tax treaty and domestic provisions, or from gaps between different domestic provisions. Moreover, these situations may be the effect either of unintended or harmful tax competition, and the benefit for taxpayers may be either from the mere effect of those provisions or the result of tax planning strategies expressly developed in order to benefit from those situations.

A consistent way of dealing with double non-taxation would be the so-called single-tax principle, based on the idea that income should be taxed once and only in one state; in other words, both double taxation and double non-taxation would be eliminated. In the current international tax system and according to the tax treaty provisions, this principle may apply but only in one direction: avoiding or correcting double taxation, either through the allocation rules in the cases of taxing rights only granted to one state (residence as a general rule, i.e. articles 12.1, 13.5 or 18 of the OECD MC) or through the specific provisions correcting double taxation, either exemption or foreign tax credit (articles 23A and 23B of the OECD MC). However, the principle does not work in the opposite direction, mainly because the scope of the taxing power still depends on the domestic provisions. For example, according to article 13 of the relevant tax treaty, the residence state has the exclusive right to tax the capital gains derived from the alienation of shares, but according to its legislation, capital gains in these cases are not taxed); double non-taxation may also arise if the residence state grants exemption or full tax credit on foreign income obtained by its residents, even in cases when that income has not been taxed at source (tax sparing clauses). In the absence of a tax treaty, double non-taxation in cross-border situations may also arise, due to exemptions granted in both states on the same income.

The concerns raised by situations of double non-taxation are similar in the cases of double low taxation. When a tax treaty applies, this situation may

result from the combination of no taxation in one state and reduced taxation in the other state; in section 5.3.1., this problem was described with respect to the IP box regimes when article 12.1 of the OECD MC applies (royalty income not taxed at source and benefiting from low taxation at residence). In the absence of a tax treaty, the situation may also arise, for instance, due to tax incentives granted both by residence and source state on the same income. However, the cases of double low taxation do not deal with the single-tax principle, as long as taxation, although reduced, is granted (at least) in one state. Avoiding double low taxation should be based on a different principle based on the idea of granting a *minimum effective taxation*, which may or may not be in combination with that principle (minimum effective taxation at least once and in one state).

Moreover, the classical distinction between juridical and economic double taxation also applies in the opposite situations. The examples above described deal with juridical double non-or low taxation (the same taxpayer benefits from no tax or reduced tax on the same income). Economic double non- or low taxation (different taxpayers in respect of the same income benefit from no tax or reduced tax) may also arise in cross-border situations, either due to mismatches in respect of the classification of the income, or to a tax benefit granted to the income related to a deductible expense (hybrid mismatches). In this case, specific linking rules addressed to counteract the mismatch could have a similar effect to the one single taxation.

In respect of the BEPS Project, one target seems to be restricting opportunities for double non-taxation, yet radical changes cannot be expected. For the time being, and after the Reports package, it can be said that neither the single-tax principle nor the minimum effective taxation can be considered as standards used by this project, in spite of some glimpses of single taxation in Action 2, as discussed later. This situation may indeed affect the consistency of the project in order to tackle double non- (or low) taxation. In respect of juridical double non- or low taxation, there is no single tax standard meaning "taxing only once and in one state" but rather a standard intended as "preventing double non- (or low) taxation as a result of aggressive tax planning". This is precisely the meaning of the recommendation, already mentioned in section 5.3.2., included in the Final Report on Action 6 about including in the Preamble of the Tax Convention "a clear statement that the states that enter into a tax treaty intend to avoid creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance".

However, beyond this statement and in order to be consistent with the objective of avoiding double non- (or low) taxation, some further steps would

have been required, and single effective taxation could have been granted. At the EU level, the Recommendation of 6 December 2012 encouraged Member States to include, in the tax treaties signed either between them or with third states a switch-over clause,[40] as well as a subject-to-tax clause in their domestic provisions related to the correction of double taxation.[41] A switch-over clause in respect of foreign income (from dividends, capital gains on shares or permanent establishments), related to lower taxation in the source state (less than 40% of the statutory rate in the residence state), was also included in the proposal of the ATAD[42] but it was finally deleted. In a similar direction, article 21.1 of the Spanish Corporate Tax Law enacted in 2014, grants exemption on dividends from foreign subsidiaries only if the subsidiary is subject to corporate tax with, at least, a statutory rate of 10%, although this condition is considered to be fulfilled if there is a tax treaty signed with the residence state of the subsidiary that includes a provision on exchange of information.

Tax jurisdictions are indeed free to restrict tax exemption or foreign tax credit in cases of non- (or low) taxation in the source state. What they cannot do, without incurring treaty override, is applying a switch-over clause intended to change the allocation rules, unless this clause is provided by the relevant Convention. This seemed to be the intention of the switch-over clause proposed by the EU Commission in the Recommendation of 6 December 2012, encouraging Member States to include such a clause in their tax treaties. However, the effectiveness of such a proposal included in a non-binding instrument is doubtful, and moreover, the competence of the EU Commission over the tax treaty-making power of the Member States is controversial. For similar reasons, deleting the switch-over clause included in the proposal of the ATAD (a binding legal instrument in this case), must be considered a right decision. The only suitable way of implementing this type of clause for treaty purposes is in the tax treaty itself, either by bilateral

40. COM(2012) 722. "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 States shall be precluded from taxing such item only if this item is subject to tax in the first contracting State".

41. Id. "Where, with a view to avoid double taxation through unilateral 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". It can be said that subject-to-tax clauses are generally included in this type of domestic provisions (i.e. arts. 21.1(b) and 31.1 of the Spanish Corporate Tax Act).

42. COM(2016) 26 final of 28 Jan. Art. 6.1 of the proposal.

agreement or according to the relevant Model Convention, such as the case of article 12.2(a) of the US MC (2016).[43]

Last but not least, the European Parliament in its Resolution of 7 July 2016 enhanced the inclusion of a minimum effective taxation (MET) clause in the Interests and Royalties Directive, as well as in the Parent-Subsidiary Directive. Aside from that, there were other more controversial measures mentioned in this Resolution, such as the implementation of an EU-wide withholding tax.[44] Although for the sake of single taxation, this kind of proposal may lead the European Union in the direction of tax protectionism with unclear and maybe negative effects.

The Final Report on Action 2 (Neutralising the Effects of Hybrid Mismatch Arrangements) deals with economic double non-taxation as a result of hybrid instruments. In this cases, either because of different classification in the tax jurisdictions (i.e. interest in state A, dividends in state B) or simply because of the relevant tax rules (deduction in state A, exemption in state B), the result is double non-taxation on the same item of income: its payment is considered a deductible expense for tax purposes in the payer's state and, in the recipient's state, the related income benefits from an exemption. More recently (22 August 2016), the OECD published a Discussion Draft related to Action 2 on "Branch Mismatch Structures" dealing with similar issues.

From this perspective, the combined effect of "deduction without inclusion" also means double non-taxation, this time on both sides of the coin (payment and related income). Precisely because of this circumstance, that Report recommends counteracting this effect by means of two linking rules: first, a primary rule (no deduction if no inclusion) according to which "countries deny the taxpayer´s deduction to the extent that it is not included in the taxable income of the recipient" and a second best or defensive rule (no deduction), so "If the primary rule is not applied, then the

43. According to which, notwithstanding the exclusive taxing rights of the residence state, "a royalty arising in a Contracting State and beneficially owned by a resident in the other Contracting State that is a connected person with respect to the payor of the royalty may be taxed in the first-mentioned Contracting State in accordance with domestic law if such resident benefits from a special tax regime with respect to the royalty in its Contracting State of residence".

44. The Resolution "calls the Member States to present a legislative proposal for an EU-wide withholding tax, to be operated by Member States, in order to ensure that profits generated within the Union are taxed at least once before it…such proposal should include a refund system to prevent double taxation…such a system based on the credit method has the advantage of preventing double non-taxation and BEPS without creating instances of double taxation".

counterparty jurisdiction can generally apply a defensive rule, requiring the deductible payment to be included in income or denying the duplicate deduction depending on the nature of the mismatch".

Article 9.2 of the ATAD on "Hybrid Mismatches" provides for a linking rule similar to the primary rule in Action 5, according to which, in the case of deduction without inclusion, "the Member State of the payer shall deny the deduction of such payment", although there is no defensive rule in this case.[45] Article 9.1 also sets out a rule in cases of double deduction resulting from hybrid mismatches, so "the deduction shall be given only in the Member State where such payment has its source".

It could be stated that the linking rules are based on a *single taxation* standard. Action 2 "seems to suggest the implementation of a "single-tax principle" in the international tax system" (Dourado).[46] Kahlenberg and Kopec, commenting on the linking rules for hybrid mismatches, state that "Such tax revenue division results from the general approach of the OECD which is that 'all income should be taxed somewhere'", although from a more critical perspective, the authors think that "it is questionable whether such an approach may guarantee the coherence of the IT system aimed by the OECD".[47]

It is important to note that, as stated in the Report, the linking rules will apply automatically, whatever the qualification of the payment and the related income may be; in other words, interpretation about whether the item of income qualifies as dividend or as interest is irrelevant, because the linking rules focus exclusively on the deduction/no inclusion effect, irrespective of the nature of the payment and its related income. In this respect, those rules have been considered as a "simply, practicable and therefore, effective tool" although not able to counteract the conflicts of qualification.[48] Counteracting double non-taxation by dealing with these conflicts would have been more problematic including the risk of legal uncertainty due to different interpretations.[49] From this perspective, the linking rules are con-

45. On 6 July 2016, the ECOFIN formally adopted a proposed amendment to the Parent-Subsidiary Directive, under which the Member State of the parent company will refrain from taxing profits from the subsidiary only to the extent that such profits are not tax deductible for the subsidiary.
46. Dourado, *supra* n. 11, sec. 2, p. 80.
47. C. Kahlenberg & A. Kopec, *Hybrid Mismatch Arrangements – A Myth or a Problem that Still Exists?"* , 8 World Tax Journal 1 (Feb. 2016), Journals IBFD, pp. 74-75.
48. Kahlenberg, *supra* n. 47, at sec. 3.3, p. 72.
49. An example of this type of conflict was the case of the *juros brasileiros* (deductible dividends paid by Brazilian subsidiaries to their parent companies abroad). Court decisions

sistent with the objective of avoiding double non-taxation, as well as being clear and easy to implement.

However, the linking effect may raise some concerns, as far as it can affect legitimate tax policy decisions. As expressed by Dourado, "it can also be argued whether it is legitimate for a country to neutralize insufficient taxation at the level of the recipient, and whether exemption corresponds to non-inclusion in taxable income".[50] The question is indeed controversial; for instance, in the case of a tax jurisdiction applying the participation exemption regime, it may seem unfair to deny this exemption because of a tax rule (deduction) applied by the state of the payer; but given the logic behind the exemption rule, which is aimed at eliminating the effect of economic double taxation on dividends, it is obvious that there is no such effect if the related payment is tax deductible, so there would be no justification for granting the exemption in this case.

The Final Report on Action 2 also includes recommendations in cases of dual residence and hybrid entities, not treated as taxpayers by either or both states for tax treaty purposes. The proposal in this case is to introduce a provision in the OECD MC in order to ensure that treaty benefits will not be granted "where neither state treats, under its domestic law, the income of such an entity as the income of one of its residents".

A recent Report of the EU Code of Conduct Group on Business Taxation,[51] deals with hybrid PE mismatches in respect of two different situations: (a) no recognition as a PE in the source state, recognition as a PE in the residence state; and (b) recognition in the source state, no recognition in the residence state. Double non-taxation that may arise from these mismatches should be avoided by different rules depending on the case. When the mismatch results in no taxation (no PE at source) without inclusion (exemption at residence), the proposal is: if there is no PE recognition in the third state, there will be no PE recognition in the Member State; if there is PE recognition in the third state, there will be PE recognition in the Member State. When the mismatch results in double deduction (other than tax relief in each of the two states), the proposal is the same, also including a defensive rule:

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in Germany (Federal Court 6 June 2012) and Spain (High Supreme Court 16 Mar. 2016) dealt with this conflict.

50. Dourado, *supra* n. 11, sec. 2, p. 3.

51. Report to the Council, 13 June 2016. "Guidance on Hybrid Permanent Establishment Mismatches Concerning a Member State and a Third State".

if there is a PE in both states and double deduction still occurs, the Member State will deny the deduction.[52]

The main goal of Action 4 (Limiting Base Erosion Involving Interest Deductions and Other Financial Payments) is also preventing the risk of double non-taxation. The Action refers to BEPS arising in two different situations. First, an inbound perspective, lending from a related entity benefiting from a low-tax regime, to a holder; so, the case deals with aggressive tax planning, also profiting from a preferential regime with the result of double non- (or low) taxation. Second, an outbound perspective, using debt to finance exempted or deferred income and claiming a current deduction for the interest expense; however, in this case, there is no reference to related parties and the intentional element is unclear.

Limitations on interest deduction is not a new issue, and several tax jurisdictions have enacted provisions in this respect, not only with an anti-avoidance purpose but also in order to solve the debt-equity dilemma, either by reclassification of dividends (thin cap rules) or directly denying or restricting the deduction. The "recommended approach" proposed in the Final Report on Action 4 is a ceiling rule consisting in "a fixed ratio rule which limits an entity's net deduction to a percentage of its EBITDA" (the recommended approach is between 10% and 30%); this approach can be supplemented with a worldwide group ratio rule that could exceed that limit in certain circumstances. The Report proposes specific group ratio rules or an uplift (up to 10%) in the cases of groups highly leveraged with third-party debt for non-tax purposes. Moreover, in order to reduce the impact of the rules in situations of less risk of BEPS, the Report also refers to counterbalance provisions (such as a minimum threshold, exclusion of interests paid to third parties or carry-forward of the disallowed interest).

Proposals for limitations on interest deduction more or less follow measures already implemented in some tax jurisdictions. The proposals are consistent with the goal of avoiding double non- (or low) taxation and counteract some well-known tax planning strategies developed by MNEs, especially in intra-group loan transactions. In this case, the standard is related to the principle of *proportionality* (excessive debt and unbalanced debt-to-equity ratio) and also, in the case of intra-group tax planning, to an economic substance and valid economic purpose requirement, thus avoiding artificial loan transactions.

52. The Report includes a safeguard clause stating that a business activity will be treated or will not be treated as a PE only to the extent necessary for preventing double deduction or non-taxation without inclusion.

However, limitations on interest deduction should be handled with care, and this type of provisions may raise some concerns.[53] One of these concerns is the risk of economic double taxation of interests[54] (except in the cases of no inclusion of the related interest income); if this is not properly resolved, the problem will become larger as the influence of these provisions spreads across tax systems. Moreover, the provisions that deny or restrict the deduction of financial expenses may have negative effects on the taxpayer's burden and seem controversial in the light of the ability-to-pay principle, as far as those are legitimate expenses; precisely in this respect, the German Supreme Court has challenged the German ceiling rule before the Constitutional Court, pointing out that interest, as such, is a legitimate business expense and the limitation rule can penalize financial arrangements that are generally seen as reasonable and concluding that the rule does not meet the constitutional requirements of equal treatment and consistency of application.[55]

From another perspective, if the provisions are not properly implemented, there is a risk of retrospective effect on mid- and long-term transactions. In these cases, the main question is whether the (new) provision could have been reasonably foreseen at the time when the transaction took place. In this respect, it should be noted that taxpayers' legitimate expectations, based on the principle of legal certainty, have been considered in a general EU law principle by the Court of Justice of the EU (CJEU),[56] as well as by the European Court of Human Rights (ECHR), according to the "fair balance" between the right to property and the tax legislation (Protocol 1, article 1

53. E. Cencerrado Millán & M.T. Soler Roch, *Limit Base Erosion via Interest Deduction and Others*, 43 Intertax 1, 2015.

54. This question was raised in the *Scheuten Solar Technology* case (C-397/09) decided by the CJEU on 21 July 2011. In respect of a German provision (*Gewerbesteuergesetz,* art. 8.1), the Court rejected the argument based on double taxation of interest contrary to the Interest and Royalty Directive, considering that this Directive aimed to avoid juridical double taxation, which was not the case. Formally, the Court's reasoning was correct, but the double economic taxation of interest in that case remained unsolved.

55. *Bundesfinanzhof,* Decision I R 20/15 of 14 Oct., published on 10 Feb. 2016.

56. GER: CJEU, 25 Jan. 1979, C-98/78, *A. Racke v. Hauptzollamt Mainz*;; GER: CJEU, 25 Jan. 1979, C-99/78 *Weingut Gustav Decker KG v. Hauptzollamt Landau*; NL: CJEU, 29 Apr. 2004, Joined Cases C-487/01 and C-7/02 *Gemeente Leusden (C-487/01) and Holin Groep BV cs (C-7/02) v. Staatssecretaris van Financiën*; FR: CJEU, 6 Nov. 2008, C-381/07 *Association nationale pour la protection des eaux et rivières – TOS v. Ministère de l'Écologie, du Développement et de l'Aménagement durables*; IT: and CJEU, 10 June 2010, Case C-396/08 *Istituto nazionale della previdenza sociale (INPS) v. Daniela Lotti, Clara Matteucci*.

of the Convention). In the light of this doctrine, the "quality" of the law has to be foreseeable in order to comply with the principle of legal certainty.[57]

At the EU level, article 4 of the ATAD on the "Interest limitation rule" includes a ceiling rule (fixed on 30% of the EBITDA). Member States are allowed to provide for special rules in some cases (low amount, standalone entities or consolidated groups in respect of the taxpayer's equity ratio compared to the equivalent ratio of the group), as well as carry-forward rules. Moreover, paragraph 4 also provides for a grandfathering clause, so Member States may exclude from the limitations the exceeding borrowing costs incurred on: (a) loans concluded before 17 June 2016; and (b) loans used to finance long-term infrastructure projects when the project operator, borrowing costs, assets and income are all in the European Union. In spite of the critical remarks expressed by the European Parliament on this clause,[58] it can be considered a consistent way to counteract the retrospective effect mentioned above, although in the light of legal certainty it should apply to all cases and not only within the European Union's borders. Again, a case of EU tax protectionism?

5.3.4. Transfer pricing

As already mentioned, transfer pricing may be considered the core of the BEPS Project, as far as tax planning strategies dealing with this issue are at the root of the BEPS phenomenon; as expressed by Brauner: "Aggressive transfer pricing is the beating heart of the BEPS planning, the *sine qua non* of the transactions that triggered the universal interest in BEPS and eventually the BEPS Project".[59] Actions 8-10 (Aligning Transfer Pricing Outcomes with Value Creation) deal with this, so from the start both the objective and the standard of the BEPS Project in this respect were clearly expressed.

However, no radical changes were expected, and the Final Report on these Actions confirms this idea when it refers to a balance between the traditional and current system, based on the arm's length principle ("the goals set by the BEPS Action Plan have been achieved without the need to develop special measures outside the arm's length principle") and the new standard based on *value creation* ("the work under Actions 8-10 of the BEPS Action Plan

57. UK: ECHR, 14 Oct. 2010, *Schockin v. Ukrania*; HU: ECHR, 14 May 2014, *N.K.M. v. Hungary*; and HU: ECHR, 2 July 2013, *R.Sz. v. Hungary*.
58. In its Resolution of 6 July 2016: "strongly regrets that the current Council draft position has weakened, notably by a grandfathering clause on interest deduction".
59. Brauner, *supra* n. 3, at sec. 2, p. 96.

will ensure that transfer pricing outcomes better align with value creation of the MNE group"). In other words: a conservative approach, yet trying to enhance and improve the anti-abuse profile of the transfer pricing regime.[60]

In principle, value creation (an unclear concept?[61]) might be a consistent standard in order to tackle BEPS created by the abuse of the current rules that follow the (formal) contractual allocation of functions, assets and risks and so may distort the (substantial) activity actually creating that value. As stated in the Report, contractual allocation is easy to manipulate and this circumstance "can lead to outcomes which do not correspond to the value created through the underlying economic activity carried out by the members of the MNE group". From this perspective, it could be said that the standard of value creation is not so new, if intended in the light of the traditional substance-over-form principle, a common ground of anti-abuse provisions. Expressed in other words, the value creation standard, rather than changing the methods, is addressed "to allocate the profits where the contributions are made to these profits", based on the idea of "conduct over contract", the OECD Guidelines shall be changed according to a "careful delineation of the actual transaction between the associated enterprises by analysing the contractual relations between the parties in combination with the conduct of the parties".

Some questions arise from this approach, especially those connected to the conduct analysis or how to implement the new rules to intangibles, which is still by far the main challenge of the transfer pricing regime and "perhaps the most difficult test of the BEPS Project".[62] Transactions involving intangibles are one of the key areas of this project (Action 8), together with risks and capital (Action 9) and other high-risk transactions (Action 10). The recommendations shall be implemented by means of changes in the OECD Transfer Pricing Guidelines.

In the case of intangibles, artificial reallocation within the companies of the group shall be counteracted following a substantial approach based on value creation, focused on the link between the return and three main factors (functions, risk control and assets). These factors will be ascertained beyond their formal appearance (such as legal ownership or contractual allocation of risks), so "The group companies performing important functions,

60. Y. Brauner, *Transfer Pricing in BEPS First Round-Business Interests Win (but not in Knock-Out)*, 43 Intertax 1 (2016).
61. "This principle is rudimentary, yet one can work with it". Brauner, *supra* n. 3, at sec. 2, p. 99.
62. Brauner, *supra* n. 3, at sec. 2, p. 96.

controlling economically significant risks and contributing assets, as determined through an accurate delineation of the actual transaction, will be entitled to an appropriate return reflecting the value of their contributions". The reallocation of risks, based on economic facts, intended as financial capacity and significant control over these risks, is supposed to be a key element, but it is controversial[63]. Other changes in the Guidelines (revisions to Chapter VI) are also significant and should be considered steps forward in the right direction. In the case of highly uncertain valuation of the intangible at the time of the transaction, the parties may depart from arm's length pricing, adopting different approaches for taking into account those uncertainties;[64] also in these cases, the tax administration could consider ex post outcomes as evidence in respect of the ex ante pricing arrangements.

In respect to Action 9, which addresses inconsistencies between the returns of a capital-rich member of the group providing funding and its level of activity (high funding/low performance), a proper return (no more than risk-free) will be applied on the basis or risk control or by disregarding non-commercially rational transactions. In the framework of Action 10, the Guidelines shall specially ensure the allocation of profits to the most relevant economic activities, with special attention to the ongoing work on the profit split method. To summarize, according to the recommended changes (revisions to Section D of Chapter I): transfer pricing shall be based on the consistency between contractual arrangements and economic reality, risk and decision-making, capital and substantial functions and transactions and commercial rationality.

Above all, the main question is the effectiveness of value creation in order to tackle BEPS. As mentioned above, this may be a consistent standard although its impact remains to be seen, as long as it will depend on the changes developed by the Guidelines and on how the different tax systems will follow the new approach. In any case, transfer pricing based on arm's length principle, which is improved by the value creation standard, will still remain for a long time. An alternative to it seems to be, for the time being, out of the question.

63. W. Schön, *International Taxation of Risk*, 68 Bulletin for International Taxation 6/7 (June/July 2014), pp. 292-293. The author considers that "The test of risk-bearing capacity makes sense, but not in the case of IP rights". In his view, "Income from transferred intangibles should be taxed on an ex post basis, since it is extremely hard to disentangle the factors contributing to the actual income generated by the intangible (rents or risks?)".
64. Brauner, *supra* n. 60, at sec. 3.4, p. 84. The author considers a key element for progress "A clear statement that arm's length is not the exclusive framework for transfer pricing analysis of transactions involving intangibles."

At the EU level, the implementation of the CCCTB project represented an opportunity to depart from the current transfer pricing framework. The project has not been cancelled, although the EU BEPS meant two steps back in this respect: first, consolidation was delayed and second, under the pressure and priority given to anti-BEPS-oriented measures, especially the ATAD, so the CCCTB remains on the waiting list. This stand-by situation is not clearly justified; in its simple version, a CCCTB could play an harmonization role, similar as the one played years ago by the Sixth Directive in respect of VAT. In respect of the more complex CCCTB, formulary apportionment should not be considered as the panacea; however, the possibility of implementing this alternative at a supranational level by means of a binding instrument (EU Directive) was a unique opportunity to deal with taxation of MNEs[65].

The Final Report on Actions 8-10 expressly refers to the link with other Actions, some of them already discussed (Action 4 in section 5.3.1.). Action 13 deserves special attention in this respect because as stated in that Report "transfer pricing analysis depends on access to relevant information". From another perspective, Action 14 is also relevant, insofar as most of the conflicts solved through dispute resolution deal with transfer pricing.

Action 13 deals with re-examining transfer pricing documentation. In this case, following a standard of *transparency***,** information is the target ("a requirement that MNEs provide all relevant governments with needed information of their global allocation of the income, economic activity and taxes paid among countries according to a common template"). The information should be mainly intended as an instrument in order to ensure an effective implementation of the transfer pricing outcomes under the new approach, so there is a clear consistency between this Action and Actions 8-10.

The Final Report on Action 13 (Transfer Pricing Documentation and Country-by-Country Reporting) focuses on three types of documentation that shall be required by MNEs: a "master file", a "local file" and a country-by-country report (CbCR). Both the master and the local file shall be delivered by MNEs to local tax administrations and will be available to all relevant tax administrations. The CbCR (to be implemented for the fiscal year beginning on or after 1 January 2016) and mandatory for MNEs with consolidated group revenue equal to or exceeding EUR 750 million, shall be filed in the tax jurisdiction where the ultimate parent company has its

65. In this respect, the European Parliament in its Resolution of 6 July 2016, identifies most of the cases of aggressive tax planning with transfer pricing under the current system, and urges the Commission to put forward the CCCTB project before the end of 2016.

tax residence, and shared between jurisdictions through automatic exchange of information. CbCR will provide annually and for each tax jurisdiction, relevant information about employees, capital, retained earnings and assets, as well as business activity engaged by each entity; also, relevant tax information about revenue, profit before tax, income tax paid and accrued.

The ultimate goal of all this information is related to a consistent implementation of Actions 8-10 and, in general as a better way to tackle BEPS as a result of aggressive transfer pricing. As stated in the Final Report "this information should make it easier for tax administrations to identify whether companies have engaged in transfer pricing and other practices that have the effect of artificially shifting substantial amounts on income into tax-advantaged environments". Needless to say, that information is essential, and the substantial approaches proposed by the BEPS Project would be useless without consistent in-depth and shared information about the taxpayers' data (MNEs in this case).

The outcomes of Action 13, considered from the beginning as "a very promising Action",[66] may go beyond the transfer pricing framework, developing a new scenario for the relationship between the taxpayers (MNEs) and the tax administrations and also at the same time, a step forward in the path of collaboration by means of automatic exchange of information. From this perspective, and taking into account the ongoing implementation in different tax jurisdictions, it can be said that Action 13 – also encouraged at the EU level[67] – may be considered by far the most successful outcome of the BEPS Project with a significant impact on the task to be developed by large MNEs.[68]

Action 14 (Making Dispute Resolution Mechanisms More Effective) was addressed to improve the effectiveness of the mutual agreement procedure (MAP), facilitating access by the taxpayers and including arbitration provisions in more tax treaties. Obviously, dispute resolution through MAPs does not exclusively deal with transfer pricing although, as already mentioned, in

66. Brauner, *supra* n. 3, at sec. 2, p. 104.
67. In its Communication to the European Parliament and the Council of 5 July 2016 on "Further measures to enhance transparency and the fight against tax evasion and avoidance" COM(2016) (451), the Commission proposed that any multinational with a turnover of more than EUR 750 million and a presence in the EU should have to publish a specified set of tax-related data online. CbCR information shall be provided by these companies, as well as aggregated figures for operations in the rest of the world.
68. According to the 2016 Global BEPS Survey Report by Thomson Reuters, 83% of the respondents considered transfer pricing (documentation and CbCR) as the biggest departmental change among all the BEPS Actions.

practice most of the conflicts deal with this issue and its use is concentrated in a few tax jurisdictions.

To some extent, it can be said that the outcomes of the Final Report on this Action are disappointing and a consistent system of international tax arbitration is still far from being implemented; obviously, this was not the intention and so the results should be considered accordingly. The first result deals with implementing minimum standards for the MAP, in order to ensure good faith, timely resolution, taxpayers' access and implementation of administrative processes. The second is about the commitment of 20 tax jurisdictions[69] to provide for mandatory arbitration in their tax treaties.

The Report considers this commitment "a major step forward as together these countries were involved in more than 90 percent of outstanding MAP cases at the end of 2013, as reported to the OECD". This can be right from a practical perspective, but in the end, these proposals are still far from the implementation of a real international tax arbitration system,[70] that could go beyond the implementation of arbitration as a mere last phase of the MAP, where the taxpayer still plays a limited role. International tax arbitration will continue to be a pending question; however, it could be considered a better dispute resolution mechanism, in line with the ISDS system provided for in bilateral investment treaties (BITs),[71] or in the more far reaching International Arbitration Court proposed by the EU document on "Investment Protection"[72] in the framework of the ongoing negotiations about the Transatlantic Trade and Investment Partnership (TTIP) with the United States. These may indeed be controversial issues, but in any case, they should not be neglected if the ultimate goal is to improve dispute resolution. Last but not least, there is a risk of using the arbitration provisions in current BITs for dispute settlement in tax matters as a kind of back door; more than a risk, this may become an increasing reality.

69. Australia, Austria, Belgium, Canada, France, Germany, Ireland, Italy, Japan, Luxembourg, the Netherlands, New Zealand, Norway, Poland, Slovenia, Spain, Sweden, Switzerland, United Kingdom and the United States.

70. A recent and comprehensive study on this topic can be found in M. Lang (ed.), *International Arbitration in Tax Matters,* WU Institute for Austrian and International Tax Law, European and International Tax Law and Policy Series, IBFD (2015).

71. As an example, in this respect: 2012 US Model Bilateral Investment Treaty, Section B (arts. 23-34). The Model also includes a provision on "Taxation" (art. 21).

72. Document of 12 Nov. 2015. Section 3 contains the provisions on "Resolution of Investment Disputes and Investment Court System".

5.4. Final remarks

An overview of the main BEPS outcomes reveals some good points and bad points. It can be said that there is a general coherence with the conservative profile of the Action Plan. There are no radical changes nor new standards, some things are implemented in a consistent manner. The weaknesses come from the lack of strong and clear principles (maybe some glimpses of single taxation and fair play) and a solid conceptual background. The overall consistency of the BEPS Project – insofar as it is present – might be expressed by an idea: the exercising of the power to tax will be reinforced and oriented even more against abuse. However, it remains to be seen whether this will lead to the proclaimed and desired "fair share" of tax on MNEs. The opportunities for aggressive tax planning may be reduced as a result of the BEPS Project, but utopian results such as the end of tax competition or tax planning should not be expected.

The BEPS Project is still a work in progress and will continue to be so in the coming years. Therefore, ideas such as the "post-BEPS era" may not express an accurate picture of the situation. This observation does not mean to ignore the tremendous work done by the OECD since the launching of the Action Plan in a very limited timeline; if there is still work in progress it is because this is an ambitious project with many issues and players involved that needs reasonable time to be properly developed and finally implemented.

Different levels and different players acting in a dynamic situation, may pose either a risk or a positive influence on the development of the BEPS Project, taking into account different legal mechanisms (hard and soft law) acting in different scenarios. The main challenge is coordination and in this respect, multilateralism and the work under Action 15, especially dealing with tax treaty issues is a key element of the process, although its final outcomes remain to be seen. In the European Union, the so-called EU BEPS Project, launched in June 2015,[73] and notably the ATAD, deal with similar issues to those of the OECD Action Plan, although some of its recommendations and provisions differ. Moreover, there are tensions created by the ongoing State aid procedures in respect of well-known MNEs, or the increasing critical position of the European Parliament in respect of the BEPS phenomenon. Last but not least, Brexit raises new questions and uncertainty in the coming years.

73. EC Communication COM (2015) 302 on "A fair and efficient Corporate Tax System in the EU: 5 key areas for action".

For the time being, the main conclusion is that there has been no revolution, yet the forecast is uncertain. Although the BEPS Project should not be considered a kind of tsunami, somehow, the tax landscape looks different and some storms may be expected in the EU area.

Part III

National Reports

Chapter 6

Questionnaire for National Reports

Tax Avoidance Revisited: Exploring the Boundaries of Anti-Avoidance Rules in the EU BEPS Context

6.1. The meaning of avoidance and aggressive tax planning and the BEPS initiative

6.1.1. The meaning of tax avoidance in national legal systems

6.1.1.1. Is there a legal definition of tax avoidance in your legal system?

6.1.1.2. Do administrative regulations clarify the meaning of tax avoidance in your legal system?

6.1.1.3. Are there tax rulings in your legal system? If yes, what impact do those tax rulings have on avoidance?

6.1.1.4. Is there case law on the meaning of tax avoidance and is it settled? Please refer to the existing case law.

6.1.1.5. If the judicial competence is also exercised by bodies that are not strictly judicial (arbitration courts or economic-administrative instances) is the case law consistent among the different bodies with judicial competence?

6.1.1.6. Is the legal, administrative and/or case law definition/meaning of tax avoidance influenced by its meaning in other jurisdictions, OECD soft law or the case law of the ECJ? Please distinguish between/among the different influences and discuss them.

6.1.1.7. Has BEPS had any repercussion on the meaning of avoidance in your legal system?

6.1.1.8. If the answer to 6.1.1.7. is yes, what type of repercussion has BEPS had in legislative amendments, in the exercise of competence by the

tax administration, and/or in the judicial interpretation by courts? Please discuss examples.

6.1.2. The meaning of tax planning, abusive tax planning and aggressive tax planning in national legal systems

6.1.2.1. Is there a legal definition of tax planning, abusive tax planning or aggressive tax planning in your legal system?

6.1.2.2. Do administrative regulations clarify the meaning of tax planning, abusive tax planning or aggressive tax planning in your legal system?

6.1.2.3. Are there tax rulings in your legal system? If yes, what impact do those rulings have on tax planning, abusive tax planning or aggressive tax planning?

6.1.2.4. Is there case law on the meaning of tax planning, abusive tax planning or aggressive tax planning and is it settled? Please refer to the existing case law.

6.1.2.5. Is there an overlap among the aforementioned concepts in your legislation, tax regulations and/or case law?

6.1.2.6. In the event that judicial competence is also exercised by bodies that are not strictly judicial bodies (for instance arbitration courts or economic-administrative), is the case law consistent among the different bodies that exercise judicial competence?

6.1.2.7. Is the legal, administrative and/or case law definition/meaning of tax planning, abusive tax planning or aggressive tax planning influenced by their meaning in other jurisdictions, OECD soft law or the case law of the ECJ? Please distinguish between/among the different influences and discuss them.

6.1.2.8. Has BEPS had any repercussion in the meaning of tax planning, abusive tax planning or aggressive tax planning in your legal system?

6.1.2.9. If the answer to 6.1.2.8. is yes, what type of repercussion has BEPS had in legislative amendments, in the exercise of competence by the tax administration, and/or in the judicial interpretation by courts? Please discuss examples.

6.2. The reaction to avoidance and aggressive tax planning in the BEPS context

6.2.1. Domestic general anti-avoidance rules (GAARs)

If your country is an EU Member State, consider the EC Recommendation C(2012) 8806 of 6 December 2012 in your answers below. The aforementioned EC Recommendation makes reference to aggressive tax planning (ATP) and proposes the adoption of a GAAR in domestic law and a subject-to-tax clause in bilateral tax treaties.

The EC Recommendation proposes that EU Member States adopt a GAAR in their domestic law that reads as follows: "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".

6.2.1.1. Is there a GAAR in your national legal system?

6.2.1.2. If the answer to 6.2.1.1. is yes, do you consider it similar to the GAAR proposed by the EC?

6.2.1.3. If the answer to 6.2.1.1. is yes, and your country is an EU or EEA Member State, do you consider your national GAAR compatible with the EU/EEA concept of abuse?

6.2.1.4. If the answer to 6.2.1.1. is yes, explain whether the following elements (tests) are part of your national GAAR:
- (a) main objective test (the accrual of a tax advantage, the grant of which is contrary to the purpose of the legal provision);
- (b) the obtaining of a tax advantage as the essential aim of the transactions concerned;
- (c) complementary business purpose test (under international tax law) or the genuine economic activity test (under EU law);

(d) subjective element, consisting of the intention to obtain a tax advantage; and
(e) the principle of proportionality.

6.2.1.5. Explain how the aforementioned tests, in case they are a part of your national GAAR, are interpreted by your courts.

6.2.1.6. Has your national GAAR been successfully applied by your tax administration or do your domestic courts often restrict its application? If the latter occurs, please explain the reasons for the unsuccessful application of your national GAAR.

6.2.1.7. If the answer to 6.2.1.1. is yes, and your country is an EU Member State, has your national GAAR already been or will it be replaced by the GAAR proposed by the EC?

6.2.1.8. If the answer to 6.2.1.1. is negative, will the proposed GAAR be introduced by your Member State?

6.2.2. EC Recommendation C-(2012) 8806 of 6 December 2012 and subject-to-tax rule

If your country is an EU Member State, consider the same EC Recommendation (8806) proposing a subject-to-tax rule aimed at dealing with double non-taxation:

> "3.2…Member States are encouraged to include an appropriate clause in their double tax convention ("DTC")…it could read as follows: Where this DTC provides that an item of income shall be taxable only in one of the Contracting State ("CS"), the other CS shall be precluded from taxing such item if this item is subject to tax in the first CS.
>
> 3.3. 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 the item is not subject to tax, Member States are encouraged to ensure that the item is taxed.
>
> 3.4….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."

6.2.2.1. Has your Member State introduced a subject-to-tax rule as proposed by the EC in its DTC's?

6.2.2.2. If the answer to 6.2.2.1. is negative, is your Member State planning to introduce a subject-to-tax rule as proposed by the EC?

6.3. Transfer pricing rules, GAARs, specific anti-avoidance rules (SAARs) and linking rules

6.3.1. Are your national transfer pricing (TP) rules often used to prevent or combat avoidance?

6.3.2. Do your TP rules often raise litigation?

6.3.3. If the answer to 6.3.2 is yes, is there case law on the application of your TP rules? Please describe and critically analyze that case law.

6.3.4. Do your DTCs include the LOB rules? Please describe the main elements of your LOB rules and refer to the DTCs in which they are included.

6.3.5. Does your tax legislation include CFC rules? Please describe the main elements of your CFC rules.

6.3.6. Did your country introduce linking rules as recommended in OECD/BEPS Action 2?

6.3.7. Does your tax legislation include limits on the deduction of interest? Please describe the main elements of your domestic rules limiting the deduction of interest.

6.3.8. Do you have any other SAARs? Please refer to them and describe their main elements.

6.4. Application of GAARs, TP rules and SAARs

6.4.1. How do GAARs, TP rules, SAARs and linking rules interact in your national legal system?

6.4.2. Is there a hierarchy, coordination or overlapping of measures?

6.4.3. Are there procedural rules underlying the application of your national GAAR, TP rules and/or SAARs?

6.4.4. If your answer to 6.4.3 is yes, please describe those procedural rules and how they have been applied by the tax administration and courts.

Chapter 7

Austria

Sebastian Bergmann

7.1. The meaning of tax avoidance

In Austria, tax avoidance is generally approached under the general anti-avoidance rule (GAAR) of Sec. 22 of the BAO,[1] permitting a recharacterization of abusive tax structures (*see* section 7.2.).[2] Although Sec. 22 of the BAO stipulates the legal consequences of tax avoidance, the Austrian legislation does not define tax avoidance itself. Therefore, an abstract and non-controversial definition of the term tax avoidance is challenging. Tax avoidance might be described as an arrangement leading to tax advantages, the grant of which is not intended by the legal system.[3]

Tax avoidance should be distinguished both from admissible tax planning and fraudulent tax evasion:

(a) It is a generally accepted principle of Austrian tax law that taxpayers are free to arrange their legal and economic relations in a tax efficient manner.[4] Hence, the forbiddance of tax avoidance, in principle, does not hinder taxpayers from organizing their affairs in a way that minimizes their tax burdens.[5] An imperative to tread on a fiscally fertile path does

1. Bundesabgabenordnung [Federal Tax Code].
2. *See* G. Kofler, *Austrian Branch Report*, in *Tax treaties and tax avoidance: application of anti-avoidance provisions*, CDFI 95a, p. 99 (IFA ed., Sdu 2010).
3. *See* S. Bergmann, *Umgehungs- und Missbrauchsverbot im Steuerrecht*, in *Die allgemeinen Bestimmungen der BAO im Spiegel des Verfassungs- und Verwaltungsrechts*, p. 155 (M. Holoubek and M. Lang eds., Linde 2012).
4. *See* VwGH, 22 Sept. 2005, 2001/14/0188; Kofler, *supra* n. 2, p. 102; M. Kotschnigg, *Beweisrecht der BAO* § 22 para. 40 (facultas 2011); S. Bergmann, *Zwischentheoretische Umgehungs- und Missbrauchsabwehr*, in *Die Bedeutung der BAO im Rechtssystem – Festschrift für Michael Tanzer*, p. 34 (H. Blasina et al. eds., LexisNexis 2014); Bergmann, *supra* n. 3, p. 155; and T. Ehrke-Rabel, *Rechtsanwendung im Steuerrecht*, in *Steuerrecht II* (seventh edition), para. 108 (W. Doralt and H.G. Ruppe eds., Manz 2014).
5. *See* VwGH, 13 Oct. 1993, 92/13/0054; VwGH, 22 June 1993, 91/14/0017; VwGH, 15 June 1993, 91/14/0253; VwGH, 29 Nov. 1988, 87/14/0200; G. Kofler, *Die steuerliche Abschirmwirkung ausländischer Finanzierungsgesellschaften*, p. 209 (Linde 2002); Bergmann, *supra* n. 3, p. 155; Bergmann, *supra* n. 4, p. 34; and Kotschnigg, *supra* n. 4, sec. 22, para. 40.

not exist.[6] Even though optimizing tax planning is principally admissible, the right to save taxes remains restricted by boundaries.[7] Crucial is a balanced relation between ends and means.[8] However, the demarcation between inadmissible tax avoidance and admissible tax planning remains difficult, as (normal or aggressive) tax planning stands undefined under the Austrian legislation, administrative regulations or case law.

(b) With respect to fraudulent tax evasion, tax avoidance differs in the way that tax avoiders fully disclose the relevant facts, whereas tax evaders either fake or withhold facts.[9] The legal consequences of tax avoidance are, therefore, limited to the tax side; whilst tax evasion involves consequences under financial criminal law.[10]

According to the Austrian Supreme Administrative Court (VwGH) case law, tax avoidance generally constitutes arrangements that are unusual and inadequate with respect to their economic result and are entered into with the intention of avoiding taxes (*see* section 7.2.).[11] Tax avoidance is, thereby, not necessarily constituted by a single legal action but by a series of transactions, each of which does not need to be abusive in itself.[12]

6. *See* Bergmann, *supra* n. 3, p. 155; Bergmann, *supra* n. 4, p. 34; and Kotschnigg, *supra* n. 4, sec. 22, para. 47.
7. *See* Kotschnigg, *supra* n. 4, sec. 22, para. 26; Bergmann, *supra* n. 3, p. 156; and Bergmann, *supra* n. 4, p. 34.
8. *See* Bergmann, *supra* n. 3, p. 156; Bergmann, *supra* n. 4, p. 34; and Kotschnigg, *supra* n. 4, sec. 22, para. 41.
9. *See* P. Kirchhof, *Steuerumgehung und Auslegungsmethoden*, Steuer und Wirtschaft (1983), pp. 173 et seq.; A. Rädler, *Do national anti-abuse clauses distort the internal market?* European Taxation (1994), p. 311; S. Bergmann, *Missbrauch im Anwendungsbereich der Mutter-Tochter-Richtlinie*, Steuer und Wirtschaft (2010), p. 248; Bergmann, *supra* n. 3, p. 156; and Bergmann, *supra* n. 4, p. 34.
10. *See* Kotschnigg, *supra* n. 4, sec. 22, para. 19; Bergmann, *supra* n. 9, p. 248; Bergmann, *supra* n. 3, p. 156; Bergmann, *supra* n. 4, p. 35; and K. Tipke, *Steuerrechtsordnung III*, p. 1324 (O. Schmidt 1993).
11. VwGH, 5 Apr. 2011, 2010/16/0168; VwGH, 25 Feb. 2009, 2006/13/0111; VwGH, 1 Oct. 2008, 2006/13/0036; VwGH, 1 Mar. 2007, 2006/15/0070; VwGH, 29 Nov. 2006, 2003/13/0026, 0027; VwGH, 18 Oct. 2006, 2003/13/0031; VwGH, 2 Aug. 2000, 98/13/0152; VwGH, 10 Dec. 1997, 93/13/0185; VwGH, 27 Sept. 1995, 93/13/0095; VwGH, 5 Oct. 1994, 92/15/0003; VwGH, 15 June 1993, 91/14/0253; VwGH, 10 Dec. 1991, 91/14/0154; VwGH, 11 Dec. 1990, 89/14/0140; VwGH, 23 May 1990, 89/13/0272, 0273, 0274, 0275; VwGH, 29 Nov. 1988, 87/14/0200; VwGH, 10 May 1988, 87/14/0084; VwGH, 4 Feb. 1987, 85/13/0120; VwGH, 13 May 1986, 85/14/0169; VwGH, 26 Sept. 1985, 85/14/0032; VwGH, 26 June 1984, 83/13/0258; VwGH, 8 Nov. 1983, 83/14/0056, 0057, 0058; VwGH, 4 Oct. 1983, 82/14/0317; and VwGH, 24 Nov. 1982, 81/13/0021.
12. *See* VwGH, 20 May 2010, 2006/15/0005; VwGH, 1 Oct. 2008, 2006/13/0032; VwGH, 29 Nov. 2006, 2003/13/0034; VwGH, 22 Sept. 2005, 2001/14/0188; VwGH, 24 June 2003,

The VwGH considers its understanding of tax avoidance to be in line with the meaning of tax avoidance in the European Court of Justice (ECJ) case law.[13] Therefore, the latter so far has had only limited implications on the VwGH's case law and national legislation. The same holds true for the meaning of tax avoidance in other jurisdictions and the Organisation for Economic Co-operation and Development's (OECD) soft law. However, both EU law (especially the EU direct tax directives) and OECD soft law, in particular the base erosion and profit shifting (BEPS) project, have repercussions for the meaning of tax avoidance to the extent that the new specific anti-avoidance rules (SAARs) were implemented in Austrian tax law (*see* sections 7.3.1. and 7.3.7.).

Austrian administrative regulations do not clarify the meaning of tax avoidance in an abstract way but merely note, on occasion, specific arrangements that are considered to be abusive tax avoidance. Furthermore, in Austria, bodies that are not strictly judicial or exercise any judicial competence also do not clarify the meaning of tax avoidance.

7.2. General anti-avoidance rule

According to the GAAR of Sec. 22 of the BAO, tax liability can neither be circumvented nor reduced by an abuse of legal forms and methods under civil law. If such an abuse has been established, taxes must be computed as they would have been in the case of a legal arrangement that is reasonable based on the economic transactions, facts and circumstances under question.

Long-lasting controversies regarding the interpretation of Sec. 22 of the BAO have resulted in two main views. According to the prevailing opinion in legal scholarship, Sec. 22 of the BAO is merely a declarative expression of an economic approach to taxation leading to a focus on the teleological interpretation method (so-called *Innentheorie*).[14] The contrary position

97/14/0060; VwGH, 14 Jan. 2003, 97/14/0042; VwGH, 10 Dec. 1997, 93/13/0185; *see also* G. Stoll, *Bundesabgabenordnung*, pp. 246 et seq. (Orac 1994); and Bergmann, *supra* n. 3, p. 171.

13. VwGH, 18 Oct. 2012, 2010/15/0010; and VwGH, 31 Mar. 2011, 2008/15/0115.

14. *See* W. Gassner, *Interpretation und Anwendung der Steuergesetze*, pp. 72 et seq. (Orac 1972); W. Gassner, *Wirtschaftliche Betrachtungsweise und Gestaltungsmißbrauch im Steuerrecht*, in *Festschrift zum 65. Geburtstag von Ernst Höhn*, p. 79 (F. Cagianut and K. Vallender eds., Haup. 1995); W. Gassner, *Der Methodenwechsel zur Verhinderung von Steuerhinterziehungen und Missbräuchen* (*§ 10 Abs 3 KStG*), in *Die Methoden zur Vermeidung der Doppelbesteuerung*, p. 345 (W. Gassner, M. Lang and E. Lechner eds., Linde 1995); W. Gassner, *Die Anerkennung der GmbH & Co KG im Steuerrecht*,

taken by the VwGH and the Austrian tax administration interprets Sec. 22 of the BAO as a provision that constitutively supplements other substantive provisions (so-called *Aussentheorie*).[15]

According to the VwGH's[16] case law on Sec. 22 of the BAO, tax avoidance generally constitutes arrangements that are unusual and inadequate with regard to their economic result (objective test) and additionally find their sole explanation in the intention of avoiding taxes (subjective test).[17]

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in *Die GmbH & Co KG im Handels-, Gewerbe- und Steuerrecht* (second edition), pp. 68 et seq. (W. Kastner and G. Stoll eds., Orac 1977); W. Gassner, *Die Aufhebung der Kredit- und Darlehensgebühren sowie des Auslandsbeurkundungserlasses durch den VfGH und die Notwendigkeit einer Gesetzesreform*, Österreichische Steuerzeitung (1980), p. 156; W. Gassner, *Der Gestaltungsmißbrauch im Steuerrecht – Änderung der Rechtsprechung?* Österreichische Steuerzeitung (1981), p. 263; W. Gassner, *Der Stand der Umgehungslehre des Steuerrechts*, Wirtschaftsrechtliche Blätter (1987) p. 5; M. Lang, *Hybride Finanzierungen im Internationalen Steuerrecht*, pp. 47 et seq. (Orac 1991); M. Lang, *Die Verordnungsermächtigung des § 10 Abs 3 KStG*, in *Forschung für die Wirtschaft – Die Europäisierung des österreichischen Wirtschaftsrechts*, pp. 95 et seq. (H. Rill ed., Service Fachverlag 1995); M. Lang, *Der Gestaltungsmißbrauch* (*§ 22 BAO*) *in der jüngeren Rechtsprechung des VwGH*, Österreichische Steuerzeitung (1994), p. 173; M. Lang, *VwGH zu Treaty Shopping*, Steuer & Wirtschaft International (1998), p. 216; M. Lang, *Der Normgehalt des § 22 BAO*, Österreichische Steuerzeitung (2001), p. 66; E. Lechner, *Die Gewinnpoolung*, pp. 189 et seq. (Orac 1986); H.G. Ruppe, *Die steuerliche Anerkennung von Vereinbarungen zwischen Angehörigen*, in *Handbuch der Familienverträge* (second edition), pp. 124 et seq. (H.G. Ruppe ed., Orac 1985); H.G. Ruppe, *Gesellschafterdarlehen als verdecktes Eigenkapital im Körperschaftsteuer- und Bewertungsrecht*, in *Die Besteuerung der Kapitalgesellschaft: Festschrift für Egon Bauer zum 65. Geburtstag*, pg. 311 (W. Doralt et al. eds., Orac 1986); G. Stoll, *Die* (*Publikums-*) *GmbH & Co KG als Abschreibungs-* (*verlust-*) *Gesellschaft*, in *Die GmbH & Co KG im Handels-, Gewerbe- und Steuerrecht* (second edition), pp. 412 et seq. (W. Kastner and G. Stoll eds., Orac 1977); M. Tanzer, *Die gewinnmindernde Abzugsfähigkeit von Geldstrafen im Abgabenrecht*, pp. 84 et seq. (Orac 1983); Werndl, *Der Geschäftsführervertrag im Abgabenrecht*, Steuer- und WirtschaftsKartei (1987), p. A I 139; P. Fischer, *Die Steuerumgehung in der neueren Rechtsprechung des Bundesfinanzhofs*, Steuer & Wirtschaft International (1999), p. 81; and Kotschnigg, *supra* n. 4, sec. 22, para. 33.

15. *See* H. Loukota, *Briefkastenfirmen und Doppelbesteuerungsabkommen*, Steuer & Wirtschaft International (1991), p. 166; W. Ellinger, *Anmerkungen zu dem Artikel „Ende oder neuer Anfang der wirtschaftlichen Betrachtungsweise?“*, Österreichische Steuerzeitung (1975), p. 204. For an intermediary approach (*Zwischentheorie*), *see* Bergmann, *supra* n. 3, pp. 160 et seq.; Bergmann, *supra* n. 4, pp. 38 et seq.

16. Verwaltungsgerichtshof [Austrian Supreme Administrative Court].

17. VwGH, 5 Apr. 2011, 2010/16/0168; VwGH, 25 Feb. 2009, 2006/13/0111; VwGH, 1 Oct. 2008, 2006/13/0036; VwGH, 1 Mar. 2007, 2006/15/0070; VwGH, 29 Nov. 2006, 2003/13/0026, 0027; VwGH, 18 Oct. 2006, 2003/13/0031; VwGH, 2 Aug. 2000, 98/13/0152; VwGH, 10 Dec. 1997, 93/13/0185; VwGH, 27 Sept. 1995, 93/13/0095; VwGH, 5 Oct. 1994, 92/15/0003; VwGH, 15 June 1993, 91/14/0253; VwGH, 10 Dec. 1991, 91/14/0154; VwGH, 11 Dec. 1990, 89/14/0140; VwGH, 23 May 1990, 89/13/0272, 0273, 0274, 0275; VwGH, 29 Nov. 1988, 87/14/0200; VwGH, 10 May 1988, 87/14/0084; VwGH, 4 Feb. 1987,

The objective test elements of unusualness and inadequateness coincide with each other and, hence, a distinction is unnecessary.[18] The examination of whether or not an arrangement is inadequate requires a valuation standard.[19] However, up to the present day, the question of which concrete criteria are suitable for this purpose remains unresolved.[20] The statistical frequency of appearances of specific arrangements in economic life is not a decisive parameter.[21] Abusive arrangements, therefore, have to be qualified as tax avoidance even when many taxpayers choose them in a similar way.[22]

With regard to the subjective test of the exclusive intention of avoiding taxes, it needs to be examined whether or not the arrangement in question makes any sense besides having a tax-saving effect.[23] The existence of valid and reasonable[24] non-fiscal reasons prevents an arrangement from being qualified as tax avoidance, even in cases of inadequate arrangements.[25] Examples of non-fiscal reasons are liability limitations,[26] liquidity requirements,[27] or social security advantages.[28]

85/13/0120; VwGH, 13 May 1986, 85/14/0169; VwGH, 26 Sept. 1985, 85/14/0032; VwGH, 26 June 1984, 83/13/0258; VwGH, 8 Nov. 1983, 83/14/0056, 0057, 0058; VwGH, 4 Oct. 1983, 82/14/0317; and VwGH, 24 Nov. 1982, 81/13/0021.

18. *See* VwGH, 19 Jan. 2005, 2000/13/0176; Bergmann, *supra* n. 3, p. 167; M. Lang and C. Massoner, *Die Grenzen steuerlicher Gestaltung in der österreichischen Rechtsprechung*, in *Die Grenzen der Gestaltungsmöglichkeiten im Internationalen Steuerrecht*, p. 21 (M. Lang, J. Schuch and C. Staringer eds., Linde 2009).
19. *See* Bergmann, *supra* n. 3, pg. 168; and Kotschnigg, *supra* n. 4, sec. 22, para. 43.
20. *See* Kotschnigg, *supra* n. 4, sec. 22, para. 46; and Bergmann, *supra* n. 3, p. 168.
21. *See* VwGH, 20 May 2010, 2006/15/0005; VwGH, 19 Jan. 2005, 2000/13/0176; Bergmann, *supra* n. 3, p. 167; C. Ritz, *Bundesabgabenordnung* (fifth edition), sec. 22, para. 2 (Linde 2014).
22. *See* VwGH, 20 May 2010, 2006/15/0005; VwGH, 19 Jan. 2005, 2000/13/0176; Ritz, *supra* n. 22, sec. 22, para. 2; and Bergmann, *supra* n. 3, p. 167.
23. *See* VwGH, 28 Jan. 2005, 2000/13/0214; VwGH, 27 Feb. 2002, 98/13/0053, 0054; VwGH, 23 May 1990, 89/13/0272, 0273, 0274, 0275; VwGH, 20 Jan. 1986, 84/15/0074; VwGH, 4 Oct. 1983, 82/14/0317; VwGH, 25 Jan. 1983, 82/14/0023; VwGH, 23 Mar. 1970, 1616/68; *see also* Kotschnigg, *supra* n. 4, sec. 22, para. 53; and Bergmann, *supra* n. 3, p. 168.
24. *See* VwGH, 20 May 2010, 2006/15/0005; VwGH, 25 Feb. 2009, 2006/13/0111; VwGH, 18 Oct. 2006, 2003/13/0031; VwGH, 22 Sept. 2005, 2001/14/0188; VwGH, 10 Aug. 2005, 2001/13/0018; VwGH, 9 Dec. 2004, 2002/14/0074; VwGH, 27 Aug. 2002, 98/14/0194; VwGH, 14 Dec. 2000, 95/15/0111; VwGH, 15 Sept. 1999, 99/13/0100; VwGH, 9 Nov. 1994, 92/13/0305; VwGH, 13 Oct. 1993, 92/13/0054; VwGH, 23 May 1990, 89/13/0272, 0273, 0274, 0275; VwGH, 22 Sept. 1987, 87/14/0063; VwGH, 4 Oct. 1983, 82/14/0317; VwGH, 25 Jan. 1983, 82/14/0023; VwGH, 28 Jan. 1976, 1378/74; and VwGH, 4 Dec. 1953, 0057/51.
25. *See* VwGH, 29 Nov. 1988, 87/14/0200.
26. *See* VwGH, 23 May 1990, 89/13/0272, 0273, 0274, 0275.
27. *See* VwGH, 9 Nov. 1994, 92/13/0305.
28. *See* VwGH, 15 Jan. 1991, 90/14/0208; VwGH, 10 May 1988, 87/14/0084; and VwGH, 21 Oct. 1986, 86/14/0107.

The GAAR of Sec. 22 of the BAO has been successfully utilized by the Austrian tax administration in many cases. The provision applies to domestic and cross-border situations alike and, hence, has international effect.[29]

The VwGH considers its interpretation of Sec. 22 of the BAO and its underlying understanding of tax avoidance to be in line with the meaning of tax avoidance as found in ECJ case law and, therefore, in accordance with the EU/EEA concept of abuse.[30]

Further, on the question of which tests known from other abuse concepts are parts of the GAAR of Sec. 22 of the BAO, the following can be said:

(a) Objective test (the accrual of a tax advantage, the grant of which is contrary to the purpose of the legal provision): According to the aforementioned objective test applied by the VwGH, tax avoidance constitutes arrangements that are inadequate with regard to their economic result.[31] Even though the examination of whether or not an arrangement is inadequate requires a valuation standard,[32] and the question as to which specific criteria is suitable for this purpose remains unresolved,[33] it is likely that the purpose of the relevant legal provision has to be taken into consideration in this regard. The prevailing doctrine nonetheless disagrees with the abuse components brought forward by the VwGH's case law and demands that tax avoidance must be tackled by a correct teleological interpretation of the legal provision in question itself (*Innentheorie*).

(b) Subjective test (intention to obtain a tax advantage): According to the VwGH, the application of Sec. 22 of the BAO inter alia requires that

29. *See* Kofler, *supra* n. 2, p. 102.
30. VwGH, 18 Oct. 2012, 2010/15/0010; and VwGH, 31 Mar. 2011, 2008/15/0115.
31. VwGH, 5 Apr. 2011, 2010/16/0168; VwGH, 25 Feb. 2009, 2006/13/0111; VwGH, 1 Oct. 2008, 2006/13/0036; VwGH, 1 Mar. 2007, 2006/15/0070; VwGH, 29 Nov. 2006, 2003/13/0026, 0027; VwGH, 18 Oct. 2006, 2003/13/0031; VwGH, 2 Aug. 2000, 98/13/0152; VwGH, 10 Dec. 1997, 93/13/0185; VwGH, 27 Sept. 1995, 93/13/0095; VwGH, 5 Oct. 1994, 92/15/0003; VwGH, 15 June 1993, 91/14/0253; VwGH, 10 Dec. 1991, 91/14/0154; VwGH, 11 Dec. 1990, 89/14/0140; VwGH, 23 May 1990, 89/13/0272, 0273, 0274, 0275; VwGH, 29 Nov. 1988, 87/14/0200; VwGH, 10 May 1988, 87/14/0084; VwGH, 4 Feb. 1987, 85/13/0120; VwGH, 13 May 1986, 85/14/0169; VwGH, 26 Sept. 1985, 85/14/0032; VwGH, 26 June 1984, 83/13/0258; VwGH, 8 Nov. 1983, 83/14/0056, 0057, 0058; VwGH, 4 Oct. 1983, 82/14/0317; and VwGH, 24 Nov. 1982, 81/13/0021.
32. *See* Bergmann, *supra* n. 3, pg. 168; and Kotschnigg, *supra* n. 4, sec. 22, para. 43.
33. *See* Kotschnigg, *supra* n. 4, sec. 22, para. 46.

the arrangement in question finds its *sole* explanation in the intention of avoiding taxes.[34]

(c) Complementary business purpose test (under international tax law): In the VwGH's interpretation of Sec. 22 of the BAO, a complementary business purpose test has to be considered, namely that the existence of valid and reasonable[35] non-fiscal reasons prevents a qualification as tax avoidance even in cases of inadequate arrangements.[36]

(d) Genuine economic activity test (under EU law): According to the genuine economic activity test, under EU law, restrictions of the fundamental freedoms are only valid for the purpose of preventing wholly artificial arrangements that do not reflect economic reality and, consequently, in cases of the pursuit of genuine economic activity through a fixed establishment, restrictions are inadmissible.[37] It has to be assumed that the VwGH, which considers its interpretation of Sec. 22 of the BAO to be in line with ECJ case law on tax avoidance, would apply the genuine economic activity test when assessing the legitimacy of EU/EEA cross-border activities.

(e) Proportionality test: As already mentioned, the objective test applied by the VwGH requires that an arrangement is inadequate with regard to its economic result. The examination of whether an arrangement is inadequate (or otherwise) should include a proportionality test.

34. VwGH, 5 Apr. 2011, 2010/16/0168; VwGH, 25 Feb. 2009, 2006/13/0111; VwGH, 1 Oct. 2008, 2006/13/0036; VwGH, 1 Mar. 2007, 2006/15/0070; VwGH, 29 Nov. 2006, 2003/13/0026, 0027; VwGH, 18 Oct. 2006, 2003/13/0031; VwGH, 2 Aug. 2000, 98/13/0152; VwGH, 10 Dec. 1997, 93/13/0185; VwGH, 27 Sept. 1995, 93/13/0095; VwGH, 5 Oct. 1994, 92/15/0003; VwGH, 15 June 1993, 91/14/0253; VwGH, 10 Dec. 1991, 91/14/0154; VwGH, 11 Dec. 1990, 89/14/0140; VwGH, 23 May 1990, 89/13/0272, 0273, 0274, 0275; VwGH, 29 Nov. 1988, 87/14/0200; VwGH, 10 May 1988, 87/14/0084; VwGH, 4 Feb. 1987, 85/13/0120; VwGH, 13 May 1986, 85/14/0169; VwGH, 26 Sept. 1985, 85/14/0032; VwGH, 26 June 1984, 83/13/0258; VwGH, 8 Nov. 1983, 83/14/0056, 0057, 0058; VwGH, 4 Oct. 1983, 82/14/0317; and VwGH, 24 Nov. 1982, 81/13/0021.

35. *See* VwGH, 20 May 2010, 2006/15/0005; VwGH, 25 Feb. 2009, 2006/13/0111; VwGH, 18 Oct. 2006, 2003/13/0031; VwGH, 22 Sept. 2005, 2001/14/0188; VwGH, 10 Aug. 2005, 2001/13/0018; VwGH, 9 Dec. 2004, 2002/14/0074; VwGH, 27 Aug. 2002, 98/14/0194; VwGH, 14 Dec. 2000, 95/15/0111; VwGH, 15 Sept. 1999, 99/13/0100; VwGH, 9 Nov. 1994, 92/13/0305; VwGH, 13 Oct. 1993, 92/13/0054; VwGH, 23 May 1990, 89/13/0272, 0273, 0274, 0275; VwGH, 22 Sept. 1987, 87/14/0063; VwGH, 4 Oct. 1983, 82/14/0317; VwGH, 25 Jan. 1983, 82/14/0023; VwGH, 28 Jan. 1976, 1378/74; and VwGH, 4 Dec. 1953, 0057/51.

36. *See* VwGH, 29 Nov. 1988, 87/14/0200.

37. ECJ, 12 Sept. 2006, Case C-196/04, *Cadbury Schweppes*, paras. 54-55.

In the way the GAAR of Sec. 22 of the BAO is interpreted by the VwGH it should be broadly in line with the GAAR proposed by the European Commission, which in 2012 read as follows:[38]

> 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.

However, according to the interpretation of the VwGH, tax avoidance of Sec. 22 of the BAO requires that the *sole* purpose of the arrangement in question lies in the goal of avoiding taxes, whereas the GAAR proposed by the European Commission is already satisfied when avoiding taxes is the *essential* purpose. Nevertheless, there are no indications that would lead to the assumption that the Austrian legislator is going to replace the GAAR of Sec. 22 of the BAO (which has not been subject to any changes since its entry into force on 1 January 1962) with the GAAR proposed by the European Commission any time soon.[39]

Essentially, the same holds true for the GAAR of Art. 6 of the recently enacted EU Anti-Tax Avoidance Directive (ATAD), which reads as follows:

> 1. For the purposes of calculating the corporate tax liability, a Member State shall ignore an arrangement or a series of arrangements which, having been put into place for the main purpose or one of the main purposes of obtaining a tax advantage that defeats the object or purpose of the applicable tax law, are not genuine having regard to all relevant facts and circumstances. An arrangement may comprise more than one step or part.
> 2. For the purposes of paragraph 1, an arrangement or a series thereof shall be regarded as non-genuine to the extent that they are not put into place for valid commercial reasons which reflect economic reality.
> 3. Where arrangements or a series thereof are ignored in accordance with paragraph 1, the tax liability shall be calculated in accordance with national law.

As interpreted by the VwGH, the GAAR of Sec. 22 of the BAO should, to a large degree, be in line with Art. 6 of the ATAD. However, Art. 6 of the

38. *See* Commission Recommendation of 6 Dec. 2012 on aggressive tax planning, C(2012) 8806 final.
39. *See*, critical in matters of replacing Sec. 22 of the BAO by the GAAR proposed by the European Commission, M. Lang, *„Aggressive Steuerplanung" – eine Analyse der Empfehlung der Europäischen Kommission*, Steuer & Wirtschaft International (2013), p. 68.

ATAD is already applicable when obtaining a tax advantage is the *main* purpose or *one of the main* purposes, whereas tax avoidance in the sense of Sec. 22 of the BAO currently requires that the *sole* purpose of the arrangement in question lies in avoiding taxes. It remains to be seen whether the Austrian legislator will replace or adapt the GAAR of Sec. 22 of the BAO in light of Art. 6 of the ATAD, or if Sec. 22 of the BAO will remain unchanged and will have to be interpreted in the sense of the ATAD.

7.3. Specific anti-avoidance rules

7.3.1. Linking rules

In 2014,[40] a prohibition on interest deduction was introduced in Sec. 12, para. 1, subpara. 10 of the KStG[41] regarding interest payments within groups of companies, if the interest payments are subject to no income tax at all or a tax rate of less than 10% at the level of the recipient. The legislative materials comment that this amendment aims to avoid profit shifting into low tax countries within groups of companies and stands in the light of the recent international developments like the BEPS initiative.[42] In 2010,[43] prior to the BEPS initiative, the Austrian legislator tackled a reverse case where a company receives payments from a foreign subsidiary that normally would be considered as dividends and therefore tax exempt under the participation exemption rules, but which was treated as deductible interest payment at the level of the distributing foreign subsidiary. Ever since Sec. 10, para. 7 of the KStG stipulates that in such cases the application of the participation exemption is refused to the parent company to avoid a double-dip with regard to hybrid cross-border financing. In this regard, Action 2[44] of the BEPS report is already implemented in Austrian national tax law.

Sec. 12, para. 1, subpara. 10 of the KStG seems to be in line with the hybrid mismatch SAAR of Art. 9[45] of the ATAD. However, it seems necessary to

40. Abgabenänderungsgesetz 2014 [Tax Amending Act 2014], Federal Law Gazette, part I, no. 13/2014.
41. Körperschaftsteuergesetz 1988 [Corporate Income Tax Act 1988].
42. *See* the explanatory remarks to government bill no. 24 of the 25th legislation period, p. 13.
43. Budgetbegleitgesetz 2011 [Budget Supplementary Act 2011], Federal Law Gazette, part I, no. 111/2010.
44. *See* OECD, *Neutralising the Effects of Hybrid Mismatch Arrangements*, pp. 29 et seq.
45. “1. To the extent that a hybrid mismatch results in a double deduction, the deduction shall be given only in the Member State where such payment has its source. [...] 2. To the

broaden the national provisions scope, since the ATAD not only addresses hybrid mismatches within associated enterprises but also "structured arrangement between parties in Member States" (Art. 2, para. 9 of the ATAD).

7.3.2. Interest deduction limitation rules

In principle, interest payments on loans and other debts both to third and related parties are deductible. However, interest payments to related parties (e.g. shareholders or subsidiaries) are subject to arm's length standards, i.e. they are deductible only to the extent that they are at arm's length and exceeding amounts are normally deemed to be hidden profit distributions or hidden equity contributions. However, there are exceptions to this principle. Besides the mentioned interest deduction limitation of Sec. 12, para. 1, subpara. 10 of the KStG (*see* section 7.3.1.), Sec. 12 para. 1 subpara. 9 of the KStG, for example, stipulates that interest payments on loans to finance acquisitions of inter-group participations are not deductible.

At present, a general interest limitation rule as stipulated by Art. 4 of the ATAD is not known in Austrian national tax law. Hence, actions of the Austrian legislator will be necessary in this respect.

7.3.3. CFC rules

Austrian tax legislation lacks specific CFC rules.[46] However, in particular situations, the tax treatment of foreign funds may be utilized as a tool to counter the sheltering of income in foreign subsidiaries.[47] According to Sec. 188 of the InvFG,[48] a look-through taxation takes place with regard to entities constituting a foreign investment fund. A foreign investment fund is deemed to exist if the foreign entity is one of the Undertakings for Collective Investment in Transferable Securities (UCITS), an Alternative Investment Fund (AIF), or any other organism without regard to its legal form, which (by law, statute, or fact) structures its investments under the principle of risk diversification and is subject to a foreign tax burden of less

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extent that a hybrid mismatch results in a deduction without inclusion, the Member State of the payer shall deny the deduction of such payment."

46. *See* Kofler, *supra* n. 2, p. 105.
47. *See* Kofler, *supra* n. 2, p. 105.
48. Investmentfondsgesetz 2011 [Investment Funds Act 2011].

than 15%. According to the similar provision of Sec. 42 of the ImmoInvFG,[49] a look-through taxation also takes place with regard to entities deemed to be a foreign real estate investment fund. This is the case if a foreign entity is an AIF in real estate, or any other organism in real estate without regard to its legal form, which (by law, statute, or fact) structures its investments under the principle of risk diversification and is subject to a foreign tax burden of less than 15%. Income earned by such foreign funds is deemed to be income of the owner of the funds, which is achieved by taxing the retained profits as fictitious distributions.[50] According to the Austrian tax authorities, a foreign company following a risk-spreading investment strategy under these provisions can be viewed as a foreign fund, even if it is entirely owned by a single shareholder.[51] This may even be the case when a foreign holding company is interposed as intermediary, as the risk diversification requirement can also be fulfilled indirectly.[52]

Since Austrian tax legislation currently lacks specific CFC rules, actions of the Austrian legislator will be necessary in respect of Art. 7 of the ATAD.

7.3.4. Transfer pricing rules

Under Austrian national tax law, transfer pricing (TP) is regulated by special provisions to a small extent.[53] According to Sec. 6, para. 6 of the EStG[54] all cross-border transactions between related parties with legal personality and a participation of more than 25%, as well as all transactions between permanent establishments (PEs) or branches and headquarters (including partnerships), have to be valued at arm's length. Additionally, TP rules are derived from general tax law principles[55] such as the treatment of hidden equity contributions and the treatment of hidden profit distribution.[56] Furthermore,

49. Immobilien-Investmentfondsgesetz [Real Estate Investment Funds Act].
50. *See* Kofler, *supra* n. 2, p. 105.
51. *See* EAS 984 = Steuer & Wirtschaft International (1997), p. 90; EAS 1155 = Steuer & Wirtschaft International (1997), p. 535; EAS 1485 = Steuer & Wirtschaft International (1999), p. 407; EAS 1980 = Steuer & Wirtschaft International (2002), p. 110; EAS 2476 = Steuer & Wirtschaft International (2004), p. 440; and Kofler, *supra* n. 2, p. 105.
52. *See* H. Loukota, *Einkünftezurechnung im Internationalen Steuerrecht*, in *Einkünftezurechnung im Einkommen- und Körperschaftsteuerrecht, 15. ÖJT III/2*, pp. 119 et seq. (Manz 2004); and Kofler, *supra* n. 2, p. 105.
53. *See* F. Rosenberger, *Verrechnungspreise – Grundlagen*, in *Internationales Steuerrecht*, para. XVII/3 (S. Bendlinger et al. eds., LexisNexis 2015).
54. Einkommensteuergesetz 1988 [Individual Income Tax Act 1988].
55. *See* Rosenberger, *supra* n. 53, para. XVII/3.
56. *See* M. Lehner, *Kostenverteilungsverträge*, pp. 73 and 76 et seq. (Linde 2014); and H. Loukota and H. Jirousek, *Internationales Steuerrecht* I/1 Z 9, para. 12 (Manz 2015).

when applying Austria's double taxation conventions (DTCs), the OECD Transfer Pricing Guidelines (OECD TPG) should be followed. Occasionally the Austrian tax authorities refer in TP cases also to the GAAR of Sec. 22 of the BAO.

In July 2016, a new law (VPDG)[57] regarding TP documentation was enacted. With this law, the Austrian legislator implemented the OECDs Multilateral Competent Authority Agreement (MCAA) on the Exchange of Country-by-Country Reports (CbC Reports) (BEPS Action 13) and the corresponding amendments of the EU Mutual Assistance Directive. Henceforth, multinational enterprise (MNE) groups are obliged to observe a three-tiered standardized documentation approach (CbC Report, Master File and Local File), if certain turnover thresholds are exceeded.[58]

7.3.5. Subject-to-tax rules in DTCs

Subject-to-tax rules are not part of Austria's treaty policy, as Austria seeks to conclude DTCs on the basis of the OECD Model Tax Convention (OECD MTC) and avoids modifications as far as possible.[59] Therefore, in Austria's DTCs, subject-to-tax rules are the exception.[60] Nevertheless, Austria accepts subject-to-tax clauses in tax treaty negotiations if the other country's negotiators propose them.[61] Examples of specific subject-to-tax rules are Art. 15, para. 2, subpara. (d) of the Austria-Australia DTC,[62] Art. 22, para. 2, subpara. (b) of the Austria-Bahrain DTC,[63] Art. 15, para. 4 of the

57. Verrechungspreisdokumentationsgesetz [Transfer Pricing Documentation Act].
58. EUR 750 million consolidated group turnover to file a country-by-country report, EUR 50 million turnover of Austrian entities to prepare and submit Master File and Local File.
59. *See* E. Burgstaller and M. Schilcher, *Subject-to-Tax Clauses in Tax Treaties*, European Taxation (2004), p. 267; and H. Jirousek, *Negotiations of Tax Treaties – an Update*, Steuer & Wirtschaft International (2003), p. 312.
60. *See* F. Rosenberger, *Subject-to-tax Klauseln*, Steuer- und WirtschaftsKartei (2008), p. S 59; and S. Bendlinger, *Doppelbesteuerungsabkommen – Methoden zur Vermeidung von Doppelbesteuerung*, in *Internationales Steuerrecht*, para. XIV/21 (S. Bendlinger et al. eds., LexisNexis 2015).
61. *See* Burgstsaller and Schilcher, *supra* n. 57, p. 267.
62. "Notwithstanding the provisions of paragraph 1, remuneration derived by an individual who is a resident of one of the Contracting States in respect of an employment exercised in the other Contracting State shall be taxable only in the first-mentioned State if: [...] the remuneration is, or upon the application of this Article will be, subject to tax in the first-mentioned State."
63. "Where a resident of Austria who is engaged in substantive active business operations in Bahrain, derives income which, in accordance with the provisions of Article 7,

Austria-Germany DTC,[64] Art. 20, para. 1 of the Austria-Malaysia DTC,[65] and Art. 3, para. 2 of the Austria-UK DTC.[66] A general subject-to-tax rule as proposed by the European Commission[67] does not exist in Austrian DTCs and, to the author's knowledge, Austria does not intend to introduce such a general subject-to-tax rule in the near future.

7.3.6. Limitation-on-benefits rules in DTCs

Normally Austria's DTCs do not include limitation on benefits (LOB) rules, i.e. additional tests a resident person has to pass in order to qualify for the treaty benefits.[68] Exceptions are the DTCs concluded with Liechtenstein, Luxembourg, Taiwan and the United States.

According to the LOB rule of Art. 26 of the Austria-Liechtenstein DTC, the treaty provisions shall apply to companies and trusts that are exempt under national Liechtenstein tax legislation from capital, income and corporation taxes, only to the extent that individuals resident in Liechtenstein and companies, foundations and Anstalten of Liechtenstein public law are directly interested in, or benefit from such companies and trusts. Thus, if individuals, companies, or other qualified entities not resident in Liechtenstein have a

may be taxed in Bahrain and is liable to tax in Bahrain according to the provisions of the domestic law of Bahrain, Austria shall, notwithstanding sub-paragraph a), exempt such income from tax."

64. "For the purposes of this Article, employment is deemed to be exercised in the other Contracting State only where the remuneration therefrom was subject to tax in that State in accordance with this Convention."

65. "An individual who is a resident of a Contracting State immediately before making a visit to the other Contracting State, and who, at the invitation of any university, college, school or other similar educational institution, visits that other State for a period not exceeding two years solely for the purpose of teaching or research or both at such educational institution shall be exempt from tax in that other State on any remuneration for such teaching or research which is subject to tax in the first-mentioned Contracting State."

66. "Where under any provision of this Convention income is relieved from Austrian tax and, under the law in force in the United Kingdom, an individual, in respect of the said income, is subject to tax by reference to the amount thereof which is remitted to or received in the United Kingdom and not by reference to the full amount thereof, then the relief to be allowed under this Convention in Austria shall apply only to so much of the income as is remitted to or received in the United Kingdom."

67. "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."

68. *See* C. Staringer, *BEPS und die Folgen für die österreichische Steuerpolitik*, in *Neue Grenzen der Gestaltung für Bilanz und Steuern*, p. 172 (R. Bertl et al. eds., Linde 2014).

direct interest in, or profit from these companies or trusts, the treaty does not apply.

According to the LOB rule of Art. 26 of the Austria-Luxembourg DTC, the convention shall not apply to holding companies within the meaning of the special national Luxembourg laws and neither shall it apply to income derived from such holding companies by a resident of Austria or to shares in such companies, belonging to such a person. Due to the expiration of the transitional regime for existing holding companies on 31 December 2010, this LOB rule has been obsolete since 1 January 2011.

According the LOB rule of Art. 25 of the Austria-Taiwan DTC, a resident person shall not receive benefits of any reduction in, or exemption from tax provided for in the treaty by the other territory if the conduct of operations by such a resident or a person connected with such a resident had as its main purpose or one of its main purposes to obtain the benefits of the treaty.

According to the extensive LOB rule of Art. 16 of the Austria-US DTC, a resident person has to pass at least one of several tests in order to qualify for the treaty benefits. Pursuant to these tests stipulated in para. 1 of the article, a resident person deriving income from the other contracting state shall only be entitled to the treaty benefits if such a person is:

(a) an individual;
(b) a contracting state itself or a political subdivision or local authority thereof;
(c) engaged in the active conduct of a trade or business in the state of residence (other than the business of making or managing investments, unless these activities are banking or insurance activities carried on by a bank or insurance company), the income derived from the other contracting state is derived in connection with, or is incidental to, that trade or business, and, with respect to income derived in connection with that trade or business, the trade or business is substantial in relation to the activity carried on in the other contracting state, giving rise to income in respect of which treaty benefits are being claimed in that other contracting state;[69]
(d) a person, if
    (i) more than 50% of the beneficial interest in such a person (or in the case of a company, more than 50% of the number of shares of each class of the company's shares) is owned, directly or indirectly, by

69. *See* for further details J. Schuch, *Die "aktive gewerbliche Tätigkeit" als Voraussetzung für die Abkommensvergünstigungen nach dem neuen DBA USA-Österreich*, Steuer & Wirtschaft International (1997), pp. 335 et seq.

persons entitled to benefits of the convention under subparas. (a), (b), (e), (f) or (g) of Art. 16, para. 1, or who are citizens of the United States, and

(ii) not more than 50% of the gross income of such a person is used, directly or indirectly, to meet liabilities (including liabilities for interest or royalties) to persons who are not entitled to benefits of this DTC under subparas. (a), (b), (e), (f) or (g) of Art. 16, para. 1, and are not citizens of the United States;

(e) a company in whose principal class of shares there is substantial and regular trading on a recognized stock exchange;

(f) a company that is at least 90% owned, directly or indirectly, by not more than five companies referred to in subpara. (e), provided that each person in the chain of ownership is a resident of a contracting state, and provided further that the owner of any remaining portion of the company is an individual resident of a contracting state;

(g) an entity which is a not-for-profit organization (including pension funds and private foundations), and which, by virtue of that status, is generally exempt from income taxation in its state of residence, provided that more than half of the beneficiaries, members or participants, if any, in such organization are persons that are entitled, under Art. 16 to the benefits of the convention; or

(h) a recognized headquarters company for a MNE group.

Under the "grace clause" in Art. 16, para. 2 of the Austria-US DTC, persons not entitled to the benefits of the treaty pursuant to the aforementioned tests may, nevertheless, be granted the benefits of the treaty if the competent authority of the source state so determines.[70]

7.3.7. Other specific anti-avoidance rules

Additionally, Sec. 22 of the BAO is supplemented by a few other SAARs – such as the anti-abuse provisions implementing the abuse reservations of the EU direct tax directives (Sec. 94, para. 2 of the EStG for the Parent-Subsidiary Directive,[71] Sec. 99a, para. 9 of the EStG for the Interest and Royalties Directive,[72] and Sec. 44 of the UmgrStG[73] for the Merger

70. *See*, for further details, W. Gassner, *Die Grenzen der Abkommensbegünstigungen und die Ermessensentscheidung nach Art. 16 Abs. 2 DBA Österreich-USA*, Steuer & Wirtschaft International (1997), pp. 448 et seq.
71. 2011/96/EU.
72. 2003/49/EC.
73. Umgründungssteuergesetz [Reorganization Tax Act].

Directive);[74] switch-over provisions for distributions from foreign companies stipulated in Sec. 10, paras. 4 and 5 of the KStG.

According to Sec. 10, para. 4 of the KStG regarding the so-called "international participation exemption" (holdings of at least 10% in a foreign subsidiary over a minimum holding period of one year) a switch-over to the credit method takes place, if the focus of the non-resident subsidiary's business operations consists directly or indirectly in deriving "passive" income (that is interest income, income from movable tangible or intangible assets, or income from the sale of participations) and the foreign subsidiary's income is not subject to a tax comparable to Austrian corporate income tax in respect of tax base and tax rate.[75] According to Sec. 10, para. 5 of the KStG regarding the exemption for "portfolio dividends" from foreign countries (EU Member States and third countries with comprehensive mutual assistance, irrespective of any minimum holding requirements) a switch-over to the credit method takes place, if the foreign tax burden is less than 15% (irrespective of whether or not the distributing foreign company derives "active" or "passive" income). Last but not least, Sec. 6, para. 6 and Sec. 27, para. 6 of the EStG contain exit taxation rules that will require only minor legislative amendments in respect of the exit taxation SAAR stipulated in Art. 4 of the ATAD.

7.4. Interaction of general and specific anti-avoidance rules

In accordance with the legal rule *lex specialis derogat legi generali* SAARs, in principle, have priority over the application of the GAAR contained in Sec. 22 of the BAO, which means that within a SAAR's scope of application, a utilization of the subsidiary GAAR contained in Sec. 22 of the BAO by tax authorities typically is not possible.[76] However, in specific situations, the VwGH has occasionally authorized the application of Sec. 22 of the BAO in addition to an insufficient SAAR (e.g. with regard to the switch-over of Sec. 10, para. 4 of the KStG).[77]

74. 2009/133/EC.
75. *See* Kofler, *supra* n. 2, pp. 104 et seq.
76. *See* Kotschnigg, *supra* n. 4, sec. 22, paras. 12 and 15.
77. *See* VwGH, 10 Aug. 2005, 2001/13/0018; *see* also in this regard G. Kofler, *Dublin Docks-Gesellschaften zwischen Missbrauch und Gemeinschaftsrecht*, Österreichisches Recht der Wirtschaft (2005), pp. 786 et seq; C. Staringer, *Konzernsteuerrecht, 18. ÖJT IV/1*, pp. 75 et seq. (Manz 2012); and Staringer, *supra* n. 66, p. 168.

7.5. Procedural aspects

In respect of procedural matters, it needs to be mentioned that the burden of proof of whether an arrangement constitutes tax avoidance, in principle lies with the tax authorities.[78] However, evidence of non-fiscal reasons, the existence of which precludes tax avoidance, has to be provided by the taxpayers.[79]

Since 2010, Sec. 118 of the BAO provides the possibility of tax rulings in the specific contexts of reorganizations, tax groups and TP. In these areas, taxpayers can request an advanced assessment of the intended arrangements. The entitlement for tax rulings presupposes a special interest of the requester in the matter in question. Such a special interest can be substantiated by doubts, whether or not the fact pattern in question has to be qualified as tax avoidance.[80] As a consequence, tax rulings should diminish the number of cases of tax avoidance qualifications.

Last but not least, in procedural matters reference is made to the general rules of Sec. 207 of the BAO regarding periods of prescription (statute of limitations), which range from 3 to 10 years depending on the type of tax and other circumstances.

78. *See* VwGH, 29 Nov. 1988, 88/14/0184; VwGH, 9 Dec. 1980, 1666/79; VwGH, 9 Nov. 1972, 2061/71; VwGH, 23 Mar. 1970, 1616/68; Stoll, *supra* n. 13, p. 255; and Kotschnigg, *supra* n. 4, sec. 22, paras. 98 and 102.
79. *See* VwGH, 19 Jan. 2005, 2000/13/0176; VwGH, 7 Nov. 1989, 86/14/0203; Ritz, *supra* n. 22, sec. 22 para. 4; Kotschnigg, *supra* n. 4, sec. 22 para. 102; and Bergmann, *supra* n. 3, p. 170.
80. *See* Bundesministerium für Finanzen [Austrian Ministry of Finance], *Richtlinien zu Advance Ruling*, sec. 3 (2011); and Ritz, *supra* n. 22, sec. 118, para. 7.

Chapter 8

Belgium*

Bart Peeters

8.1. The meaning of avoidance and aggressive tax planning and the BEPS initiative

8.1.1. Legal definition

In a Belgian context, the distinction between tax planning and the more general principle of tax avoidance seems rather artificial. Based on the constitutional legality principle, persons and goods are exempted from taxation unless expressly provided for by law. As will be explained, this implies that "tax avoidance" in general, to be construed as setting up a favourable tax structure, is treated in combination with the possibility of (even aggressive) tax planning. A distinction has to be made between legal tax planning or avoidance and illegal tax evasion or tax fraud.

In general, the Belgian Constitution provides that "no taxation can be levied to the benefit of the State, unless it has been implemented by a law".[1] Most scholars interpret the word "by" in this phrase as demanding a formal involvement of the legislative parliamentary power that has to determine the basic aspects of any tax. Only the legislature itself can establish such taxation, and it cannot be delegated to any other (e.g. executive or administrative) authority.[2] This interpretation is, inter alia, based on a historical argument, developed from the textual differences between the 1831 Belgian Constitution and the preceding Dutch *Grondwet*, in force when the region fell under the reign of the Dutch King Willem I. Whereas the latter text left open the possibility of delegation ("*Geene belastingen kunnen ten behoeve*

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1. Art. 170. §1 Belgian Constitution (hereinafter: Const.). The same principle of legality applies with regard to taxes to the benefit of the regional and local entities (Art. 170 §2-4 Const.).

2. *See*, for example, E. VAN DE VELDE, *Afspraken met de fiscus: de grenzen, juridische kwalificatie en rechtsgevolgen* (Larcier 2009), pp. 157-160.

van 's Lands kas worden geheven, dan uit krachte van eene wet"), the Belgian Constitution reinforced the legality principle as a reaction against abuses under the former Dutch regime.[3]

Legal theory, therefore, generally demands a formal act of the legislative authority to establish a tax. Whenever the legislature delegates the determination of particular aspects of tax legislation to an executive authority, the Constitutional Court will verify whether these consist only of minor practical procedures.[4] Tax is, therefore, not to be presumed. Tax liabilities have to be clearly defined in a legal text, which has to be strictly construed. Taxation through analogous interpretation is prohibited.

From this point of view, the Belgian Supreme Court (*Hof van Cassatie*, *Cour de Cassation*) has derived the free choice of a taxpayer to opt for the least taxed way when structuring a particular operation. Named after the first case decided in this context, this is known as the "*Brepols* doctrine". According to the Supreme Court, "there is no prohibited simulation, and, therefore, tax evasion, where, in order to benefit from a more favourable tax treatment, and using the freedom of contract, without however violating any legal provision, the parties enter into acts of which they accept all consequences, even if the form they give thereto is not the most usual",[5] and "even if these acts are entered into with the sole purpose of reducing the tax burden".[6] Tax avoidance, therefore, cannot be considered a crime or administrative offence, as a taxpayer does not evade any tax legally due. As long as the taxpayers involved accept all consequences of their legal transactions, tax avoidance has to be distinguished from sham or tax evasion. The tax administration in general will also have to accept all consequences.[7]

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3. This interpretation, allegedly based on the historical method, has, however, been questioned. According to De Groot, nothing in the constitutional history can clearly establish that the text of the current Article 170 of the Belgian Constitution was willingly worded differently from Article 197 of the former Dutch Constitution as a reaction against the latter, which was perceived as giving too much discretionary power to the executive authority. In addition, the Dutch constitutional law literature does not confirm that the legality principle in tax matters in the Netherlands ("taxes imposed by the State shall be levied pursuant to an Act of Parliament" (Art. 104)) would be less restrictive than the Belgian one. *See* D. DE GROOT, "*Over de invoering en het belang van het grondwettelijke legaliteitsbeginsel in fiscale aangelegenheden*", 360 *TFR* (2009), p. 339.
4. *See*, for example, Constitutional Court, 21 Feb. 2007, no. C-32/2007; and 3 Mar. 2016, no. 37/2016, available at www.const-court.be.
5. Supreme Court, 6 June 1961, *Brepols*, *Pas.*, 1961, I, 1082.
6. Supreme Court, 22 Mar. 1990, *Au vieux Saint-Martin*, *Pas.*, 1990, I, 853.
7. This point of view has been repeated by the court several times. *See*, for example, Supreme Court, 19 Oct. 1965, 27 Feb. 1987, 29 Jan. 1988, 23 Dec. 1993, 19 May 1995, 16 Oct. 1997, 5 Mar. 1999 and 16 Oct. 2009, available at www.cassonline.be.

Although legal, the legislator can limit the scope of this free choice by means of general anti-avoidance rules (GAARs) as well as specific anti-avoidance rules (SAARs). Besides, one notices instances of particular legal texts being deliberately construed with the purpose of combating tax avoidance, even in cases where this was not necessarily the particular aim of the legal text at stake.

Most Belgian tax codes contain a GAAR.[8] Apart from the one in the Belgian VAT Code (BVAT), these GAARs all follow the approach of Article 344 §1 of the Belgian Income Tax Code (BITC), as reformed by a law of 29 March 2012.[9] This text reads as follows:

> The legal act or separate legal acts that realise the same operation is/are not binding on the tax authorities when the tax administration can, on the basis of objective circumstances, establish by means of presumptions or other legal items of evidence mentioned in Article 340 that tax abuse has occurred. There is tax abuse where the taxpayer carries out, by means of a legal act or a series of legal acts, one of the following transactions:
>
> 1. a transaction by which the taxpayer places himself, contrary to the purpose of a provision of this Code [i.e. the BITC] or the decrees implementing it, outside the scope of application of such provision; or,
> 2. a transaction through which the taxpayer claims a tax advantage provided for by a provision of this Code or the decrees implementing it, the aim of which is essentially the obtaining of such benefit, where the granting thereof would be contrary to the purpose of that provision. It is up to the taxpayer to prove that the choice of the legal act or series of legal acts is justified by other motives than the avoidance of income taxes. If the taxpayer does not provide this counterproof, then the taxable base and tax computation are restored so that the transaction is subject to a tax assessment that is consistent with the purpose of the law, as if no abuse had occurred.

In contrast to the preceding version, this text contains an explicit definition of "tax abuse", one which contains an objective element and a subjective

8. Art. 344 §1 Belgian Income Tax Code (BITC); Art. 18.2 Code on registration duties (as applicable in Brussels and Wallonia); Art. 106.2 Inheritance Tax Code (as applicable in Brussels and Wallonia); and Art. 3.17.0.0.2 Flemish Tax Code. A different text is foreseen in Art. 1 §10 Belgian VAT Code (BVAT).

9. Program law of 27 Dec. 2012, Belgian Gazette, 31 Dec. 2012. Given the importance of this topic, it has been widely commented on in the legal literature. *See*, inter alios, T. AFSCHRIFT, *L'abus fiscal* (Larcier 2013), p. 286; M. BOURGEOIS and A. NOLLET, "*L'introduction d'une notion générale d'abus (de droit) fiscal en matière d'impôts sur les revenus, de droits d'enregistrement et de droits de succession*", 6 *RGF* (2012), pp. 4-20; and X. (Ed.), *De nieuwe antimisbruikbepaling: verslagboek van het grote antimisbruik-seminar georganiseerd door Kluwer opleidingen op 10 mei 2012* (Kluwer 2013), p. 193.

element. The objective element involves the situation into which the taxpayer has placed himself. As such, a taxpayer can place himself in a situation wherein he benefits from a certain tax advantage, although this was not the intention of the legislator, or a taxpayer can avoid a particular charging provision, although the legislator intended to subject his behaviour to the taxation in question. It is important to note the explicit reference to a particular tax code and the decrees implementing it. Each tax code has its own definition of tax abuse and only refers to its own legislation and executive decrees. Tax legislation that would be implemented in separate legal texts therefore would not be covered by this general text.[10] Moreover, the attaining of an advantage, as well as the exclusion from a tax, should frustrate the legislator's intention. Defining this intention can, however, be very difficult in practice. The Minister of Finance made a very questionable statement during the discussion of the draft bill. He asserted that tax statutes are charging provisions aimed at collecting the financial means necessary to spend in the public interest.[11] However, this cannot be seen as the intention of each particular tax law. The specific objectives of each provision taken separately cannot be confused with or assimilated to the general purpose related to taxation as a whole. The GAARs refer to the purpose of the specific charging/relief provision at stake. This is ascertainable from the statute itself, the broader legal context in which the provision is included and the preparatory works (i.e. the legislative history of the GAARs). Unilateral constructions by the tax authorities (Circular letters, FAQs, answers by the Minister of Finance to parliamentary questions etc.) are irrelevant to this purpose. The Constitutional Court has given some details about how the tax authorities can identify the objectives of the circumvented tax provisions.[12] First, it is necessary to prove that the effect of the taxpayer's transaction is inconsistent with the objectives of the tax provision concerned, and not just irrelevant to such objectives. Second, this requires that the objectives of the tax provisions are sufficiently clearly apparent from the wording and, where appropriate, from the legislative history of the draft bill (preparatory documents). Elements to be taken into account by the tax authorities in this respect include the general context of the relevant tax law, the practices usually prevalent at the time of the entry into force of the tax provision concerned and the possible existence of specific provisions already aimed at countering

10. During the legislative history, an amendment to stop this limit was not accepted. *See Parl. St*. Kamer DOC 53, no. 2081/016.

11. *Doc. Parl.*, Chambre, session 2011-2012, no. 53 2081/16, p. 6.

12. Constitutional Court, 30 Oct. 2013, no. 141/2013, B.21.1. and B.21.2. *See* A. NOLLET, "*La nouvelle règle anti-'abus fiscal' à l'épreuve du juge constitutionnel: une validation prévisible, des clarifications appréciables, des considérations discutables*", *RFRL* (2013), pp. 296-322.

certain abuses of the tax provision concerned. As a consequence, where the preparatory works of the circumvented charging/relief provisions are too unclear or are ambiguous, the principle *in dubio contra fiscum* should be applied (unless the objective of the circumvented tax provision can be found through a systematic approach to the legal rules at stake).

The subjective element relates to the taxpayer's intentions. For a transaction to qualify as tax abuse, the taxpayer's concern to avoid the tax must be either the exclusive motive behind that transaction or an essential motive to such an extent that any other concerns should be regarded as negligible or purely artificial, not only in economic terms but also with regard to other relevant considerations, particularly personal or family considerations.[13] So the intention of the taxpayer matters. This is a sole-purpose test. Taxpayers can escape the GAAR by proving that their choice of legal act(s) is justified by other genuine non-tax reasons than the avoidance of income tax (or registration/inheritance taxes). Nevertheless, the non-tax reasons must be specific to the taxpayer's transaction and not be general and inherent in all transactions of that nature. In addition, if the non-tax motive(s) is/are specific to the taxpayer's transaction, it/they should not be wholly secondary to tax motives and so insignificant that a reasonable taxpayer would not have entered into the transaction in the absence of the tax benefits involved.

The legislative history of the GAARs indicates that the government was inspired to this purpose by the ECJ decisions in the *Part Service* and *Foggia* cases.[14] In an administrative Circular,[15] this subjective element is further linked to the European notion of a "wholly artificial arrangement", although, in a Belgian context, this refers to the subjective intention rather than describing the objective element.

13. *Doc. Parl.*, Chambre, 2011-2012, no. 53-2081/001, 114-115. This construction has been confirmed by the Constitutional Court (30 Oct. 2013, no. 141/2013, B.20.3).
14. ECJ, 21 Feb. 2008, C-425/06, *Part Services*; ECJ, 10 Nov. 2011, C-126/10, *Foggia*. However, in legal scholarship, this reference has been criticized, as the definition was more particularly inspired by the *Halifax* and *Cadbury Schweppes* cases. *See* L. DE BROE en J. BOSSUYT, "*Interpretatie en toepassing van de algemene antimisbruikbepalingen in de inkomstenbelasting, registratie- en successierechten*", 11 *AFT* (2012), p. 8.
15. Circular no. Ci.RH.81/616.207 (AFZ 3/2012 – AAF 17/2012 – AAPD 4/2012) of 4 May 2012.

Since 2006,[16] the BVAT has also provided for a GAAR, in Article 1 §10. This text was, when implemented, largely inspired by European case law.[17] It reads as follows:

> For the application of this Code there is supposed to be abuse when the executed transactions result in the obtaining of a tax benefit, where the granting thereof is contrary to the purposes of this Code and the decrees implementing it and the transactions basically were set up for obtaining this benefit.

In addition to GAARs, the legislator also provides for several SAARs in a number of different contexts. These can apply in particular to cross-border transactions[18] or to purely domestic tax avoidance mechanisms. Especially in a domestic context, the scope of the rules can be quite diverse, including legal requalification of taxable income causing a higher tax burden,[19] additional taxation because of uncommon transactions,[20] non-deductibility of certain costs,[21] particular priority rules in the allocation of distributions,[22]

16. Program law of 20 July 2006, Belgian Gazette, 28 July 2006. This text replaced a previous anti-abuse clause implemented in Art. 59 §3 BVAT (by the law of 27 Dec. 2005, Belgian Gazette, 2005), which was closer to the text of the then-current Art. 344 §1 BITC.
17. In particular ECJ, 21 Feb. 2006, C-255/02, *Halifax*. The text replaced an earlier anti-abuse disposition to bring Belgian practice more in line with the European prerequisites. *See* I. MASSIN and K. VYNCKE, "*BTW-planning aan banden gelegd*", 12 *AFT* (2006), pp. 3-17. The previous text (Art. 59 §3 BVAT) was comparable with Art. 344 §1 BITC.
18. For example, when focusing on Belgian residents investing abroad, Arts. 54, 198, 11 and 344 §2 BITC (rebuttable presumption of non-deductibility/non-opposability of expenses to the advantage of a resident in a tax haven); Art. 364 *bis* BITC (a particular exit tax for buildup pension rights when a person emigrates from Belgium); and, when focusing on Belgian income of non-residents, Art. 228 §3 BITC (a "catch-all clause" to tax income acquired by a non-resident deducted as a cost by a resident, whereas taxation is not excluded based on double tax conventions).
19. For example, Art. 18.4 BITC (a particular thin capitalization rule, requalifying interest into a dividend for loans granted to its own company by a director or shareholder when certain limits are exceeded); and Art. 4 and following Inheritance Tax Code (particular goods are supposed to form a part of an inheritance submitted to taxation, although they were already during the life of the deceased transferred to final beneficiaries).
20. For example, Art. 537 BITC (this temporary rule provided a favourable possibility to distribute dividends subjected to lower taxation than normally applicable; however, if a company distributed dividends under this regime and did not also continue the standard dividend distribution of the last 5 years, an additional tax of 15% was due on the less-distributed dividend, submitted to the normal tax regime – this is the so-called claw-back).
21. For example, Art. 45 §1 *quinquies* BVAT (rejecting the deduction of input VAT for investment goods used for purposes besides an enterprise's activities).
22. For example, a contradiction exists, as two different tax rules oblige a Belgian company reducing its capital for a redistribution to its shareholders to hold this against particular equity parts of the company (*see* Art. 537 BITC versus Art. 269 §2 BITC). Therefore, the tax administration accepted a choice for the taxpayer between the two SAARs. *See* Circular no. Ci.RH.233/630.825 (AAFisc Nr. 4/2014), 23 Jan. 2014.

non-application of an exemption system,[23] non-opposability of legal acts accomplished by another legal subject when taxing third parties[24] and determining the application in time of new legislation.[25] Some rules apply automatically, while others contain an option to exclude their effects if the taxpayer concerned proves justifiable economic or financial reasons for his specific behaviour.[26] Some recent legislation in particular has provided for highly technical and punctually defined SAARs which, it seems, will prove rather complex in terms of being respected by taxpayers and verified by tax administrators.[27] Given the limited explanations accompanying these SAARs, as well as the rather casuistic and incoherent[28] approach taken to defining them, increased legal uncertainty seems likely to result.[29]

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23. For example, Art. 183 *bis* BITC (the tax neutrality provided for business restructurings does not apply when a certain operation has as its principal purpose or one of its principal purposes tax evasion or tax avoidance). This legal article was introduced with the implementation of the Merger Directive. Its application in Belgian legal practice is to a large extent inspired by the Court of Justice decisions in, inter alia, the cases of *Kofoed* (ECJ, 5 July 2007, C-321/05) and *Modehuis Zwijnenburg BV* (ECJ, 20 May 2010, C-352/08).
24. Art. 344/1 BITC provides a text that is clearly inspired by the GAAR of Art. 344 BITC but is meant to apply for legal acts of an intermediate entity when taxing a third person participating in a so-called legal construction.
25. A typical clause in this context used by the Belgian legislator excludes the consequences of changing the annual accounts of a company to integrate past income in, or exclude income from, a new regulation. In addition, legislation is also sometimes enacted retroactively, which, in particular circumstances, has been accepted by the Constitutional Court. *See*, for example, Constitutional Court, 4 Mar. 2008, no. 41/2008, available at www.const-court.be.
26. For example, Art. 207 §3 and Art. 292 *bis* §2 BITC (in case of a change in the control of a company not justified by economic or financial needs of this company, some existing reported tax deductions are lost for future use).
27. For example, to encourage shareholders to contribute capital in a company, a lower withholding tax is foreseen on future dividend distributions. However, this rule provides that a new capital contribution cannot consist of income from a capital reduction of another company linked to this shareholder or its family (Art. 269 §2 BITC). It seems rather difficult to control this origin of newly invested capital.
28. For example, whereas, under a previous tax favour demanding a contribution in cash, the conversion of debt was also accepted by the Minister of Finance, contrary to the expectation of taxpayers, the same approach is no longer accepted for a new legal rule that also prescribes a contribution in cash (Art. 269 §2 BITC). Nonetheless, this point of view is contrary to the general commentary of the administration on the income tax legislation, which still qualifies the conversion of debt as a contribution in cash (*see* Comm. IB no. 261/103).
29. A recent example is Art. 541 BITC. This article provides the possibility of a reduction of withholding tax on a later dividend distribution if a company previously pays a tax of 10%. Although this rule dates from 2015, it focuses on the company's profits of 2013 and 2014. Although the tax of 10% had to be paid, some doubts existed about the precise benefits qualifying for this tax favour. This caused companies to pay a 10% tax,

Finally, one can refer to the application of more general legislation by the administration as a tool for combating tax avoidance. Article 49 of the BITC, for example, mentions some general conditions for costs to be tax-deductible, which provision, however, was construed in a more stringent way by the administration to combat certain tax planning possibilities.[30] Further, Article 207 § 2 of the BITC limits the use of tax deductions in case of transactions conducted under "unusual conditions".[31] The administration also tried to use this article as a SAAR, but that approach was rejected in recent jurisprudence. As both of these examples involve case law, they will be treated in more detail below (*see* section 8.1.4.).

8.1.2. Administrative clarifications

Given the highly technical aspects of the anti-avoidance regulations and the frequency of the changes made to them, the tax administration usually attempts to clarify their meaning using a number of different techniques. First, when establishing legislation, the text of the law is often accompanied by additional explanations regarding the aim of the legislator, the meaning and intended interpretation of the text, and sometimes some practical examples. However, when further questions arise in the course of the application of legislative acts, the administration provides for answers through so-called public FAQs, administrative Circulars, general commentaries and ministerial answers to parliamentary questions. The legal value of these various tools is, however, rather weak. Administrative Circulars and particular ministerial answers to parliamentary questions are binding for the administration but not for the individual taxpayer or for the courts. In addition, general commentaries on a particular piece of legislation sometimes give a highly valuable insight into the administrative view, but these commentaries are not subsequently updated and therefore sometimes differ from views expressed in other administrative documents. In order to address questions quickly, the administration started using FAQs published on its website, but their legal value is highly disputable: they are not recognized as a legal source; they are not always dated or signed; and they are tacitly adapted in

whereas, after the expiry of the period to pay, the administration applied an unexpected, rather strict interpretation of this tax rule, causing companies to have paid taxes for non-qualifying income.

30. For example, the payment of management fees to an intermediate entity that immediately sources out these services to a third party for a large lesser amount. *See* Court of First Instance Antwerp. 22 Nov. 2006, as mentioned by D. GARABEDIAN, analysis of Supreme Court, 10 June 2010, *AFT* (2011), p. 28.

31. *See* Supreme Court, 23 Feb. 1995; and Supreme Court, 29 Apr. 2005, available at www.cassonline.be.

case of changing views. Especially when expressing points of view that are not literally reflected in the text of the law, the legal value of such clarifications is rather doubtful.

The GAAR of Article 344 §1 of the BITC, cited above in section 8.1.1., was introduced in 2012,[32] replacing an earlier GAAR dating from 1993. The preparatory documents for this law, therefore, focus in particular on the changes expected from this new text. As the old text only applied under very stringent conditions, in practice it had a very limited impact on tax avoidance. The new text, although following the same general logic, was meant to facilitate the use of the GAAR by removing certain barriers to its application.[33] This aim is further elucidated in a number of subsequent Circulars.[34] A first (federal) Circular explains in general how the new rule is to be understood and focuses on some peculiarities. In a following (federal) Circular, particular transactions were described and analysed in terms of whether or not they would trigger the application of the GAAR in the context of registration duties and inheritance taxes. This latter Circular has subsequently been replaced by a new list of transactions in a third Circular. Although demanded by practitioners, no list has been created concerning the envisaged transactions under the BITC. The approach of listing up transactions was also followed in the Flemish Region.[35]

The first federal Circular[36] explains how the new Article 344 §1 of the BITC is to be understood and focuses in particular on improvements in the new

32. Program law of 29 Mar. 2012, Belgian Gazette, 6 Apr. 2012.
33. *See* L. DE BROE and J. BOSSUYT, "*Interpretatie en toepassing van de algemene antimisbruikbepalingen in de inkomstenbelasting, registratie- en successierechten*", 11 *AFT* (2012), pp. 4-23.
34. Circular no. Ci.RH.81/616.207 (AFZ 3/2012 – AAF 17/2012 – AAPD 4/2012) of 4 May 2012; Circular no. 8/2012 of 19 July 2012, replaced by Circular no. 5/2013 of 10 Apr. 2013; and, as far as the Flemish Region is concerned, Circular no. 5/2013 of 10 Apr. 2013, subsequently replaced by Circular no. 2014/2 of 23 Dec. 2014 and Circular no. 2015/1 of 16 Feb. 2015.
35. In a first Circular, only transactions that would trigger the anti-abuse provision were listed. *See* Circular no. 2014/2, "*Art. 3.17.0.0.2 van de Vlaamse Codex Fiscaliteit van 13 december 2013, zoals gewijzigd door het decreet van 19 december 2014*", Belgian Gazette, 23 Jan. 2015. In a subsequent Circular, to be retroactively applied from 1 Jan. 2015, transactions that would not be considered to be abuse were also mentioned. *See* Circular no. 2015/1 "*betreffende Art. 3.17.0.0.2 van de Vlaamse Codex Fiscaliteit van 13 december 2013, zoals gewijzigd door het decreet van 19 december 2014 dd. 16.02.2015*". As these Circulars largely follow the federal approach, they will not be further treated separately.
36. Circular no. Ci.RH.81/616.207 (AFZ 3/2012 – AAF 17/2012 – AAPD 4/2012) of 4 May 2012.

text in comparison with the earlier GAAR. The following aspects of the new law are addressed:

– Whereas, under the old GAAR, the administration had to respect the acts of a taxpayer and could only change the legal qualification of the acts to a qualification with similar effects, under the new text, this is no longer the case. The acts themselves no longer have to be respected by the administration if all further conditions are fulfilled. The tax administration can requalify the transaction(s) to obtain the correct level of taxation, without having to respect all the facts of the "abusive" tax construction set up by the taxpayer. This applies for a single legal act as well as for a combination of separate legal acts realizing one same operation, even if these acts were to be fulfilled during separate tax years.

– In contrast to the previous text, Article 344 §1 of the BITC now contains a particular definition of tax abuse (as previously noted; *see* section 8.1.1.).

– The burden of proof for both the administration and the taxpayer is more precisely described. The text leaves it up to the taxpayer to prove that the particular setting of his transaction "is justified by other motives than the avoidance of income taxes". This creates a system of proof and counterproof. The tax authorities must establish the objective element of tax abuse and part of the subjective element thereof. The first burden is on the tax authorities: they must demonstrate, by all legal means of proof (including presumptions of facts), that the taxpayer has opted for a legal act (or separate legal acts realizing the same operation) that is in contradiction with the objectives of a clearly identified tax provision and that the motive behind it is to avoid the tax.[37] The taxpayer can then rely upon all justifications other than tax avoidance to prevent any tax adjustment following from the tax abuse qualification. Whereas the previous text demanded that the taxpayer prove other economic or financial motives, the new version no longer limits the counterproof. All motives, including purely private motives, can be demonstrated. Neither the tax authorities nor the taxpayer should be required to provide negative evidence: the tax authorities cannot be expected to prove that the choice

37. Although the administration has to prove an objective and a subjective element, it can be expected that presumptions, based on the objective act of a taxpayer, serve as a tool for proving the taxpayer's intentions. Besides it can be noticed that, according to the administrative Circular, the administration considers itself limited to proving the objective element. *See* Circular no. Ci.RH 81/616.207 §C.1.2.3.

of the legal act by the taxpayer is solely explained by tax avoidance motives; and the taxpayer should not be expected to establish the absence of tax motives. Negative evidence amounts to a *probatio diabolica*, which is not required by the legislator.

– Because the tax administration no longer needs to requalify certain acts, it can simply "replace the tax effect" of the abusive transactions and restore the taxable base so that the taxation is rendered consistent with the objectives of the tax provisions, as if the abuse did not take place. According to the administration, this can be realized against one or both parties participating in an agreement/transaction,[38] and it does not influence other (non-tax) effects of these legal acts. It is clear that this position, effecting differences between the tax aspects and other legal aspects of a transaction, as well as differences in the tax treatment of one unique operation in respect of different taxpayers, can create significant inconsistencies in the treatment of a transaction.[39] In addition, the precise effect of the GAAR, when applied towards a taxpayer, is not particularly clear.[40] The text does not demand that the administration redefines particular transactions of the taxpayer.[41] Scholars therefore debate the manner and extent of the readjustment of a taxpayer's position. The administration and certain commentators[42] argue that the GAAR changes the scope of a circumvented provision. There is a discrepancy between the text of a legal provision and the lawmaker's objective underlying this specific provision. The material scope of the latter would thus be extended (charging provision) or restricted (exemption/relief

38. *Contra* B. PEETERS, "*De algemene fiscale antimisbruikbepalingen*", 5 *AFT* (2014), pp. 29-30; and L. DE BROE and J. BOSSUYT, "*Interpretatie en toepassing van de algemene antimisbruikbepalingen in de inkomstenbelasting, registratie- en successierechten*", 11 *AFT* (2012), p. 14. Peeters explicitly takes the point of view that this effect can only be realized against taxpayers that have committed the tax abuse. For other parties, the effect of the transactions, as executed, should be kept. According to De Broe and Bossuyt, other taxpayers should at least be able to benefit from changes, supposing a coherent approach of the administration.

39. *See* L. DILLEN, "*Symmetrische of assymetrische toepassing van de fiscale algemene antimisbruikbepalingen*", 1 *AFT* (2013), pp. 15-20.

40. In this context, in particular for inheritance taxes and registration duties, the text differs from the text for income taxes and only mentions that taxation will be applied "as if no abuse had occurred".

41. *See* L. DE BROE en J. BOSSUYT, "*Interpretatie en toepassing van de algemene antimisbruikbepalingen in de inkomstenbelasting, registratie- en successierechten*", 11 *AFT* (2012), p. 12. These authors, however, further distinguish between simply refusing certain tax benefits and applying an additional taxation (p. 14).

42. *See* T. AFSCHRIFT, *L'abus fiscal* (Larcier 2013), pp. 140-167; and D. GARABEDIAN, "*La nouvelle règle fiscal anti-abus et les 'ensembles d'actes juridiques réalisant une même operation'*", *JDF* (2013), p. 206.

provision) so that the taxpayer's avoidance scheme can be taxed (charging provision) or excluded from the tax benefit (exemption/relief provision). However, other authors argue that the GAAR allows the tax authorities to redefine the taxpayer's legal act(s) to enable tax assessment in line with the objectives of the tax provision at stake.[43]

– The Circular further focuses on particular questions such as the possibility of applying the GAAR in combination with SAARs and the availability of tax rulings that will be dealt with further below (*see* sections 8.1.3. and 8.4.). However, one particular comment is remarkable: although the Circular explicitly confirms that the application of the GAAR is not a sanction against tax fraud and that a taxpayer to whom it applies has not breached any tax rule, it nonetheless accepts that administrative penalties (tax majorations) may be imposed on taxpayers who are subject to its provisions.

The subsequent federal Circulars[44] do not deal with the general interpretation of the GAAR but list examples of tax planning techniques that are considered not to qualify as tax abuse or are considered in particular to qualify as tax abuse (unless counterproof is submitted by the taxpayer). As mentioned, these Circulars only list examples in respect of registration and inheritance duties. Although the BITC contains largely the same GAAR-text, and although it would also give some guidance for direct taxation cases, this is not illustrated. The Circulars repeat the statement that, because all possible arguments can be used as counterproof, the GAAR also applies in private contexts as far as inheritance taxes are concerned.

In addition, the GAAR in Article 1 §10 BVAT is the subject of substantial commentary in a Circular.[45] The administration's approach is, however, based on European jurisprudence and is not particularly corrected for a Belgian context. Therefore, it will not be further analysed in this chapter (although it can be questioned whether the rather partial legal implementation, combined with an extensive interpretation, is in line with the legality principle).[46]

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43. *See* M BOURGEOIS and A. NOLLET, "*La réécriture de la mesure 'générale anti-abus' applicable en matière d'impôts sur les revenus de droits d'enregistrement et de droits de succession*", *JT* (2012), pp. 500 and 503; and B. PEETERS, "*De algemene fiscal antimisbruikbepalingen*", 5 *AFT* (2014), p. 16.
44. Circular no. 8/2012 of 19 July 2012, replaced by Circular no. 5/2013 of 10 Apr. 2013.
45. Circular no. AFZ/2006-0604 (AFZ 14/2006) of 24 Aug. 2006.
46. *See* L. DE BROE, "The Belgian Rule against Abusive Practices in VAT Matters", in L. HINNEKENS and P. HINNEKENS (eds.), *A Vision of Taxes within and beyond European Borders – Festschrift in Honour of Prof. Dr F. Vanistendael* (Kluwer Law International 2008), pp. 111-149.

In addition to the GAAR, a number of SAARs and particular interpretations of legal articles are further explained in administrative commentaries, as well as by means of other forms of clarification. However, especially when these clauses form part of a general regulation, the comments are integrated with this particular topic.[47] Again, these instructions are only binding for the tax administration and not for individual taxpayers. Given the fact that not all commentaries are updated and conflicts and contradictions tend to arise between various administrative views, legal uncertainty is not uncommon.

8.1.3. Tax rulings

Given the unavoidable uncertainty concerning the application of a GAAR, the possibility of obtaining an advance ruling from the tax administration on whether (and how) they would apply this rule in a particular context is extremely valuable. In 2002, a Ruling Commission (*Service des decisions anticipées/Dienst voorafgaande beslissingen*) was installed to provide for a system of anticipated decisions in federal tax cases.[48] Rulings can be delivered concerning the establishment of all taxes falling under the competence of the federal tax authorities, as well as those recovered by the federal tax administration.[49]

However, a Royal Decree limits the scope of topics that can be submitted to the Ruling Commission.[50] In particular, it excludes rulings concerning the use of means of proof or legal remedies.[51] This has given rise to a doctrinal debate concerning the competence of the Ruling Commission as far as the GAAR is concerned. Effectively, when questioned about the constitutionality of Article 344 §1 of the BITC, the Constitutional Court considered this GAAR to be a "procedural rule" (means of proof), which would, however, make it possible to determine the factual tax base.[52] In addition, when ruling

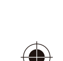
47. For example, being confronted with perceived abuses of the Belgian notional interest deduction, a Circular explains how the tax administration will react against these tax planning structures. *See* Circular no. Ci.RH.840/592.613 (AOIF 14/2008) of 3 Apr. 2008, followed by two further addenda of 2 June 2008 and 20 June 2011.
48. Law of 24 Dec. 2002, Belgian Gazette, 31 Dec. 2002.
49. A decree of 17 July 2015 (Belgian Gazette, 14 Aug. 2015) installed the same system in the Flemish Region for demands for a preliminary ruling that exclusively concerns tax matters dealt with in the Flemish Tax Code (*see* Arts. 3.22.0.0.1 and 3.22.0.0.2 Flemish Tax Code).
50. Royal Decree of 17 Jan. 2003, Belgian Gazette, 31 Jan. 2003.
51. Art. 1 §3° Royal Decree of 17 Jan. 2003**.** The same exclusion is implemented in Art. 3.22.0.0.1 §3 2 c) Flemish Tax Code.
52. Constitutional Court, 30 Oct. 2013, no. 141/2013, available at www.const-court.be.

in regard to its predecessor, the Constitutional Court considered Article 344 §1 of the BITC to be a means of proof for the administration to judge particular situations in a determined context.[53]

Therefore, when introducing the new Article 344 §1 of the BITC, the legislator considered the competence of the Ruling Commission limited to judging whether the taxpayer could provide valuable counterproof.[54] However, as the Minister of Finance confirmed, such an interpretation leads to the strange effect that, when a taxpayer consults the Ruling Commission, it could seem as if he implicitly confirms that the objective element of tax abuse would have been present.[55] This could not be the aim of the legislator. At present, Belgian tax scholars do not agree whether, given the abovementioned limits of the Royal Decree, the Ruling Commission is competent to take a position on the entire application of the GAAR.[56]

In practice, however, the Ruling Commission follows the point of view of the Minister of Finance. It has already delivered a considerable number of rulings on the question of whether, in a particular case, the demanded counterproof of a taxpayer's motives would be accepted,[57] as well as on the entire non-application of the GAAR of Article 344 of the BITC itself.[58] This proves that, at least in practice, the Ruling Commission fulfils an important role in clarifying whether this GAAR would be applicable.[59] As far as VAT legislation is concerned, the Ruling Commission has already delivered several rulings concluding that certain transactions are not considered to be

53. Constitutional Court, 24 Nov. 2004, no. 188/2004; 2 Feb. 2005, no. 26/2005; and 16 Mar. 2005, no. 60/2005, available at www.const-court.be.
54. *MvT Parl. St.* Kamer 2011-2012, no. 53-2081/1, p. 112. *See also* Circular no. Ci.RH.81/616.207 (AFZ 3/2012) of 4 May 2012.
55. *Parl. Vr.* no. 190 Wouters, *Vr. en Antw.* Kamer 2012-2013, no. 124, pp. 498-501.
56. Most explicit are, on the one hand, M. BOURGEOIS, "*La bombe du ruling sur l'abus fiscal*", *L'Echo*, 25 Apr. 2014, considering that, without legal corrections, the provided rulings are unconstitutional, and, on the other hand, L. DE BROE, "*Rulingdienst is bevoegd om rulings af te leveren over toepasselijkheid algemene antimisbruikregels*", 24 *Fisc. Act.* (2014), pp. 1-3, confirming the legal competence of the Ruling Commission. Other authors confirm that, at least, it would serve legal certainty if the legislator were to amend the Royal Decree cited. *See also* B. PEETERS, "*De algemene fiscale antimisbruikbepalingen*", 5 *AFT* (2014), pp. 30-32.
57. For example, preliminary rulings no. 2012.011, 10 July 2012; no. 2012.496, 8 Jan. 2013; no. 2013.568, 10 Dec. 2013; no. 2013.500, 17 Dec. 2013; no. 2015.491, 20 Oct. 2015; no. 2015.613, 15 Dec. 2015; no. 2015.667, 26 Jan. 2016; no. 2016.080, 15 Mar. 2016; no. 2016.085, 5 Apr. 2016; and no. 2015.433, 12 Apr. 2016, available at www.ruling.be.
58. For example, preliminary rulings no. 2013.162, 30 Apr. 2013; no. 2013.178, 28 May 2013; no. 2013.568, 10 Dec. 2013; no. 2013.642, 18 Feb. 2014; and no. 2015.404, 1 Dec. 2015, available at www.ruling.be.
59. The procedure for receiving such a ruling in Belgium starts with a so-called pre-filing procedure. In this procedure, the taxpayer can ask what the position of the Commission



abusive, although it seems that the number of rulings is relatively low compared to the number of rulings in direct tax cases.[60] Besides these rulings on the application of a GAAR in particular cases, the Ruling Commission has also published some general opinions regarding how it deals with particular frequently raised questions. In this context, a number of general opinions also explain how the GAAR could, according to the Ruling Commission, be applied in the particular circumstances described in these opinions.[61]

Finally, the Ruling Commission also provides legal certainty concerning the application of SAARs. In this context, it has already had to issue countless pronouncements on such questions as whether certain costs are tax-deductible,[62] whether a taxpayer could be considered to have valid economic or financial reasons to act in a particular way[63] and whether a transaction is at arm's length.[64] Although a positive ruling can provide some legal certainty for an individual taxpayer, in this context, it is clear that the Ruling Commission often demands particular conditions from the taxpayer before delivering a positive ruling. In this regard, one could wonder whether the Commission does not exceed its competences, especially when particular demands are not literally foreseen in the tax legislation itself.

8.1.4. Existing case law on the meaning of tax avoidance

GAARs – as well as SAARs – are often used by the tax administration in practice and challenged before the courts. However, in order to determine the generally applicable notions of "abuse" and "tax avoidance", it seems less relevant to analyse the particularities of this case law. Within this section, therefore, only the general point of view as can be deducted from the case law of the superior courts will be summarized.

would be if he were to demand a ruling. As, in case of a negative decision, the taxpayer will not continue the procedure, delivered and published rulings are positive about the non-application of the GAAR.

60. For example, preliminary rulings no. 2013.570, 11 Feb. 2014; and no. 2014.256, 29 July 2014, available at www.ruling.be.

61. For example, the Commission published a general opinion on the application of anti-abuse provisions in case of business restructurings and adapted a previous opinion on the realization of capital gains on shares by a shareholder-natural person. Both opinions can be found on the website of the Commission, at www.ruling.be.

62. For example, preliminary ruling no. 2016.141, 12 Apr. 2016.

63. For example, preliminary ruling no. 2015.085, 10 Mar. 2015.

64. For example, preliminary ruling no. 2015.376, 15 Sept. 2015.

As already mentioned (*see* section 8.1.1.), the Constitutional Court has had to rule on whether the current GAAR[65] (as well as its predecessor)[66] was in conformity with the Belgian constitutional legality principle, as well as on the constitutional distribution of competences between the federal and regional entities. The court considered the GAAR a particular means of proof for the federal tax administration when recovering taxes due. Although for some taxes the regional authorities have the exclusive competence to determine the tax base, tax rate and possible exemptions, being a procedural rule for recovering taxes, the federal GAAR does not violate this distribution of competences, as far as the taxes concerned are to be collected by the federal tax administration. Neither do these rules, according to the Constitutional Court, violate the legality principle. Given the very strict limitations and conditions for its application, the GAAR only limits the free choice of a taxpayer to opt for the least taxed way. Given the general phenomenon of tax abuse, it would not be possible for the legislator to define more precisely how this rule should be applied.

In this context, it might be enlightening to refer to some judgments of the Court of Justice concerning particular Belgian SAARs. The most recent case deals with Article 54 of the BITC, denying the deduction of, inter alia, interest costs, salaries and licence payments paid to a foreign taxpayer or a foreign permanent establishment (PE) in cases where these persons are not subjected to income taxation or the payments benefit from a substantially more advantageous tax treatment than the Belgian tax treatment of such income. Deduction of the costs will only be allowed if the Belgian taxpayer proves that the payments concern real and genuine transactions and do not exceed the normal limits.

When determining this provision's compatibility with the European freedom to provide services, the Court of Justice noticed a difference with the general presumption of deductible costs, making it more difficult for a foreign taxpayer to provide the same services. This restriction could be justified by objectives of preventing tax evasion and avoidance and of preserving both the effectiveness of fiscal supervision and the balanced allocation between Member States of the power to impose taxes. However, the court considered the rule to be framed in such vague terms that it was impossible, at the outset, to determine its scope with sufficient precision, causing its applicability to remain a matter of uncertainty. Therefore, the rule could

65. Constitutional Court, 30 Oct. 2013, no. 141/2013, available at www.const-court.be.
66. Constitutional Court, 24 Nov. 2004, no. 188/2004; 2 Feb. 2005, no. 26/2005; and 16 Mar. 2005, no. 60/2005, available at www.const-court.be.

not be considered proportionate to these objectives and the justifications offered were not accepted.[67]

In an earlier judgment, the court considered Article 26 of the BITC in line with the European freedom of establishment.[68] This rule also allows the tax administration to raise the taxable income of a Belgian taxpayer by the amount of unusual or gratuitous advantages accorded to a related foreign company, whereas, for domestic entities, this rule generally does not apply. This limits the freedom of establishment but can be justified by the objective of preventing tax avoidance, taken together with that of preserving the balanced allocation of the power to impose taxes between the Member States. Because the initial burden of proof as to the existence of an "unusual" or "gratuitous" advantage[69] rests with the tax administration, after which the taxpayer still has an opportunity to provide counterproof, the court considered the rule not to be disproportional.

Furthermore, in an older case, the court had to consider Article 18.4 of the BITC.[70] This concerns a Belgian thin cap rule requalifying deductible interest payments as non-deductible dividends if the interest payments are made to a director and exceed a defined limit. Belgian companies acting as directors of other companies are excluded from this regulation. The distinction between Belgian and foreign companies acting as directors was considered a restriction on the freedom of establishment and could not be justified. The objective of preventing tax avoidance was not accepted, because the threshold for requalification was based on a purely mathematical calculation. The tax administration did not need to prove the unusual character of the payments or that they exceeded market conditions.[71]

Finally, the legislator installed a new GAAR as a response to the extremely strict conditions for the applicability of the previous rule as determined in the case law of the Supreme Court.[72] According to the court, under the old GAAR, the tax administration could only requalify a legal act (or a series of linked acts) if the ultimate legal effects of this new qualification (of an act or acts) would be similar to the initial qualification used by the taxpayer. As this caused this article to be rather difficult to apply in practice, the

67. ECJ, 5 July 2012, C-318/10, *SIAT*.
68. ECJ, 21 Jan. 2010, C-311/08, *SGI*.
69. A notion being further definable, as explained by the court (*see* §4).
70. At the time of the case, this article was placed under Art. 18 §3 BITC.
71. ECJ, 17 Jan. 2008, C-105/07, *Lammers & Van Cleeff*.
72. *See* Supreme Court, 21 Apr. 2005; 4 Nov. 2005; 22 Nov. 2007; 11 Dec. 2008; and 10 June 2010, available at www.cassonline.be.

GAAR was replaced with the new rule, as noted above (*see* section 8.1.1.). In contrast to this strict interpretation of the (previous) GAAR, however, the Supreme Court applied a rather extended approach under some other rules, creating new possibilities for the tax administration to combat (abusive) tax avoidance. Article 207 §2 of the BITC, for example, provides that the taxable income of a company[73] obtained from unusual or gratuitous advantages cannot be reduced by means of certain listed tax deductions.

In this context, the Supreme Court defined "unusual" to include not only transactions that are not at arms' length but also transactions that are at arms' length but that fall outside the usual economic activities of a given company.[74] This jurisprudence was heavily criticized in legal circles. Although the tax administration recently tried to apply this doctrine in other contexts, the jurisprudence does not follow this point of view.[75] In addition, Article 49 of the BITC has been applied in certain situations as a particular anti-avoidance rule. This Article determines the general requirements for a cost to be tax-deductible. According to this Article, costs are only deductible when made during a taxable period to gain or maintain taxable income, and the taxpayer has to prove the reality of the cost, as well as the declared amount. In recent jurisprudence, the court inferred from this Article that, in the case of management costs as well, the reality of the services delivered had to be justified. A mere written contract between a company and its director would not suffice.[76]

73. Art. 79 BITC provides a similar limitation for personal income taxes. However, given the difference in tax deductions for natural persons and companies, this article only forbids the deduction of previous losses.

74. *See* Supreme Court, 23 Feb. 1995; and 29 Apr. 2005, available at www.cassonline.be. *See also* L. KETELS and E. VANDINGENEN, "*Artikel 207, lid 2 WIB 1992: anti-misbruikbepaling voor de notionele interestaftrek? Enkele kritische bedenkingen*", 4 *AFT* (2014), pp. 45-51.

75. *See* A. HUYGHE, "*NIA ook als vennootschap weinig substantie heeft: opnieuw bevestigd*", *Fiscoloog* no. 1462, p. 4; S. GNEDASJ, "*Kritische beschouwingen bij de rechtspraak over misbruiken met de notionele interestaftrek*", 34 Fisc. Act. (2015), p. 6; and P. VAN ROMPAEY and L. HERREMAN, "*Abnormale of goedgunstige voordelen in de vennootschapsbelasting*", in *Fiscaal praktijkboek 2015-2016 – Directe belastingen* (Kluwer 2015), p. 56. *See* Court of Appeal Liège, 26 June 2015, *Fisc. Koer.* (2015), p. 801.

76. Supreme Court, 15 Oct. 2015, available at www.cassonline.be. *See also* B. COOPMAN and I. PELGRIMS, "*Koste wat het kost … de grabbelton van rechtspraak over artikel 49 WIB 1992*", *TFR* (2015), pp. 103-114.

8.1.5. Different bodies with judicial competence

As mentioned (*see* section 8.1.3.), when delivering a ruling, the Belgian Ruling Commission sometimes demands additional aspects/conditions that do not actually figure in the tax legislation as such. This does not, however, have to cause a conflict: a ruling only exists to provide legal certainty when a particular operation has been planned but not yet executed. Therefore, there is no conflict with jurisprudence on particular cases, even if the point of view, as defended by the Ruling Commission, would not be considered obligatory in posterior jurisprudence.

Nonetheless, in this context, it is useful to mention the Ruling procedure, as, for registration and inheritance taxes, the Flemish Region installed its own Ruling Commission.[77] Although the legislation on anti-abuse and the clarifying Circulars are very similar to those found in the federal system, nonetheless, this splitting leads to the risk of different interpretations in particular contexts. While the federal anti-avoidance system still applies for the Walloon and Brussels Regions, the interpretation could differ from the qualification given to transactions by the Flemish Ruling Commission.

As far as judicial competence is exercised, Belgium applies a unitary system to deal with cases of tax avoidance. In this context, it is important to note again the difference between legal (but combated) forms of tax avoidance and illegal forms of tax fraud. The latter can be dealt with via tax legislation or criminal prosecutions. For this topic, however, reference is made to the report of the 2015 EATLP congress.[78]

8.1.6. External influences

As previously mentioned (*see* section 8.1.1.), Article 1 §10 of the BVAT replaced Article 59 §3 of the BVAT (which was in force for only 1 year) to implement a clause more in line with the European jurisprudence following

77. *See* Arts. 3.22.0.0.1 and 3.22.0.0.2 Flemish Tax Code.
78. J. MALHERBE, B. PEETERS and G. GALEA, *Belgium*, in R. SEER and A.L. WILMS, *Surcharges and Penalties in Tax Law* (IBFD 2016), pp. 207-258 (in particular pp. 239-242).

from the court's judgments in cases such as *Halifax*,[79] *Kofoed*,[80] *Part Service*[81] and *Weald Leasing*.[82]

As far as the old and new GAARs in the context of income taxes are concerned, scholars debate the precise meaning of the text. Some considered it an integration of the Dutch *fraus legis* doctrine into the Belgian tax system,[83] while, according to some other authors, this would severely limit the scope of this provision.[84] Other scholars focus on perceived differences with the Dutch doctrine.[85] In addition, the legislator mentioned being influenced by the European jurisprudence, but the references to the case law cited (*Part Services* and *Foggia*) are disputed.[86] At the very least, it can be noted that the government seems to consider it necessary to add an additional particular provision for the implementation of the anti-abuse provision of Article 1 §2-§3 of the Parent-Subsidiary Directive,[87] and the burden of proof differs from the new proposal in Article 6 of the Anti-Tax Avoidance Directive (ATAD), as will be shown below (*see* section 8.2.1.).

8.2. The reaction to avoidance and aggressive tax planning in the BEPS context

8.2.1. European demand for domestic general anti-avoidance rules (GAARs)

As already noted (*see* section 8.1.1.), as far as income taxes, registration duties and inheritance taxes are concerned, the definition of tax avoidance is included in the text of the GAAR, as amended in 2012. The previous text, leaving open a possibility for the administration to requalify certain acts under the very stringent conditions set in jurisprudence (to maintain a qualification with similar effects), was rather hard for the administration to apply – and therefore ineffective. Under the new rule, in line with recommendation 8806 of 6 December 2012, as well as Article 6 of the ATAD,

79. ECJ, 21 Feb. 2006, C-255/02, *Halifax*.
80. ECJ, 5 July 2007, C-321/05, *Kofoed*.
81. ECJ, 21 Feb. 2008, C-425/06, *Part Service*.
82. ECJ, 22 Dec. 2010, C-103/09, *Weald Leasing*.
83. *See* S. VAN CROMBRUGGE, "*Fraus legis of wetsontduiking in het Belgisch fiscaal recht anno 2012*", *TRV* (2012), pp. 537-562.
84. *See* B. PEETERS, "*De algemene fiscale antimisbruikbepalingen. Een commentaar in het licht van de rechtspraak van het Grondwettelijk Hof*", 5 *AFT* (2014), p. 20.
85. T. AFSCHRIFT, *L'abus fiscal*, (Larcier 2013), no. 141.
86. *See supra* n. 13.
87. *See* preliminary draft, as discussed in *Fiscoloog* no. 1478, p. 1.

the administration no longer has to requalify given facts into an applicable legal qualification with similar legal consequences; it only has to respect the given facts to which other legal consequences can be confined.

However, it is clear that the precise consequences of the treatment possibilities for the tax administration are not completely cleared out. Whereas all three texts recognize the power of the administration to ignore abusive arrangements, the formulation of the consequences attached thereto differs. Under the 2012 EC recommendation, a tax treatment should be applied "by reference to [the arrangements'] economic substance". The ATAD refers to a calculation "in accordance with national law". The Belgian text provides a restoration to submit the arrangement to "a tax assessment that is consistent with the purpose of the law, as if no abuse had occurred". Nonetheless, all three formulations leave a certain unavoidable scope for the tax administration to fill in. As described, the Belgian administration hereby grants itself a large degree of autonomy, which is disputed in Belgian legal doctrine.

When the definition of abuse under the three rules is compared, some differences become apparent. All provisions consider the possibility that one single act, as well as a series of acts, can constitute tax abuse. However, as mentioned (*see* section 8.1.1.), the Belgian GAAR requires the administration to prove an objective element (taxation being avoided or a tax advantage being obtained in contrast with the purpose of the particular legal provision), and the beginning of a subjective element (the operation is organized to obtain this tax effect). Given that both aspects can be demonstrated by all legal means, it might be assumed that the objective element will function as a presumption for the subjective element, although both aspects form separate parts of the notion of tax abuse. It will be up to the taxpayer to demonstrate other (economic, financial or private) motives that led him to apply this particular legal format. The European provisions seem to make a less clear distinction between an objective and a subjective element, as the subjective element helps to describe the objective element. This causes the initial burden of proof to fall more on the tax administration. The objective element ("an artificial arrangement avoiding taxation and leading to a tax benefit" versus "non-genuine arrangement(s) causing the acquirement of a tax advantage" has to be the purpose for the taxpayer. However, whereas the 2012 recommendation requires the tax avoidance to be the essential purpose of the arrangement(s), for the new directive, it suffices if obtaining a tax advantage is one of the main purposes. The mere formulation of other (financial, economic or private) purposes besides tax avoidance seems not necessarily sufficient to exclude the GAAR. Nonetheless, if "valid commercial reasons which reflect economic reality" are present, arrangements

are not presumed to be non-genuine. In this formulation, as well as in §11 of the considerations preceding the directive, only valid *economic* (including financial) reasons seem to be accepted. Private reasons are not mentioned as such.

Finally, §11 of the ATAD explicitly accepts the possibility for Member States to apply penalties in cases in which a GAAR is applicable. Although the interpretation has been criticized by Belgian scholars, the Belgian tax administration also considers this to be possible under Article 344 of the BITC (*see* section 8.1.2.).

8.2.2. Subject-to-tax rules to deal with double non-taxation

Article 156 of the BITC provides a particular unilateral remedy against double taxation of Belgian resident persons earning foreign taxable income: the Belgian income taxes linked to this income are cut in half. However, for some categories (e.g. professional income), this rule only applies if the foreign income has been "taxed" under a foreign tax system. In a famous decision of 1970, however, the Belgian Supreme Court held that an explicit legal exemption can be considered as "taxed" for the purposes of this Article.[88]

This interpretation has focused particular attention in Belgian tax practice on the precise wording of the exemption method in Article 23 of the double tax conventions in cases where Belgium is the residence state of a taxpayer. The tax administration makes a distinction between income which "may be taxed/is taxable in the source state" (meaning that Belgium always applies the exemption method, without verifying the treatment in the source state), income which "is taxed in the source state" (meaning that a particular legal exemption has to be foreseen in the source state's domestic legislation, in which case Belgium will exempt) and income which "is effectively taxed in the source state" (meaning that the income has to be submitted to income taxation before Belgium applies the exemption method).[89] This interpretation, however, has to be complemented with the OECD solution for conflicting interpretations leading to double non-taxation as articulated in the Partnership Report and repeated under Action 2 of the BEPS action plan. It must also be noted that this administrative point of view is not always

88. Supreme Court, 15 Sept. 1970, *Pas.* 1971, I, 37.
89. *See* Circular no. Ci.R 9.Div./577.956 (AOIF 21/2006) of 11 May 2006; and AFZ no. 4/2010 of 6 Apr. 2010. *See also* L. DE BROE and N. BAMMENS, "Interpretation of Subject-to-Tax Clauses in Belgium's Tax Treaties – Critical Analysis of the '*Exemption vaut impôt*' Doctrine", 63 BIT 2 (2009), pp. 68-73.

followed in jurisprudence[90] or legal doctrine,[91] and in some treaties, the contracting States provide a particular interpretation.[92] The Belgian Model Convention (2010) therefore expressly provides that "Belgium shall only exempt such income from tax to the extent that such income is effectively taxed in … ". In terms of the use of the word "taxed", §6 of an additional protocol provides that subjection to the normally applicable tax system is sufficient.

In terms of Belgium being the source state of income falling under the "other income" article, until 2010, Belgium made an observation that, as the source state, it would be able to tax such income, unless it had been taxed in the residence state.[93] This observation was removed from the OECD Commentary of 2014. The Belgian Model Convention (2010), however, expressly adds this subject-to-tax requirement in an additional paragraph to the "other income" article.

8.3. Transfer pricing rules, GAARs, SAARs and linking rules

8.3.1. Transfer pricing rules

Based on the legality principle, Belgian tax rules are based on a "legal reality", which cannot be changed by interpreting actions by means of concepts such as an "economic reality". However, in terms of transfer pricing (TP), the conditions of transactions are verified to determine whether they are "at arm's length".

Some rules could be considered to be in-between SAARs and TP regulations,[94] but, in general, anti-avoidance rules focus on the transactions

90. *See* Rb. Bergen, 19 Feb. 2008, *FJF* (2010), p. 216; Rb. Bergen, 11 Sept. 2013, 459 *TFR* (2014), p. 364; and Rb. Brussels, 8 Mar. 1988, *FJF* (1988), 205. The term "taxed" was understood to refer to a real taxation.
91. W. HEYVAERT, "*Artikel 23*", in B. PEETERS, *Het Belgisch-Nederlands dubbelbelastingverdrag* (Larcier 2008), pp. 627-636.
92. For example, the Belgian double tax conventions with the Netherlands and Hong Kong use the term "taxed", which is to be understood as effectively taxed.
93. §16 OECD Commentary on Art. 21 (2010).
94. Art. 26 BITC, for example, corrects the result when abnormal or gratuitous advantages are being accorded. The application becomes more severe in case of transactions between related parties or favours for a party in a tax haven. As mentioned, the ECJ accepted this rule, being justified as a means against tax avoidance.

themselves, whereas TP regulations merely correct the economic conditions of certain transactions.

Two judgments of the Belgian Supreme Court that apply Article 207 §2 of the BITC in the context of combating tax abuse have already been noted (*see* section 8.1.4.). However, when the tax administration tried to apply this same analysis in recent case law, the judgments of the lower courts did not follow its approach.[95]

8.3.2. Particular clauses in double tax conventions

Belgium has no particular limitation on benefits (LOB) clause in its model convention. If at present such a clause has been added in a particular double tax convention (DTC) (*see*, for example, Article 21 of the DTC with the United States), it is due to an initiative of the other contracting state.

However, in his action plan, formulated in December 2015, the Belgian Minister of Finance accepted that, in light of the BEPS initiatives, additional clauses could be added to existing DTCs and new DTCs would contain more anti-avoidance clauses. In particular, a principal purpose test,[96] an LOB clause and a particular reaction against conduit companies were considered possible options.[97]

This has to be distinguished from the use of domestic anti-avoidance rules when a tax treaty is at stake. In this context, on the one hand, abuse of a tax treaty cannot be combated with a domestic GAAR, because, as previously noted (*see* section 8.1.1.), the scope of each GAAR is limited to the tax code in which it has been implemented. Therefore, Article 344 §1 of the BITC, for example, could only be applied when internal rules of the BITC that further implement the functioning of a tax treaty are circumvented. However, as Belgium has a monistic system, treaties are immediately applicable in the domestic law order, without further implementing actions. The effect of a domestic anti-avoidance rule will, therefore, be very limited.[98] On the other hand, the question arises whether, through domestic rules, the functioning

95. *See supra* nn. 74 and 75.
96. For example, Art. 27 of the recent convention with Russia (19 May 2015).
97. *See* "*Plan ter bestrijding van de fiscale fraude*" (Dec. 2015), available at http://vanovertveldt.belgium.be/sites/default/files/articles/Plan%20ter%20bestrijding%20van%20de%20fiscale%20fraude_2015.pdf.
98. One could think, for example, of Art. 155 BITC, implementing a progression reservation on exempted income; or Art. 466 *bis* BITC, giving municipalities the ability to tax exempted income.

of a treaty can be changed (because of a different qualification or tax rate). In this context, Belgium adheres to the OECD Commentary as amended in 2003. In short, this interpretation leads to the conclusion that, if the taxing power is accorded to Belgium, it can also apply its GAAR, causing a higher tax burden. However, the division of tax powers cannot be changed by means of a domestic GAAR.

8.3.3. CFC legislation

Until a few years ago, Belgium hardly had any kind of particular controlled foreign company (CFC) regulation. Article 344 §2 of the BITC limited the effect of a transfer of rights, licences or other forms of intellectual property, as well as amounts of money, in the case of a transfer to a foreign taxpayer residing in a tax haven. This transfer was not binding for the tax administration, unless a taxpayer proved that he obtained the market value in exchange or the transaction corresponded with justifiable financial or economic reasons.

An important additional rule was installed by the Law of 23 December 2009.[99] As from 1 January 2010, corporate taxpayers must declare to the tax administration all direct or indirect payments to persons residing in a qualifying country. Two possible categories are mentioned. First, the rule targets payments to countries that, after a phase 2 review of the OECD Global Forum Committee, are considered to be non-compliant with the exchange-of-information-on-request standard for the entire tax year.[100] Second, a Belgian list is provided in Article 179 of the Royal Decree executing the BITC.[101] Payments must be declared once the total of payments exceeds EUR 100,000. If a payment is not declared, it is generally not tax-deductible.[102] If a payment is declared, a taxpayer needs to prove that the transaction is genuine, economically valid and not set up by means of an artificial legal structure. This rule has been interpreted in a very broad way by the tax administration as far as the notions of "payment" and "residency" in a

99. Belgian Gazette, 30 Dec. 2012.
100. http://www.oecd.org/tax/transparency/exchange-of-information-on-request/#d.en.368658.
101. Art. 307 BITC refers in general to countries with a nominal tax rate less than 10%.
102. Art. 198 §10 BITC. In a more recent addendum of 3 Sept. 2015, the administration accepts that the mere non-declaration cannot cause a non-deductibility if Belgium has a double tax convention providing a non-discrimination clause for expenses or if the free movement of capital applies. *See* C. BUYSSE, "*Niet-aangifte betalingen aan Luxemburg: geen automatische verwerping aftrek*", *Fiscoloog* no. 1442, p. 4.

qualified country are concerned.[103] As such, a payment does not necessarily have to be a deductible cost but can be any transfer of economic value, on the taxpayer's own behalf, as well as for third parties.[104] The link with a qualified country is fulfilled if that country is the residence of the person who receives the payment or if the payment is made to a bank account situated in that country (unless the taxpayer proves residency elsewhere).

Finally, as from tax year 2014, natural persons must declare the existence of a so-called juridical construction if they have participated in this construction or benefitted from certain advantages. Whereas this legislation started with a mere declaration,[105] as from tax year 2016, this has been further elaborated into the so-called Cayman tax:[106] a juridical construction[107] is considered to be tax transparent, and its income is taxed at the level of Belgian settlors or beneficiaries.[108] This transparency not only applies to natural persons[109] but also to non-commercial legal entities.[110] Such a juridical construction can be an entity without legal personality[111] or a legal entity not subject to an income tax regime or taxed at a tax rate of less than 15%, calculated according to Belgian tax legislation. Two Royal Decrees further determine the scope of this second category. The Royal Decree of 18 December 2015[112] provides an exhaustive list of such entities located within the European Union. For entities outside the European Union an illustrative, more extensive list is provided in the Royal Decree of 23 August 2015.[113] In addition to technical provisions for the functioning of this transparency, the legislator also added a GAAR,[114] stating that the acts of such an entity are not opposable to the tax

103. Circular no. AFZ 13/2010 of 30 Nov. 2010, completed with two addenda of 27 July 2011 and 22 Nov. 2012.
104. An exception has been accepted for payments of financial institutions executed for third parties.
105. Law of 30 July 2013, Belgian Gazette, 1 Aug. 2013.
106. Program law of 10 Aug. 2015, Belgian Gazette, 18 Aug. 2015.
107. *See* Art. 2 §1 13 BITC.
108. Both categories are extensively defined in Art. 2 §1 14 and 14/1 BITC.
109. Art. 5/1 BITC.
110. Art. 220/1 BITC.
111. It is defined as a legal settlement whereby the property is governed by a director-legal owner, although it is separated from this person's personal belongings according to certain defined criteria. The legal text does not mention it as such, but this definition seems to focus primarily on a trust.
112. Belgian Gazette, 29 Dec. 2015. This decree enumerates foreign reverse hybrid entities earning Belgian income, two legal entities of Liechtenstein (*Anstalt* and *Stiftung*) and two Luxembourg entities (*Société de gestion patrimoine familiale* and *Fondation patrimoniale*). In addition, excluded financial entities are reintegrated when being kept by one single shareholder.
113. Belgian Gazette, 28 Aug. 2015.
114. Art. 344/1 1 BITC.

administration when taxing the taxpayers behind the entity under the transparency regime. This final CFC regulation has given rise a lot of criticism from legal scholars, as the precise functioning, boundaries and application still leave a lot of questions unanswered.[115] It might be expected that this will be further adapted to and inspired by the new proposal of Articles 7-8 of the ATAD.

8.3.4. Linking rules

As previously noted (*see* section 8.2.2.), in its DTCs, Belgium, as a residence state, applies the exemption method. In this context, it often demands that income be taxed in the source state (or at least be integrated into tax legislation). In addition, the advantageous tax legislation of another country will often be a criterion for particular anti-avoidance rules – such as, for example, a deduction refusal, the transparency regime of the Cayman tax or a thin cap regulation – to apply.

Moreover, as the exemption method focuses on avoiding an economic double taxation of distributed dividends, the Belgian exemption method requires that the dividend-distributing company has been subjected to taxation.[116]

However, Belgium does not currently apply technical linking rules such as have been described in BEPS Action 2. Further, although Article 4.1 of the Parent-Subsidiary Directive provides that this had to be undertaken before 1 January 2016, the Belgium exemption system still hasn't been brought in line with these prerequisites. A proposal in this regard has been discussed at the ministerial level and is expected to be implemented soon.

8.3.5. Limits on the deduction of interest

Besides the general prerequisites for a cost to be deductible, figuring in Article 49 of the BITC, several rules further limit the deduction of interest costs in the income tax legislation. First of all, interest is only deductible in

115. *See*, inter alios, N. APPERMONT, "*De kaaimantak: geen paradijselijke maatregel*", 11 *AFT* (2015), pp. 5-37; G. GOYVAERTS, "*De kaaimantaks, een kritische beschouwing*", 490-491 *TFR*, pp. 865-924; and A. VAN ZANTBEEK, "*Naar een efficiënte en effectieve Kaaiman*", 490-491 *TFR*, pp. 859-864.
116. Art. 203 BITC.

so far as it does not exceed regular market conditions.[117] This limit does not apply to payments of financial institutions or to payments to these institutions (unless, in the latter case, the entity is a company directly or indirectly related to the debtor of the interest).[118] Further, interest payments to a foreign taxpayer or a foreign PE are not deductible if those persons are not subject to income taxation or if the payments benefit from a substantially more advantageous tax treatment than the Belgian tax treatment of such income.[119] The Court of Justice considered this rule to violate the European freedoms because of its vague terms (*see* section 8.1.4.).[120]

Finally, two more particular thin cap rules further limit the deduction of interest costs. A first rule focuses in particular on debts accorded by shareholders or directors.[121] If they lend to their company an amount exceeding the equity of the company[122] or at an interest rate above market conditions, the interest paid is requalified as a dividend. This requalification applies both to the recipient of the payment (taxed as a dividend) and to the paying company (non-deductible dividend).

In addition, a further limit of five times the equity applies for loans from related parties[123] or entities resident in a tax haven.[124] For each category, interest paid on the exceeding amount is not deductible. This limit was tightened by the Law of 29 March 2012.[125] It reduced the previous limit of 7:1 and extended the category of receivers to related companies. In a subsequent Law of 22 June 2012,[126] a correction was provided for so-called

117. Art. 55 BITC.
118. Art. 56 BITC.
119. Art. 54 BITC.
120. ECJ, 5 July 2012, C-318/10, *SIAT*.
121. Art. 18 §4 BITC. As far as shareholders are concerned, this limit is only applicable to natural persons (and their partner and children under their custody). For directors, this also applies to companies, although Belgian companies subject to the Belgian corporate income tax are excluded. As mentioned, because Belgian companies are excluded, the Court of Justice did not accept this rule being applied towards foreign European director companies (*see* sec. 8.1.4.). *See* ECJ, 17 Jan. 2008, C-105/07, *Lammers & Van Cleeff*.
122. Defined as the sum of the “taxed reserves at the beginning of the tax year and the paid-up capital at the end of the tax year”.
123. Although loans from third parties are not included, a particular anti-abuse provision provides for the inclusion of such loans if they are guaranteed or supported by a third related party. *See* Art. 198 §3 2 BITC.
124. Art. 198 §1 11 BITC. Interest paid to financial institutions is excluded from this limit.
125. Belgian Gazette, 6 Apr. 2012.
126. Belgian Gazette, 28 June 2012.

cash-pooling companies within a group.[127] Although the same borrowing capacity applies, to calculate the proportion of non-deductible interest of the cash-pooling company, only the difference between supported interest and received interest is taken into account.

The second thin cap rule, in particular, largely differs from the interest limitation rule of Article 4 of the proposal for an ATAD. This latter rule calculates the deductible interest costs on the taxable income (instead of the equity), and exempted income would be excluded. Moreover, this rule seems to apply a larger definition of interest costs and is also applicable for costs paid to third parties.[128] However, as it focuses on "exceeding borrowing costs", netting calculations will still remain possible. Despite these differences, according to the Belgian Minister of Finance, Belgium could apply for the delay until 1 January 2024 (or an agreement between the OECD members), as its domestic legislation is "equally effective" to this rule.[129]

8.3.6. Other particular SAARs

As noted in section 8.1.1., the definition of tax avoidance appears via particular legal provisions because of the constitutional legality principle. In SAARs, particular kinds of "abusive acts" are mentioned in legal texts limiting their effect or forbidding their particular form. Given the highly casuistic approach, it is sometimes questionable how to interpret these clauses, whereas they lack general coherence.

For example, because of the link between a director and his company, the possible transactions between those related parties are often submitted to additional limits. This chapter has already made note of an additional thin cap-rule[130] (*see* section 8.1.4.), but a director is also excluded from a particular tax reduction for shareholders investing equity in a start-up company.[131] However, whereas the thin cap rule explicitly refers to a director (as well as his direct family relatives (spouse and children)), this extension appears

127. Art. 198 §4 BITC. These are companies that fade out the liquid assets of companies belonging to the group by borrowing from those having excesses and lending to those in need of liquid assets.
128. But Art. 4 §3 leaves the possibility to exclude the first costs up to EUR 3 million and to exclude stand-alone entities.
129. "*Anti Tax Avoidance Directive is een win-win geworden. België stemt in*.", available at http://vanovertveldt.belgium.be/nl/anti-tax-avoidance-directive-een-win-win-geworden-belgi%C3%AB-stemt.
130. Art. 18 §4 BITC.
131. Art. 145/26 BITC.

only partly in the tax reduction. As such, this investment is not possible in the case of a company that owns the immovable property being used by its director (or his spouse or children),[132] but as far as the investment in the company is considered, only the director himself is excluded.[133] This exclusion for additional tax benefits when investing equity in a company is not foreseen in Article 269 §2 of the BITC, which provides for a lower withholding tax on dividends to attract shareholders for new investments in a company. However, for this tax advantage to apply, the new investment cannot come from a capital reduction of another company linked to the person that invests or linked to his relatives (defined not only as the spouse and children but also the parents of the person investing).[134] In a recent tax support for debt investments, directors are not excluded at all.[135]

Another example concerns tax advantages for an employer engaging new workers. Under certain conditions, 25% of the withholding tax on salaries does not have to be transferred to the tax treasury. This rule distinguishes between two categories,[136] based on whether or not the company qualifies as a small or medium-sized enterprise (SME) according to European criteria.[137] Only for large companies is an anti-abuse rule provided, which determines that this advantage will not apply if the same activity has been exercised by this company in another EU Member State and has ceased within 2 years before the new engagement or if the employer does not confirm that he will cease a similar activity within 2 years.[138] It is not clear why this anti-abuse clause (especially as far as previous cancelling is concerned) only applies to large companies.

In addition to differing, SAARs sometimes even contradict each other. This was the case with different provisions that provided for a reduced withholding tax on dividends if shares were kept for at least a certain delay. Both rules mentioned that, in case the liberated capital of the company was reduced, this reduction primarily had to be imputed to the particularly favoured capital.[139] As no further legal indications existed as to how both

132. Art. 145/26 §3 1 5 BITC.
133. Art. 145/26 §3 3 2 BITC.
134. Art. 269 §2 9 and 10 BITC.
135. Art. 21 §13 BITC.
136. Art. 275/8 and 275/9 BITC.
137. Balance sheet of max. EUR 43 million or annual turnover of max. EUR 50 million, and workers of fewer than 250 FTE. These criteria have to be fulfilled for at least 2 years in the preceding 3 years.
138. Art. 275/9 §3 5 BITC.
139. Art. 269 §2 11 versus Art. 537 5 BITC.

rules could be combined, the administration accepted that a taxpayer could freely opt between both rules.[140]

As mentioned (*see* section 8.1.1.), in new legislation, the legislator very often adds particular SAARs. However, given their highly technical and casuistic character and lack of general coherence, this causes legal uncertainty in regard to their application in practice. Taxpayers are the first persons that have to deal with these rules, whereas the tax administration verifies their application during subsequent tax years. Although the struggle against tax avoidance can be considered legitimate, this imbalance leads to a similar level of uncertainty as is created with a GAAR. Whereas for a GAAR this cannot be avoided, for SAARs, the legislator should try to limit this uncertainty to the extent possible.

8.4. Combination of GAARs and SAARs

As mentioned, the formulation of a GAAR is necessarily vague because of its particular scope in dealing with transactions within a legal context but outside the aim of the tax legislation. This is opposed to the often much more precisely defined SAARs, which react against a particular technique.

Thus, in its first general Circular regarding Article 344 of the BITC,[141] the administration confirmed that a GAAR would be applicable by way of last resort, in case neither the mere interpretation of a tax rule, its technical application provisions, the provided SAARs or the legal doctrine of tax fraud (simulation) could help to obtain the taxation intended. However, this formulation can be questioned, as it combines several different topics that have nothing to do with a GAAR. Again, a GAAR is meant to apply to situations in which the strict text of the law is objectively followed but the taxpayer acts with the intention of obtaining a result that was not anticipated by the legislator. This differs from simulation, whereby a disguised operation is fraudulently presented as something other than it is. If a SAAR reacts against a certain technique, the text of the law as such is changed to avoid it being abused. There is no real hierarchy between those three different concepts.

140. Circular no. Ci.RH.233/630.825 (AAFisc 4/2014) of 23 Jan. 2014.
141. Circular no. Ci.RH.81/616.207 (AFZ 3/2012 – AAF 17/2012 – AAPD 4/2012) of 4 May 2012, in particular C.2.3.

Finally, the question arises as to whether a GAAR can be used in cases in which a SAAR has been technically avoided. This seems to depend on the character of the SAAR, as well as that of the abuse. For example, if a SAAR allows borrowing five times the amount of equity, this barrier will be accepted and cannot be further limited based on a GAAR. However, where family members of a director are not literally mentioned in a SAAR limiting the possible actions of a director of a company in respect of that company, it might be expected that a director circumventing the SAAR through the use of a family member risks being confronted with the GAAR in order to apply the effects of a particular SAAR outside its literal scope. It remains clear, however, that, given the vague formulation of GAARs, any link to a SAAR will also, to a certain extent, necessarily remain vague.

Chapter 9

Brazil

Luís Eduardo Schoueri and Ricardo André Galendi Júnior

9.1. Preliminary remarks

Brazilian legislation does not define avoidance, tax planning, abusive tax planning or aggressive tax planning. Neither does it contain a clarification on this issue in the administrative regulations. Despite the pressure by international organizations for developing domestic mechanisms to confront abusive tax behaviour and the increasing demands by the government for tax revenues, the Brazilian tax authorities have failed to come up with a domestic law solution compatible with the National Tax Code. This statement does not mean that they have failed to combat tax avoidance, but rather that they have carried out a crusade whose legality is quite questionable.

This chapter, after briefly addressing the approach of the tax authorities towards tax planning, provides a general perspective on some of the Brazilian SAARs, as well as on the current TP legislation. It then addresses the interaction of the current Brazilian approach on tax avoidance with TP rules and SAARs, based not only on legislation but also on the guidance provided by case law.

9.2. The meaning of avoidance and aggressive tax planning and the BEPS initiative

For a long time, tax planning debates in Brazil were based mostly on a formalist approach.[1] Until the mid 2000s, the jurisprudence of the Brazilian Administrative Council of Tax Appeals[2] (*Conselho Administrativo de*

1. The present topic contains an update on the overview presented in L.E. Schoueri & M.C. Barbosa, "Brazil", in M. Lang et. al (ed.), *GAARs – A Key Element of Tax Systems in the Post-BEPS Tax World?*, (Linde: Wien, 2016), pp. 109-146.
2. The Court is a body within the Ministry of Finance composed of a specialized group of experts chosen amongst tax authorities and taxpayers for reviewing the tax assessment. The bodies of trial within the CARF are composed equally of tax agents and taxpayers, all appointed by the Minister of Finance, and the chair of the body – to whom the casting vote is granted – is always a tax authority. The review procedure within the court is similar to its judicial counterpart and, where the appeal is not granted by the CARF, the taxpayer

Recursos Fiscais, CARF[3]) traditionally resorted to the legality argument in order to adopt a formalist approach with respect to tax planning. Transactions whose formal profiles were in accordance with the applicable laws were usually considered as undisputed, even if they could eventually lead to lower taxation, irrespective of the existence of purposes other than those related to taxation.

This approach was an outcome of the then prevalent position among scholars regarding the interpretation of tax law. Tax planning was judged on the basis that, if no specific legal concept were applicable to the case, the structure would be legitimate. Indeed, Brazilian scholars have historically rejected the application of an "economic interpretation", as it would supposedly "destroy what is legal in tax law".[4]

9.2.1. Complementary law 104/2001: The amendment to the National Tax Code

In 2001, the National Tax Code was amended, and a paragraph was added to its article 116, to allegedly provide for a GAAR. The provision included by Complementary Law 104, enacted on 10 January 2001, reads as follows:

is always allowed to appeal to the judicial courts, where debates shall restart regardless of any opinions previously handed down within the administrative review. Moreover, should the court grant the taxpayer's request, the Revenue Service cannot bring its claim to the judiciary, since the former's decision extinguishes the tax assessment.

3. Law 11.941, of 27 May 2009, unified the former "Councils of Taxpayers", creating the CARF, as it is currently structured. For the purposes of this article, the administrative court is referred to by its current name, even when addressing situations occurred before the enactment of the reform.

4. A.A. Becker, *Teoria Geral do Direito Tributário* [General Theory of Tax Law], (2nd ed., São Paulo, Saraiva, 1972), p. 118. In the same sense, *see* J. Barbosa Nogueira, *A Interpretação Econômica no Direito Tributário* [Economic Interpretation in Tax Law], (São Paulo, Resenha Tributária, 1982), p. 44; G. de Ulhôa Canto, *Elisão e Evasão* [Avoidance and Evasion], in I. Gandra da Silva Martins (coord.), Elisão e Evasão Fiscal, (São Paulo, Resenha Tributária, 1988), p. 16; A.R. Sampaio Doria, *Elisão e Evasão Fiscal* [Fiscal Avoidance and Evasion], (2nd ed., São Paulo, José Bushatsky, 1977), p. 96; P. de Barros Carvalho, *O absurdo da interpretação econômica do "fato gerador" – direito e sua autonomia – o paradoxo da interdisciplinariedade* [The Absurd Economic Interpretation of "Tax Events" – Law and its Autonomy – the Interdisciplinarity Paradox], 97 Revista de Direito Tributário (2007), p. 16; H. de Brito Machado, *Curso de Direito Tributário* [Tax Law Course], (5th ed., Rio de Janeiro, Forense, 1992), p. 68; L. Amaro, *Direito Tributário Brasileiro* [Brazilian Tax Law], (17th ed., São Paulo, Saraiva, 2011), pp. 252-253 . For a contrary position, admitting the economic interpretation in certain situations, *see* R. Gomes de Souza, *Interpretação no Direito tributário* [Interpretation in Tax Law], (São Paulo, Saraiva, 1975), p. 373; and A. de Araújo Falcão, *Introdução ao Direito Tributário* [An Introduction to Tax Law], (Rio de Janeiro, Forense, 1959), p. 99.

> The administrative authority may disregard acts or legal transactions carried out with the scope of dissimulating the occurrence of the tax event or the nature of the elements which constitute a tax obligation, as per a procedure to be established by ordinary law.

The intention of the government with such a provision was to support the enactment of a GAAR. According to the Brazilian Federal Constitution, a Complementary Law is a requisite for the enactment of general rules on tax law and it requires an absolute majority for its approval.[5] It is clear that an ordinary law, approved by a simple majority, would not be the adequate vehicle for a GAAR.

Indeed, the explanatory memorandum following the Bill of Complementary Law 77/99, later converted into Complementary Law 104/01, stated that the inclusion of the sole paragraph in article 116 was "necessary to establish, in Brazilian tax law, a rule allowing the tax authority to disregard legal acts or transactions carried out within the aim of avoidance", thus corresponding to "an effective instrument to combat tax avoidance schemes implemented by means of abuse of forms or abuse of law".[6]

Similar statements were addressed in the course of the debates held in Congress. As put forth by the congressman who reported the project, the proposed ruling dealt with the "inclusion, in the National Tax Code, of a General Anti-Avoidance Rule".[7] Being "broad and ambitious", the provision was intended to "avoid or diminish the effects of the so-called tax planning carried out by companies and of their attempts to avoid taxes, which jeopardize their ability to pay, the isonomy and the competition". Furthermore, it was mentioned that the provision attributed "considerable powers of interpretation and decision to the Revenue".[8] According to another congressman who spoke during the debates, "the theme dealt with by the project is the anti-avoidance rule, which is a simple provision that allows the Federal Revenue to annul any and every legal act or transaction undertaken within the scope of dissimulating the occurrence of a taxable event".[9]

5. Brazilian Federal Constitution, art. 146, III.
6. Explanatory Memorandum following the Bill of Complementary Law 77, of 17 Oct. 1999, item VI.
7. Transcription of the Extraordinary Session of the Chamber of Deputies, of 6 Dec. 2000, p. 792. Excerpts of this transcription are available in G. Lacerda Troianelli, *O planejamento tributário e a lei complementar 104* [Tax Planning and Complementary Law 104], in V. Oliveira Rocha (coord.), *O planejamento tributário e a Lei Complementar 104* (São Paulo, Dialética, 2001), pp. 87-118.
8. Id.
9. Id., p. 799.

Albeit clearly oriented, these explanations are misleading. If those were the intentions, then unintended results were achieved, due to the problematic wording of the rule. The authors pointed out the inaccuracy of the expression "dissimulating"[10] for the purposes of enforcing a GAAR, since the wording adopted therein indicates that the legislator rather resorted to a concept solely related to sham transactions instead of establishing a rule with broad standards.[11] In this sense, the only reasonable interpretation of this article would be that the provision allows the tax authorities to disregard sham transactions in order to consider, for tax purposes, the actual transactions, i.e. the "dissimulated transactions"[12] carried out by the taxpayer. If Complementary Law 104/01 was intended to provide for a GAAR, it is not an exaggeration to qualify the wording of the provision as a "monumental mistake".[13]

Despite the declared intention, it is therefore reasonable to understand that the provision does not support the application of substance-over-form, "business purpose" or "abuse of law" doctrines, since these may not be inferred from the Brazilian sham doctrine, and are not even related to it.

While an institute referred to as "abuse of law" may be found in French legislation, and Germany introduced the notion of "abuse of legal structures" long ago, the Brazilian tax system has never adopted or endorsed these institutes.

10. *See* A. Xavier, *Tipicidade da tributação, simulação e norma antielisiva* [Typicality of Taxation, Sham and Antiavoidance Rule], (São Paulo, Dialética, 2002); P. de Barros Carvalho, *Curso de Direito Tributário* [Tax Law Course], (14th ed., São Paulo, Saraiva, 2002), p. 272; S. Calmon Navarro Coêlho, *Evasão e elisão fiscal: o parágrafo único do Art. 116, CTN, e o direito comparado* [Tax Evasion and Tax Avoidance: the Sole Paragraph of Article 116 of the National Tax Code and the International Experience], (Rio de Janeiro, Forense, 2006), p. 48; J. Marins, *Elisão tributária e sua regulação* [Tax Avoidance and Its Regulation], (São Paulo, Dialética, 2002); G. Lacerda Troianelli, *supra* n. 7; L. Amaro, *Direito tributário brasileiro* [Brazilian Tax Law], (15th ed., São Paulo, Saraiva, 2009), p. 238; and M. Delgado Gutierrez, *Planejamento tributário: elisão e evasão fiscal* [Tax Planning: Tax Avoidance and Tax Evasion], (São Paulo, Quartier Latin, 2006), pp. 99-101.
11. *See* R. Mariz de Oliveira, *A Simulação no Código Tributário Nacional e na Prática* [Sham in the National Tax Code and In Practice], 27 Revista Direito Tributário Atual, p. 561.
12. *See* L.E. Schoueri, *Planejamento tributário e garantias dos contribuintes: entre a norma geral antielisão portuguesa e seus paralelos brasileiros* [Tax Planning and Taxpayer's Guaranties: Between the Portuguese GAAR and Its Brazilian Parallels] in D. Freire e Almeida et. al. (org.), *Garantias dos contribuintes no Sistema Tributário*, (São Paulo, Saraiva, 2012), p. 400.
13. J. Marins, *Elisão tributária e sua regulação* [Tax Avoidance and Its Regulation], *supra* n. 12, p. 57.

Moreover, there is no doubt left that the provision demands further regulation in order to become applicable. This condition was also clear during the legislative process, in which, as per an opinion issued by a Senate congressman, it was concluded that the provision allowed "the tax authority to tax sham transactions", but was "not self-applicable", since it required "that an integrative rule sets the limits to the exercise of the prerogative attributed to the tax administration".[14]

9.2.2. MP 66/2002: The rejection of the regulations on tax avoidance

Despite the serious concerns with respect to the provision, its wording has been interpreted broadly both by some scholars,[15] in whose opinion the paragraph would have a meaning not related to traditional private law concepts, and by the government, which proposed controversial regulations to the sole paragraph of article 116.

These regulations, which brought concepts going far beyond the scope of the Brazilian sham doctrine, were immediately rejected by the Brazilian parliament.

Indeed, Provisional Measure (MP)[16] 66 was enacted by the government in 2002 with the purpose of fulfilling "the requirement set forth by the sole paragraph of Article 116 of the National Tax Code".[17] In its articles 13 to

14. Commission of Economic Affairs of the Federal Senate, Opinion No. 1.257.
15. *See* R. Lodi Ribeiro, *Justiça, interpretação e elisão tributária* [Justice, Interpretation and Tax Avoidance], (Rio de Janeiro, Lumen Juris, 2003); M.A. Greco, *Constitucionalidade do parágrafo único do artigo 116 do CTN* [Constitutionality of the Sole Paragraph of Article 116 of the National Tax Code], in V. Oliveira Rocha (coord.), *O planejamento tributário e a Lei Complementar 104* (São Paulo, Dialética, 2001), pp. 181-204. Arguing that the rule is unconstitutional, but still considering it as an anti-avoidance rule: I. Gandra da Silva Martins, *Norma antielisão é incompatível com o sistema constitucional brasileiro* [Anti-avoidance Rule is Incompatible with the Brazilian Constitutional System], in V. Oliveira Rocha (coord.), *O planejamento tributário e a Lei Complementar 104* (São Paulo, Dialética, 2001), pp. 117-128.
16. A provisional measure is a feature of the 1988 Constitution by means of which the President is authorized to unilaterally enact measures invested with "force of law" in cases of "relevance and urgency". Once it has been enacted by the Executive Branch, an MP is sent to the Congress, which may convert it into a law in a maximum period of 120 days. If it is not approved within this deadline, the provisional measure loses its enforceability *ex tunc*, being up to the Congress to "regulate, by means of a legislative decree, the juridical relations deriving from it".
17. Explanatory Memorandum of Provisional Measure No. 66, of 29 Aug. 2002, items 11 and 14.

19, this provisional statute provided for situations in which the administrative authority could disregard legal acts or transactions carried out by the taxpayer. Such provisions, allegedly consistent with the concepts set forth in countries that have successfully regulated tax avoidance, were aimed at situations that, "whilst licit, pursue a more favorable tax regime and involve abuse of forms or lack of business purpose".[18]

Article 14 of MP 66 included expressions such as "lack of business purpose" (defined as "the option for a more complex or more expensive form, between two or more forms available for the taxpayer") and "abuse of forms" (described by the statute as "the indirect act which produces the same economic result as the dissimulated act or legal transaction").

According to article 62 of the Federal Constitution, MPs are enacted by the government and are subject to a posterior analysis of Congress, which may reject or accept the provisional measure. Only in the latter case, it is converted into an ordinary law. As Congress rejected MP 66/02, the sole paragraph of article 116 has never been regulated, and, therefore, is not applicable, as it expressly requires further regulation.

Prior to the rejection by Congress, the Brazilian Federal Revenue had issued a statement clarifying that the regulation would "include Brazil among the countries that offer a normative solution to tax avoidance and tax planning". Accordingly, "such countries have in common a strong democratic tradition and the respect to individual rights".[19] However, although at that time this statement appeared to be an assertion of the democratic values observed by the institution, later it became clear that the clarification was actually a warning: Congress would either pass the "democratic" solution or it would resort to the authoritarian option. As the MP was rejected, the Executive Branch made clear that it had no intention of maintaining the former formalist tradition.

9.2.3. The CARF's approach towards tax planning

It was reasonable to expect that the rejection of the above doctrines by Congress would be a benchmark for the definition of the current legal status of tax planning along the lines of enforcing the legality argument

18. Id., items 12 and 13.
19. Brazilian Federal Revenue, "*Em nota, Receita esclarece regulamentação da norma antielisão"* [Revenue's Statement Clarifies the Regulation of the Anti-avoidance Rule], issued on 8 Nov. 2002, available at http://www.receita.fazenda.gov.br/.

then adopted by the CARF. Instead, however, there was a movement of the CARF towards a substance-over-form approach, whereby doctrines such as "business purpose" and "abuse of law" began to be invoked by the judges in order to disregard transactions undertaken by the taxpayer for no visible reason other than for tax reduction.

Why was there such a change? Some authors speak of a "formalism crisis in Brazilian tax law", attributed to the rise of "consciousness that the creativity must be privileged, but it is important to react against the mere trickery of those who want to take advantage as if each individual lived isolated, with the world at his disposal".[20] Without a sound tax policy and clear legal statutes, however, it is hard to infer which "trickery" the tax administration is responding to, and the taxpayer became subject to the tax administration's arbitrary judgment. As a result, an enormous uncertainty ensued.

At first, given the lack of legal basis for applying such doctrines, the CARF would jeopardize private law concepts, in order to mask its intention of applying the regulations that had been rejected by the Congress. More recently, however, the CARF issued a decision in which it directly applied the business purpose doctrine, expressly denying it was a case of sham.

In brief, the business purpose argument, notwithstanding the lack of regulation in Brazilian law, has been taken into account by the CARF, sometimes under the label of sham (which, if confirmed, would not be acceptable by the tax authorities) and sometimes with no legal basis at all.

9.2.3.1. The misuse of private law concepts and the introduction of the business purpose doctrine

The misuse of private law concepts, namely the sham doctrine, to address economic considerations has led to a confusion that has been observed in jurisdictions that lack GAARs.[21] It has been reported that certain jurisdictions that lack an anti-avoidance legislation "succumb to temptation and

20. M.A. Greco, *Crise do formalismo no direito tributário brasileiro* [Formalism Crisis in Brazilian Tax Law], 1 Revista da PGFN (2011), pp. 9-18.
21. This trend has been described by Frederik Zimmer in the 2002 IFA General Report. The branch reporters were asked to analyse whether a dividend stripping case could be considered a sham under the respective legislation. Curiously enough, while most countries would resort to "a narrow concept of sham/simulation", denying their applicability to the case, jurisdictions "with no tax anti-avoidance rule" were likely to resolve the issue by widening the private law concept. Mexican and Colombian reporters, for instance, suggested the application of the concept of sham/simulation, maintaining that there was

make use of sham transaction doctrines or rules in order to correct these situations".[22] In such jurisdictions, "the concept of sham/simulation tends to be extended beyond the private law concept".[23]

This conclusion is apt for the Brazilian experience, where the concept of sham has been deeply jeopardized by the tax administration. According to the new approach, the CARF started to question decisions, for example, what would be the business purpose justifying the merger of a profitable company into a loss-making one.[24]

This is not to say that sham doctrine is not a valid tool to counter abusive behaviour. However, whenever a transaction is characterized by deliberate inaccuracies, it ought to be of no value to the tax administration. The inconsistency rather lies in the misuse of the doctrine, namely where no legal grounds can support the disregard of a valid tax-related transaction undertaken by the taxpayer.

The business purpose argument became usual in cases involving transactions carried out for the amortization for tax purposes of the goodwill accounted for the acquisition of investments. In this respect, one may see the decision handed down by occasion of the judgment of the *Carrefour* case, in which it was observed that:

> From the description of the facts and proof elements in the process one may note the absence of any business or corporate purpose in the merger undertaken, being characterized the utilization of the merged company as a mere "conduit company" so as the goodwill could be transferred to the merging company, with the sole purpose of reducing the taxable gain resulting from the sale of the premises to Carrefour. (…) In my opinion, the case should be qualified as sham, followed by the application of the penalty.[25]

"no real underlying economic event" or that "the transaction does not make sense commercially". *See* F. Zimmer, General Report, in *Cahiers de droit fiscal international*, vol. LXXXVIIa, (Kluwer, 2002), pp. 29-33.

22. J.J. Zornoza Pérez and A. Báez, The 2003 Revisions to the Commentary to the OECD Model on Tax Treaties and GAARs: a mistaken starting point, in M. Lang et. al. (org.), *Building Bridges between Law and Economics*, (IBFD, 2010), p. 137.
23. F. Zimmer, *supra* n. 21, at 64.
24. Frequently, the non-tax-related purposes pointed at by the taxpayer are one of the main reasons considered for the validity of a transaction: "(…) no major effort is necessary to conclude that the company resulting from the transaction, in business terms, has gained efficiency and has reduced costs, namely those costs which are inherent to the mere fact of the existence of the company." (CARF, Judgment 107-07.596, decided on 04.14.2004)
25. CARF, Judgment 103-23.290, decided on 12.05.2007.

The excerpt above is symptomatic: whilst the lack of business purpose – which does not count on legal grounds in the Brazilian legal system – revealed itself as the main reason for the rejection of the tax planning, the judge ended up basing his interpretation on the private law concept of sham, which does not bear any link to the above doctrine rationale. In other words, it demonstrates the court's will in masking the application of doctrines that currently are not supported by Brazilian tax legislation through concepts provided by private law.

The same reasoning may be inferred from other decisions. It has been argued, for instance, that "[t]he transfer of participation by means of a sequence of corporate acts configures a sham, if such acts have no purpose other than carrying out such transfer".[26]

Surprisingly enough, even attempts to define the business purpose regardless of any legal basis may be found in CARF case law. It has been said that "the business purpose is not related to the existence of employees, offices or other material elements, but to the actual presence and performance of the business considered".[27]

In this case, though, the court decided that the characterization of a sham deviating from its private law profile – where no concerns as regards the tax outcomes of the transaction are raised at all – would "only be possible through the application of the provisions of the sole paragraph of article 116 of the Tax Code, which currently – due to the lack of specific regulation – cannot be done by the tax agents". However, despite of these considerations, the judges observed that the "business purpose" had been "duly proved" in the case, as if these criteria were relevant.

26. CARF, Judgment 104-21.610, decided on 05.25.2006. In another case, not only the sham argument was evoked, but the decision was also based on constitutional concerns: "If the evidences show that the formal acts (reorganization) diverged from the actual intent (selling), it is the case of a sham (…) the fact that each transaction is individually and formally legal does not grant legitimacy to the series of operations, when it is proved that the acts carried out had a diverse purpose than their proper ones (…) the freedom of self-organization, mitigated by the constitutional principles of equality and ability to pay, no more endorses acts that lack of a business purpose". (CARF, Judgment 104-21.675, decided on 06.22.2006)

27. CARF, Judgment 1301-001.356, decided on 12.04.2013.

9.2.3.2. The *Lupatech* case and the incoherencies in the Court's reasoning

In a final development on its way towards a substance-over-form argument and comparable approaches, the CARF has already resorted to the business purpose argument irrespective of any consideration as to a sham transaction and even recognizing its absence in the case.

When analysing a transaction triggering the amortization of goodwill, the court concluded that it was not a case of sham:

> There is no sham if the acts carried out are licit and coherent with the private law institutions adopted, and the taxpayer takes on the charges and consequences of the legal structure he adopted, even if motivated by tax reasons.[28]

However, the judges still deemed the transaction invalid, considering it "artificial" due to "the lack of business purpose". The court found that the sole intent of the transaction was to "diminish the tax burden over the transaction effectively carried out". The leading opinion also considered that the company had no "headquarters, operational structures, employees, or operational activities".

On the one hand, the court reasonably ascertained that the sham doctrine is not an adequate basis for business purpose or substance-over-form considerations, while on the other hand it decided to "disregard the transaction for tax purposes" instead of validating the taxpayer's structure. Sham considerations were left behind and the court relied solely on business purpose and economic substance arguments, as if their legal grounds were self-evident. That is to say, while expressly stating that no sham was to be found in the transaction, the court deemed the structure invalid by resorting to grounds not provided for by the Brazilian legislation.

Intending to clarify which requirements are truly upheld by the court when disregarding transactions for tax purposes, a comprehensive survey[29] on every decision issued by the CARF on the matter from 2002 to 2008 (in total 78) confirmed that, in light of tax planning charges, the judges not only asked whether the facts were deemed existent just as described by the taxpayer or whether the applicable law was duly observed. These are two criteria usually linked to the legality argument. It was concluded that

28. CARF, Judgment 1402-001.404, decided on 07.09.2013.
29. *See* L.E. Schoueri, *O desafio do planejamento tributário* [The Tax Planning Challenge], in Luís Eduardo Schoueri (coord.), "*Planejamento tributário e o "propósito negocial*", (São Paulo, Quartier Latin, 2010).

the CARF would also question whether the transaction had non-tax-related purposes, in an approach clearly influenced by the business purpose and the substance-over-form doctrines.

Moreover, the aforementioned survey concluded that, while assessing the existence of a business purpose in the transaction, the CARF paid attention to (i) the independence of the parties concerned; (ii) the time gap between the transactions; and (iii) the coherence between the transaction and the business activity involved.

Taking into account the economic purposes of the operations, the CARF has regarded as valid the following means of tax planning, for instance: swap transactions between companies of the same economic group, if carried out as hedge instruments;[30] mergers undertaken with the intent of reduction of operational expenses;[31] loans from the controlled to the parent company due to the parent company's liquidity needs,[32] or intended to improve the balance as to favour the submission of a proposal in a call for bids;[33] and maintenance of a separate entity for purposes of providing financial services that could not be developed by a parent company due to regulatory limitations, even if the subsidiary has no establishment or employees.[34]

9.2.4. The incentivized instalment programmes: Where was the judiciary in the meantime?

When confronted with the CARF's approach towards tax planning, one immediately assumes that taxpayers would petition before the judiciary to annul the decisions of the tax administration, which lack legal basis. However, this was not the reaction of the taxpayers: there are no significant tax planning cases that have been submitted to a judge in Brazil.

One of the possible explanations for such a phenomenon is the enactment of incentivized instalment programmes (REFIS) by the Federal Government.[35]

30. CARF, Judgment 101-93.616, decided on 09.20.2001; Judgment 9101-00.412, decided on 11.03.2009.
31. CARF, Judgment 105-15.822, decided on 06.22.2006.
32. CARF, Judgment 101-94.399, decided on 10.16.2003.
33. CARF, Judgment, 107-08.034, decided on 04.13.2005.
34. CARF, Judgment 1301-001.356, decided on 12.04.2013.
35. *See* I.G.S. Martins, "*Aspectos controvertidos na Adesão do Programa de Parcelamento Especial com Vistas à obtenção de regularidade fiscal*" ["Controversial Aspects of the Adhesion to the Special Installment Programs Aiming at Obtaining Fiscal Regularity"], 178 Revista Dialética de Direito Tributário (2010), pp. 131-132.

The enactment of these programmes has been a trend in Brazil since 2000. According to a REFIS, the government offers the taxpayer an opportunity to pay its debts in instalments with substantial reduction on penalties and financial charges. But, in order to adhere to a REFIS, the taxpayer is also required to waive the right to appeal to the judiciary. In other words, by means of such programmes, the tax administration buys the taxpayer off to avoid litigation.

At first glance, such a requirement may seem positive since the number of tax claims is substantially reduced, but a more accurate analysis shows that the uncertainty with respect to tax planning means that the instalment becomes the sole reasonable choice for the taxpayer. Given the complete uncertainty with respect to how the judiciary will react to the CARF's approach and the considerable amounts under discussion in these cases, in most situations, rather than being an option these instalment programmes are a "lifeline" for the taxpayer. Moreover, the recurrence of these programmes is harmful, because it incentivizes the non-payment of taxes. The expression "tax of the fools" (*Dummensteuer*) is used in Germany to refer to a situation where the payment of taxes is not ensured, thus giving rise to a situation where the principle of equality is violated.[36]

These programmes have been enacted in 2000,[37] 2003,[38] 2006,[39] 2009[40] and 2013.[41] The benefits they entail to taxpayers may include complete elimination of penalties and payment in instalments in a period of up to 15 years. When facing litigation with regard to a specific issue, the government is likely to offer instalment programs to the group of taxpayers involved in the discussion, as occurred with respect to financial institutions controversies,[42] autarchies and foundations tax debts,[43] and also with regard to the taxation of profits by controlled foreign companies.[44]

36. *See* K. Tipke, "*Princípio da igualdade e ideia de sistema no Direito Tributário*" ["Principle of Equality and the Idea of System in Tax Law"], in B. Machado (coord.), *Direito Tributário: Estudos em homenagem ao professor Ruy Barbosa Nogueira*, (São Paulo, Saraiva, 1984), pp. 515-527.
37. *See* Law 9,964/2000.
38. *See* Law 10,684/2003.
39. *See* Provisional Measure No. 303/2006.
40. *See* Law 11,941/2009.
41. *See* Law 12,865/2013.
42. *See* Law 12,865/2013.
43. *See* Law 12,249/2010.
44. *See* Law 12,865/2013. The issue of CFCs will be addressed in sec. 9.4.3.

Assessments involving expressive amounts, including interests and a 150% penalty became suddenly common and the adhesion to an instalment programme seems a reasonable way, from a taxpayer's perspective, to reduce uncertainty. Another issue is the costs of maintaining tax litigation. After the administrative procedure within the CARF, the taxpayer is only able to suspend the tax enforcement while litigating in the judiciary by depositing the total value under discussion or presenting guaranties.

Even in larger companies, which would be able to finance litigation, the REFIS present distortive effects with respect to the behaviour of managers. When considering a short-term perspective, managers are incentivized to adhere to the programmes, so that it is possible to reduce reserves and deduct the respective loss, affecting the profits of the company positively and, perhaps, their own performance – even if this is at the expense of a reasonable right that could be later granted by the judiciary.

In any case, for more than a decade, the Federal Government has successfully bought taxpayers off to avoid tax planning litigation. As a consequence, the final decisions on these questions have been handed down by the administrative court, and not by the judiciary.

The path dependency entailed by more than one decade of CARF tax planning case law over future decisions of the judiciary is still to be confirmed. If it is true that "where we go next depends not only on where we are now, but also upon where we have been",[45] one may expect the judiciary to be strongly influenced by the CARF's reasoning when analysing tax planning cases, or, at least, to be faced with the need to confront the arguments addressed therein.

Apparently, however, the rationality developed within the administrative court is not shared by the legislative branch. A recent proposal of legislation shows that the Chamber of Deputies does not take for granted the existence of means to combat tax avoidance merely upon interpretation of Brazilian tax law.

45. Stan J. Liebowitz & Stephen E. Margolis, "Path Dependence", in 1 *Encyclopedia of Law & Economics: the History and Methodology of Law and Economics* 981, 981 (Boudewijn Bouckaert & Gerrit De Geest eds., 2000).

9.3. The reaction to avoidance and aggressive tax planning in the BEPS context

9.3.1. Here they come again: MP 685/2015 and the BEPS Project

As addressed in section 9.2.3., Brazil does not have a GAAR in force. There is currently no proposal by the government to enact a GAAR. However, allegedly inspired by Action 12 of the OECD/G20 BEPS Project, on 21 July 2015, the Brazilian President, without previous discussion with civil society, enacted MP[46] 685/2015, which is intended to create the obligation for taxpayers to disclose aggressive tax planning. As described, there is no legal certainty with respect to what would constitute “aggressive tax planning” and the proposal has brought nothing with respect to such clarification.

According to article 7 of MP 685/2015, taxpayers would be obliged to report to the Brazilian tax authorities, until 30th of September of each year, the transactions carried out in the previous year, if they included elimination, reduction or deferral of taxes. This statement would have to be filed when: (a) the performed transactions would not have relevant reasons other than tax ones; (b) the adopted form would not be usual for the intended transaction, or when the contract contains clauses that result in effects different from a typical contract; or (c) the specific transactions performed by the taxpayer would match those included on a list to be enacted by the Federal Revenue Secretariat (RFB).

If the RFB did not recognize the transactions carried out by the taxpayer as legitimate, the taxpayer would be notified to pay (or be requested to pay in instalments) the taxes due with interest within 30 days. The penalty would only be applied if the taxpayer presented the statement after the RFB started its tax inspection.

On the other hand, according to article 12 of this MP, the lack of a statement or an incomplete or incorrect one would characterize an omission intended to hide tax evasion or tax fraud, and the RFB would charge taxes due with penalty (150%) and interest.

46. The mechanism of an MP is explained in footnote 16, *supra.*

Although the Brazilian government has argued that the disclosure of tax planning strategies would be following BEPS recommendations, a closer look shows that MP 685/2015 ignored many of the OECD proposals.

As stated in the Public Discussion Draft of the BEPS Action 12 (Mandatory Disclosure Rules): "[t]he information that a taxpayer is required to provide under a mandatory disclosure regime is generally no greater than the information that the tax administration could require under an investigation or audit into a tax return".[47]

The rules related to mandatory disclosure should therefore be precisely articulated and clearly understood to make it easier for taxpayers to comply with them.[48] In addition, sanctions to encourage disclosure and to penalize those that do not comply with their obligations have to be clear.[49] Consequently, this Draft highlights the importance of being explicit in domestic law about the consequences of reporting a scheme or transaction under a disclosure regime.[50]

When analysing the expressions prescribed in MP 685/2015, the conclusion is that the mandatory disclosure set forth in this law was not clear. In Brazilian domestic law, there is no definition of "relevant reasons other than tax reasons". Moreover, this law is inaccurate when it refers to the "adopted form" or to the "typical contract". Also, there is no relevance in analysing whether the adopted form is usual or not because, unlike the German legislation for example, Brazilian domestic law does not take this aspect as a requisite to deem an operation as abusive. Brazil simply has no tradition in applying such concepts and there is no reason to believe that they should be used as hallmarks for mandatory disclosure.

Furthermore, such information would never be found in an audit or investigation, as suggested by the OECD. In other words, the tax authorities do not obtain from the taxpayer the information that "there was a transaction without relevant reasons other than tax reasons". The tax authorities can only reach this conclusion on their own. Thus, MP 685/2015 would compel the taxpayer to recognize an incriminating fact without actually being able to predict the legal consequences of it. As a consequence, given that the lack

47. OECD, *Action Plan 12: Mandatory Disclosure Rules, Public Discussion Draft, BEPS, OECD*, published on 11 May 2015, at 47.
48. Id.
49. Id.
50. Id., at 50.

of a statement could entail the presumption of tax fraud, MP 685/2015 could be deemed to entail self-incrimination concerns.

The problems arising from such legislation become even clearer when one considers the lack of adequate anti-avoidance legislation in Brazil. By enacting MP 685/2015, the Executive Branch intended to take for granted the existence of an applicable GAAR in Brazil, even though its regulation has never been approved by Congress, as addressed in section 9.2.2.

In other words, the basic premise of a "mandatory disclosure rule" is clarity with respect to what shall be disclosed by the taxpayer. However, as described in the current Brazilian tax legislation, there is no clear definition with regard to how should tax avoidance be combated by the tax administration. For this reason, the fact that Congress has rejected these provisions of the MP is not surprising.

During the debates in Congress, the government has stepped back from its proposal. The self-incrimination concerns have been eliminated and the statement has become "optional" in most cases. The taxpayer would mandatorily disclose solely the operations to be listed by the RFB.[51] However, even this proposal has been rejected by the Deputies.

This makes it clear that there is a need to further discuss the issue of tax avoidance in Brazil. The Brazilian tradition in tax law demonstrates a strong rejection of open clauses that grant a wide interpretation of attributions to tax authorities. Whilst the Executive Branch has managed to "kidnap" the jurisdiction to tax planning cases in the last decade, a more authentic evaluation of the current scenario shows that the alleged evolution in the Brazilian approach to tax avoidance is actually unsustainable. If the government agrees with the doctrine applied, the legislative authorities surely do not and the judiciary is still to be heard on this issue.

Such a conclusion leads to critiques not only of the Brazilian tax authorities, but of the BEPS Project itself. Action 12 takes for granted that all G20 countries have effective (and similar) means of combating tax avoidance in force, but this is not the case. Brazil still struggles in terms of legislation and institutional capacity in this regard.

Besides the critiques with respect to the actual involvement of non-OECD member countries in the BEPS Project, an example in Brazil shows how

51. *See* Bill 22, referring to MP 685/2015.

harmful it can be to take solely the tax administration's perspective during debates. In Brazil, if one asks tax officials whether there are sufficient mechanisms to combat tax avoidance, the answer will surely be "yes, and they work very well". However, a closer look shows that taxpayers in Brazil are actually submitted to a high degree of uncertainty, due to the lack of legal basis for the assessments of tax authorities. Since the final decision ends up being handed down by the tax authorities themselves, they are able to seek in substance-over-form, business purpose and/or abuse of law doctrines what better suits their needs, even though Congress has clearly rejected both MPs that tried to introduce such criteria in the Brazilian legal system.

In the meantime, there are no further developments with regard to enhancing the relationship between tax administration and tax authorities. In Brazil, there is a form of tax ruling (*Solução de Consulta*), whereby the taxpayer is allowed to submit a query before the RFB, with regard to interpretation of tax legislation and classification of services and intangibles. In 2013, the regulations were improved. The outcome of a *Solução de Consulta* is now binding to the tax administration, not only when applying the rules to the taxpayer that requested the tax ruling (as in the former regulations), but also to any and every taxpayer in the same conditions as the consulting person. Another important development in the tax rulings is that the reasoning of the solution met by the tax administration shall be disclosed. This shows that rulings are not intended to benefit only the taxpayer concerned; they are rather a clarification of the tax authorities' understanding in cases they are asked about.

9.4. Transfer pricing rules, GAARs, SAARs and linking rules

Even though Brazilian legislation is still silent with respect to a GAAR, Brazil has enacted important SAARs. Besides, Brazilian TP policy demonstrates relevant deviations from the OECD Guidelines. These deviations, if adequately interpreted, may offer a suitable solution to current feasibility problems of the application of TP legislation as addressed in the OECD Guidelines.[52]

52. This argument has been further developed in L.E. Schoueri, *Arm's Length: Beyond the Guidelines of the OECD*, 69 Bulletin for International Taxation 12, December 2015, pp. 690-716.

It is also important to describe why the Brazilian regime of taxation of controlled foreign companies cannot be considered as a SAAR. Finally, in this topic, the treaties in which Brazil has recently included specific anti-abuse provisions are addressed, since this can be claimed to be an important feature in Brazil's recent treaty negotiation policy.

9.4.1. Brazilian transfer pricing rules and fixed margins

According to Law 9,430/1996, Brazilian TP rules are applicable to imports and exports of products, services and rights in controlled transactions. The rules are also mandatory in regard to intercompany loans and to any and every import and export uncontrolled transaction between a Brazilian resident (either an individual or a legal entity) and residents in low-tax jurisdictions, or in jurisdictions whose domestic legislation provide for the secrecy of corporate ownership. These jurisdictions are listed by the Brazilian tax authorities,[53] along with privileged tax regimes to which TP rules are also mandatorily applicable.[54]

53. *See* IN 1,037, 4 June 2010. The listed jurisdictions are: Andorra; Anguilla; Antigua and Barbuda; Netherlands Antilles; Aruba; Ascension Island; the Commonwealth of the Bahamas; Bahrain; Barbados; Belize; Bermuda; Brunei; Campione D'Italia; Channel Islands (Alderney, Guernsey, Jersey e Sark); Cayman Islands; Cyprus; Singapore; Cook Islands; Republic of Costa Rica; Djibouti; the Commonwealth of Dominica; United Arab Emirates; Gibraltar; Grenada; Hong Kong; Kiribati; Labuan; Lebanon; Liberia; Liechtenstein; Macau; Madeira Island; Maldives; Isle of Man; Marshall Islands; Mauritius Island; Monaco; Montserrat Island; Nauru; Niue Island; Norfolk Island; Panama; Pitcairn Islands; French Polynesia; Qeshm Island; American Samoa; Western Samoa; San Marino; Saint Helena Island; Saint Lucia; Federation of Saint Kitts and Nevis; Saint-Pierre and Miquelon Islands; Saint Vincent and the Grenadines; Seychelles; Solomon Islands; St. Kitts and Nevis; Swaziland; Sultanate of Oman; Tonga; Tristan da Cunha; Turks and Caicos Islands; Vanuatu; United States Virgin Islands; and British Virgin Islands.

54. IN 1,037/2010 also includes the following as privileged tax regimes: Uruguay's regime regarding legal entities incorporated in the form of "Financial Companies Investment (Safis)" until December 31, 2010; Denmark's regime applicable to legal entities incorporated as a holding company; Netherlands' regime applicable to legal entities incorporated as a holding company; Iceland's regime applicable to legal entities incorporated as International Trading Company (ITC); United States' regime applicable to legal entities incorporated as a limited liability company (LLC), whose membership is made up of non-residents that are not subject to federal income tax; Spanish regime applicable to legal entities incorporated in the form of *Entidad de Tenencia de Valores Extranjeros*, ETVEs; Maltese regime applicable to legal entities incorporated as International Trading Company (ITC) and International Holding Company (IHC); Switzerland's regimes applicable to legal entities incorporated as a holding company, domiciliary company, auxiliary company, mixed company and administrative company whose tax treatment results in incidence of Income Tax of Legal Entities (IRPJ) in order combined, less than 20%, according to the federal, cantonal and municipal legislation as well as the arrangements applicable to

Therefore, the anti-avoidance intent of Brazilian TP legislation is clear: not only does it aims at controlled transactions, whose price may not follow market price, but also to uncontrolled transactions carried out between a Brazilian resident and a resident in a listed jurisdiction.

The transactions described must be evaluated on an annual basis, under any of the methods available in Brazilian legislation. Even though there is no "best method rule", the same method must be applied consistently to the same product or transaction in the same fiscal year. It is possible, however, to apply different methods to transactions involving distinct products or services, or to transactions involving the same product or service, but occurring in different fiscal years.

The methods concerning the import of goods, services or rights are: (i) the comparable independent price method (PIC); (ii) the resale price less profit method (PRL); (iii) the production cost plus profit method (CPL); and (iv) the quotation price on imports method (PCI). For exports, the methods applicable are: (i) the export sales price method (PVEx); (ii) the resale price method (RPM);[55] (iii) the purchase or production cost-plus tax and profit method (CAP); and (iv) the quotation price on exports method (PCEX).

The main deviation from the international standards lies in the adoption of predetermined profit margins under the equivalents of the resale and cost-plus methods. The so-called "fixed margins" should not be confused with formulary apportionment (FA). The Brazilian approach does not pursue a division of the global profit of the MNEs among the entities. Neither does it take into consideration the amount of profits to be paid to the other entities of the group. The Brazilian legislation only takes into consideration the profits of the Brazilian entity. Therefore, it is clearly not an FA-based method, since neither does it take into account the global profit of the MNE, nor does it disregard the intra-group transactions. The fixed-margins approach is essentially a transactional approach.

According to the fixed-margins approach, countries may establish "different profit margins per economic sector, line of business or, even more specifically according to the kind of goods or services dealt with, to calculate the

other legal forms of incorporation of legal entities, by rulings issued by tax authorities, resulting in incidence of IRPJ, in combination, less than 20%, according to the federal, cantonal and municipal legislation.

55. In contrast to the OECD Guidelines, in the Brazilian RPM, fixed margins are used instead of resorting to comparables.

parameter price",[56] on the application of the relevant arm's length standard (ALS) -base methods. The profit margins must be determined based on market research. This pricing research could be either carried out by the tax administration or purchased from third parties. It is important that the pricing is previously submitted to discussion with the economic groups to which it will be applied.

If the legislation establishes numerous and very specific margins, the chances that the applicable margins correspond to a consensus concerning reality increase. The Brazilian chapter in the UN Practical Manual describes that in some cases the existence of many different margins may not be necessary, depending on the diversity of goods and services exported and imported by the country.[57] Determining how numerous and how specific the fixed margins are is deemed to be a policy decision, which may vary according to the characteristics of the state's economy.[58]

The legislation may establish fixed margins by economic sector (distinguishing, for example, extraction or production of raw materials, manufacturing and services) or more specifically with reference to the relevant activities of the MNE. As suggested by the UN Practical Model, "the country could use a margin for the chemical industry as a whole, or different margins for different types of products of the chemical industry (agrochemical, petrochemical, explosives, cosmetics etc)".[59]

The Brazilian chapter in the UN Practical Model deems it possible to establish a "range of profit margins". It is important to note that current Brazilian legislation does not include such a mechanism. In some cases, it would be necessary to determine a maximum and a minimum profit margin that would statistically correspond to the available relevant data of

56. United Nations, *Practical Manual on Transfer Pricing for Developing Countries* (hereinafter the UN Practical Manual), UN Committee of Experts on International Cooperation in Tax Matters (New York, 2013), at 372, para 10.2.9.1.
57. Id.
58. Accordingly, "[e]ach country should determine, according to its specific circumstances, the amounts involved and types of goods and services, how specific the margins should be and whether more margins are merited. Besides, a country may combine different levels of margin specifications if it seems appropriate; it may set forth some general margins for a line of business in addition to more specific margins for some goods." (UN Practical Manual, at 373, para 10.2.9.4).
59. The Brazilian chapter highlights that "[t]he differentiation per industry into types of products is adopted by Brazil, where, for the Resale Price Method for imports, the margin for chemicals sector in general is 30 per cent, while the margin for pharmaceutical chemicals and pharmaceuticals is 40 per cent." (UN Practical Manual, at 373, para 10.2.9.3)

uncontrolled transactions. This range would represent "an acceptable divergence margin".[60] In this case, the legislation should establish ranges instead of margins. If the pricing research discovers that some companies have a 25% margin and others a 38% margin, the range would be advisable instead of fixed margins, because margins of 25%-38% would be acceptable. If the range becomes too wide, it may be the case for further specification concerning the products or activities.[61]

The advantages of fixed margins are immediately visible:[62] (i) they may avoid the need for specific comparables; (ii) they can be applied both by tax administrations and companies without the need for technical knowledge on specific TP issues, which is a scarce human resource both for companies and tax administrations in developing countries; (iii) they grant legal certainty to taxpayers, since this is an ex ante objective alternative, not relying on further subjective analysis; (iv) they reduce costs for both tax administrations and taxpayers, since they diminish the need to empirically determine gross margins in a comparability analysis; and (v) they promote competition among enterprises in the state, submitting them to the same tax burden.

However, if not correctly considered, the approach may be incompatible with the ALS. Despite being important for tax policy considerations, the "Comments for Countries Considering the Adoption of Fixed Margins" in the UN Practical Manual ignores the need for rebuttable presumptions.

The Brazilian chapter was written by the Brazilian tax authorities and, as a consequence, it does nothing more than express the RFB's interpretation of the Brazilian legislation. Hence, it considers as a "weakness" of the method the "unavoidable" outcome "that some Brazilian enterprises will be taxed at (higher or lower) profit margins not compatible with their profitability", which would be due to the fact that "the fixed margin method applies regardless of the cost structures of taxpayers".[63] The Brazilian tax authorities also regard that "[t]he approach may lead to double taxation in case there is no access to competent authorities to negotiate relief of double taxation".[64]

60. UN Practical Manual, at 373, para 10.2.9.5.
61. Id., at 374, para 10.2.9.7.
62. Id., at 370, para 10.2.7.1.
63. Id., at 371, para 10.2.7.2.
64. Id.

Therefore, the Brazilian chapter ignores that the ALS may be inferred from the Brazilian tax legislation[65] and is also included in every single tax treaty signed by Brazil.[66] If the tax authorities' interpretation is adopted, the allegedly "unavoidable" outcome of the methods applied clearly violates provisions of the Brazilian tax system. This interpretation is liable for the worldwide rejection of Brazilian TP legislation, given that, in the terms contended by the tax administration, the Brazilian approach is clearly in breach of the international agreements signed by Brazil.

The only reasonable interpretation of the fixed-profit margins is that the margins set forth by the legislation are rebuttable. The taxpayer must be entitled to put forward arguments to convince that an ALS margin in the transaction described would probably be distinct from the margin reached by the tax administration, or would not fall within the range of margins provided. A distinct interpretation would imply a violation of both domestic legislation and tax treaties providing for the ALS. Unfortunately, the Brazilian tax authorities still do not share this view, and the Brazilian TP legislation has been deemed compatible with Brazilian tax treaties, with no further need to consider the fixed margins as rebuttable presumptions.[67]

Having read the text of Law 9,430/1996, as amended in 2012, it is clear that margins may be revised. However, this has not been the practice in Brazil. It is difficult to determine the reason why taxpayers have not challenged the determined margins. It is true that previous legislation required enormous documentation for any application for revision of margins, which

65. *See* L.E. Schoueri, *Preços de Transferência no Direito Tributário Brasileiro* [Transfer Pricing in Brazilian Tax Law] (3rd ed., São Paulo, Dialética, 2013), at 60; R.L. Torres, *O Princípio Arm's Length, os Preços de Transferência e a Teoria da Interpretação do Direito Tributário* [The Arm's Length Principle, Transfer Pricing and Theory of Interpretation of Tax Law], 48 Revista Dialética de Direito Tributário (1999).

66. Brazil currently has DTCs with the following countries (date of signature noted): Japan (24 Jan. 1967); France (10 Sept. 1971); Belgium (23 June 1972, amended 20 Nov. 2002); Denmark (27 Aug. 1974); Spain (14 Nov. 1974); Sweden (25 Apr. 1975); Austria (24 May 1975); Italy (3 Oct. 1978); Luxembourg (8 Nov. 1978); Argentina (17 May 1980); Norway (21 Aug. 1980); Ecuador (26 May 1983); the Philippines (29 Sept. 1983); Canada (4 June 1984); Hungary (20 June 1986); Czechoslovakia (now the Czech Republic and Slovakia) (26 Aug. 1986); India (26 Apr. 1988); Korea (Rep.)(7 Mar. 1989); the Netherlands (8 Mar. 1990); China (5 Aug. 1991); Finland (2 Apr. 1996); Portugal (16 May 2000); Chile (3 Apr. 2001); Ukraine (16 Jan. 2002); Israel (12 Dec. 2002); Mexico (25 Sept. 2003); South Africa (8 Nov. 2003); Venezuela (14 Feb. 2005); Peru (17 Feb. 2006); Trinidad and Tobago (23 July 2008); and Turkey (16 Dec. 2010).

67. *See*, for example, CARF, Judgment 108-09.763, decided on 11.13.2008; and Judgment 1401-000.801, decided on 06.12.2012. Not surprisingly, the tax treaty concluded with Germany (27 June 1975) was denounced by the German authorities on 7 April 2005 due to disagreements that also included TP issues.

made any such request virtually infeasible. However, this legislation is not in force anymore, which could offer taxpayers and tax administration the opportunity of discussing industry-specific margins. The fact that this has not occurred so far may be considered the major weakness in practice in Brazil. It shows that the current practice may not be considered as a final solution, but rather a methodology under construction.

Another failure of the fixed margins, as presently existing in practice, is that there is scarce evidence concerning the methodology employed to reach said margins. Such opacity implies a clear lack of legitimacy of the presumption itself, since no one can convincingly argue whether the margins are reasonable or not. A further development of the method seems therefore necessary for the methodology, as well as the data collected and employed, to be transparent, thus allowing the presumption to be checked.

Under such conditions, the Brazilian TP legislation can certainly be compatible with the ALS and could be seen as an important tool to circumvent the feasibility issues present in the current OECD Guidelines. The present practice in Brazil is not what the authors claim to be the final solution: it should be considered an alternative under construction that requires further corrections.

9.4.2. Limits on the deduction of interests in the Brazilian legislation

BEPS Action 4 includes rules that limit the level of interest expense or debt in an entity with reference to a fixed ratio. Examples of these rules include debt-to-equity ratios, interest to EBITDA ratios and interest-to-assets ratios.

According to Law 12,249/2010, interests paid or credited by a Brazilian source to an individual or a legal person resident abroad are deductible only to the extent that they are an expense deemed necessary for the economic activity of the Brazilian company (article 24). As to complying with such a requirement, there is a debt-to-equity fixed ratio that limits the deduction of interests.

In case of controlled cross-border transactions, interest expenses are only deductible if the debt value does not exceed twice the value of the Brazilian company's equity (article 24, II). If the foreign company holds shares in the Brazilian company, the debt value cannot exceed twice the value of the participation of the foreign company in the Brazilian company's equity

(article 24, I). If the foreign individual or legal entity is located in a tax haven or is under a privileged tax regime, the debt value cannot exceed 30% of the equity of the Brazilian company (article 25).

In any case, there is also a constructive ownership rule, whereby if the Brazilian company pays interests to more than one individual or legal entity abroad, the limitation applies in taking the sum of the debt values into account (article 24, III).

To conclude, since 2010, Brazil has been adopting rules that can be deemed even more restrictive than the ones suggested by the BEPS Project, given the discrimination against tax havens and privileged tax regimes, which is not mentioned in Action 4 of the BEPS Project.

9.4.3. The Brazilian CFC rules: No-deferral universal taxation regime is not a SAAR

Brazilian CFC rules are not proper CFC rules, as commonly seen internationally. Most importantly, they are certainly not SAARs. Unlike the profile of the CFC regime found elsewhere, Brazilian rules are broad and applicable to any and every Brazilian controlled foreign company. Hence, Brazilian rules concerning the taxation of foreign profits have been under serious question since their enactment in 1995.

Accordingly, profits derived by a foreign controlled company shall be deemed available to the Brazilian parent company on an annual term. No relevant distinction is made with respect to the jurisdiction where the subsidiary is located (the "designated jurisdiction approach"), nor any reference to the nature of the income derived by the company (the "tainted income approach"). If a Brazilian company develops heavy industry activities in Germany through a subsidiary, the profits of such a subsidiary shall be taxed in Brazil on a yearly basis, as if they were distributed to the Brazilian parent company, even if they are not.

Despite the reasoning adopted by the Explanatory Memorandum of Law 9,249/1995, nothing in the profile of the former Brazilian legislation therefore leads to the conclusion that it has been specifically drafted to counter abusive behaviour. The only aspect that has always been clear with respect to the profits was the government's intention to tax profits derived by Brazilian CFCs, irrespective of the need of actual distribution. It was thought that taxpayers would naturally question the constitutionality of the

rule. Unexpectedly, however, the decision of the Supreme Court took 12 years to be completed, with a mostly inconclusive outcome.[68]

Under Brazilian judicial review, the majority principle must be observed in order to deem a rule as constitutional or unconstitutional: six out of eleven Justices had to consider the rule to be constitutional or unconstitutional.[69] In the judgment on CFC rules, one of the Justices had been previously involved as Attorney General and could not vote. Four Justices considered the regime to be unconstitutional and four considered it to be compatible with the constitution. Another Justice considered the article to be unconstitutional only with respect to associate companies.[70]

The last remaining opinion was finally issued in 2013. Justice Barbosa understood, on the one hand, that "the obsolescence of tax legislation" could not "be evoked as to protect [the practice of] tax evasion", but admitted, on the other hand, that "as it has been written, the Brazilian rule deems, indistinctively, that every controlled or associated foreign company has avoidance or evasion purposes".

After a brief description of the international experience of CFC rules, Justice Barbosa decided that the application of the Brazilian regime should be limited to the taxation of associate or controlled foreign companies that are situated in low-tax jurisdictions or countries that lack transparent corporate regulations, "usually known as tax havens".[71] He also considered that, "in case of companies not situated in tax havens, the tax authorities must contend and prove the tax evasion". Thus, according to his understanding, even in the case of companies not located in tax havens, Brazilian CFC rules would only be applicable in exceptional situations.

68. Supreme Court, Direct Action of Unconstitutionality No. 2588, decided on 04.10.2013.
69. Law 9.868, of 10 Nov. 1998, art. 23.
70. Associate companies are regarded as those in which the investor holds "significant influence", characterized when the investor holds or exercises the power to take part in financial or operational policymaking of the investee, without controlling it. The "significant influence", though, is presumed when the investor holds 20% or more of the voting stocks of the investee, without controlling it. It should also be mentioned that, according to the Civil Code, an associate company may also be characterized once the investor holds 10% of participation.
71. Under art. 24 of Law 9.430 of 27 Dec. 1996, tax havens are deemed as jurisdictions that (i) tax their resident's income at a rate lower than 20% or (ii) impose secrecy regarding the shareholding of legal entities or the identification of the beneficial owner of income attributed to non-residents. Taking into account the general criteria above, the tax authorities enacted Normative Ruling 1.037, of 4 June 2010 – the Brazilian "blacklist".

Summarizing Justice Barbosa's view, in cases involving companies incorporated in tax havens, this newly conceived SAAR would be applicable. If the company is not in a low-tax jurisdiction, tax authorities would have to prove the case of tax evasion in order to apply the CFC rules.

Due to the diversity of opinions, the outcome of the decision is mostly inconclusive. According to the Supreme Court's "average opinion" system, the majority decided that: (i) the taxation of controlled companies located in tax havens is constitutional; and (ii) the taxation of associated companies not located in tax havens is unconstitutional. The decision is silent with respect to controlled companies not located in tax havens and associated companies incorporated in tax havens.

Where the position of the Supreme Court with respect to the taxation of foreign profits remains unclear, the reform proposed by the government still lacks proportionality and harms the competitiveness of Brazilian investors. MP 627, of 11 November 2013, amended the legislation in view of the unconstitutionality of its application to associate companies not located in tax havens, though still generally maintaining the taxation of CFC profits regardless of distribution to the country and also comprising within its scope companies indirectly held (second- and further tiers). The MP was later converted into Law 12,973/2014, excluding the part applicable to individuals.

To conclude, while European countries aim to tighten up their respective CFC rules to target solely wholly artificial arrangements and the United States discusses restrictions on the taxation of their CFCs due to competitiveness concerns, Brazilian legislation goes against the grain, punishing legitimate investments abroad without setting a clear and definitive distinction between actual economic activity and abusive behaviour.

The reaction of the Executive Branch to the Supreme Court's decision shows that there is no intention by the Brazilian government to adopt legislation similar to that observed in the United States or in the European Union.

Under the current no-deferral universal taxation regime, there is no need for actual CFC rules, since the situation of abuse envisaged by such rules is not present. According to the BEPS Action Plan, "[o]ne of the sources of BEPS concerns is the possibility of creating affiliated non-resident taxpayers and routing income of a resident enterprise through the non-resident affiliate". Law 12,973/2014 does not allow such a situation. If Action 3 aims to strengthen CFC rules, the Brazilian legislation is surely a case where there is no space for "strengthening".

Any form of standardization proposed by the BEPS Project would demand that Brazil "weakens" its current regime, and not the contrary. There is no evidence to conclude that the Brazilian government is willing to do so. In any case, it is clear that the Brazilian rules do not constitute an anti-abuse regime, but rather a general regime applicable to any and every Brazilian company carrying out activities through subsidiaries abroad.

9.4.4. Brazilian SAARs in tax treaties

Brazil has also recently inserted SAARs in tax treaties, which may be deemed to be a part of its treaty negotiation policy. It is not clear, however, whether the initiative to include such provisions came from Brazilian negotiators, since there is no uniform text in recent treaties.

For decades, the OECD maintained that states willing to apply their domestic anti-avoidance legislation to situations within the scope of a tax treaty should negotiate specific provisions in order to do so. As from 2003, however, the organization changed its position, suggesting that the application of anti-avoidance domestic provisions to situations governed by a tax treaty would not be troublesome, even in cases where the domestic legislation of a contracting party does not provide for the abuse of treaties.[72]

Traditionally, Brazilian treaty negotiators were not likely to consider the inclusion of specific anti-abuse provisions when signing a tax treaty. Since 2002, however, tax treaties signed by Brazil provide for limitations on the treaty benefits and for situations in which domestic legislation is considered applicable.

In a couple of treaties, such clauses are much less comprehensive than LOB and PPT clauses found elsewhere, namely within the US treaty framework, and are solely intended to forbid third-country residents from obtaining treaty benefits. The treaties concluded with South Africa (2003) and Peru (2006) provide, in general terms, that the treaty benefits shall not be granted to a resident of a contracting state the majority of shares that are directly or indirectly held by persons who are not a resident in that contracting state,

72. On the debates regarding the 2003 Revisions to the OECD Commentaries, *see* J.J. Zornoza Pérez & A. Báez, *supra* n. 21; A. Martín Jiménez, *The 2003 Revision of the OECD Commentaries on the Improper Use of Tax Treaties: A Case for the Declining Effect of the OECD Commentaries?*, 58 Bulletin for International Taxation (2004); and B.J. Arnold, *Tax Treaties and Tax Avoidance: The 2003 Revisions to the Commentary to the OECD Model*, 58 Bulletin for International Taxation (2004).

unless the entity concerned develops therein a "substantial business activity" other than holding investments.

In the treaties concluded with Mexico (2003), Israel (2002) and Turkey (2010), much broader clauses were adopted. The treaty with Mexico includes a specific provision whereby the contracting states may use the mutual agreement procedure in order to deny treaty benefits if it is their opinion that granting those benefits would constitute "a treaty abuse according to its purpose". In the treaty with Israel, such a denial does not require the mutual agreement, and a "notice of the application" of the provision to the authorities of the other contracting state is considered sufficient. According to the treaty with Turkey, neither the mutual agreement procedure nor the referred notice is necessary to deny the treaty benefits in a situation of abuse.

Apart from the clauses described above, the treaties with Mexico and Turkey also set forth that the provisions of the treaty do not prevent the contracting states from applying their domestic thin capitalization and CFC rules, or "any similar legislation". The treaty with Peru does not mention thin capitalization rules, but includes the broader "any similar legislation" expression. The treaty with Israel includes a provision that solely makes reference to the thin capitalization rules, not mentioning other situations.

It is the authors' opinion that such references are necessary to make domestic legislation applicable to situations governed by a tax treaty. Where such clauses are absent, the application of domestic provisions would constitute a treaty override, which is not acceptable under the Brazilian Constitution.

With regard to the PPT or the LOB proposals currently presented in Action 6 of the BEPS Project, the authors do not consider them desirable in their proposed form, since they entail too much discretion to tax authorities in the application of tax conventions. Moreover, since several Brazilian treaties entail tax advantages, including matching credit provisions, it is not clear that PPT would correspond to Brazilian treaty policy. Finally, there are some concerns on the legal effect of including Action 6 in a multilateral instrument (Action 15), due to its compatibility with the object and purpose of treaties signed with traditional Brazilian investors. Notwithstanding that, from the Brazilian tax authorities' perspective, there is no reason to believe that such clauses would be rejected in a negotiation, even though there could be resistance in Congress upon the ratification of the treaty.

9.5. Application of GAARs, TP rules and SAARs

With regard to the application of GAARs, SAARs and TP rules, there are two situations worth reporting. The first refers to the application of the CARF's doctrine in a case involving TP legislation. The second refers to the application of the limits on the deduction of interests described above together with TP legislation.

9.5.1. The CARF's doctrine, SAARs and TP rules

The *Marcopolo* case provides important guidance with respect to the application of the CARF's doctrine to a situation governed by TP legislation. Marcopolo S/A was assessed with regard to export operations carried out from 2001 to 2007. According to the company's structure, vehicle chassis were exported to two subsidiaries, one located in BVI and the other in Uruguay, which then sold the products to consumers. Following the doctrine described in section 9.2.3., the tax authorities alleged that the operation was a sham, considering a supposed lack of business purpose in the transactions performed. According to the RFB, the incorporation of the trading companies was completely unnecessary and had the sole purpose of avoiding taxes. In the assessment, the trading companies were described as "mere reinvoicing centres". Also, the fact that the company in Uruguay had not proved that it had made phone calls to Mexico, Chile or Paraguay, where the buyers of the chassis were located, was taken as evidence of the alleged lack of substance.

Another argument raised by tax authorities was that the offshore companies had no substance. During the auditing procedure, the tax authorities requested electricity and phone bills from the companies incorporated abroad, intending to prove that the whole structure was a tax fraud, thus applying a 150% fine. In fact, tax authorities considered that the fine should be raised to 225%, on the grounds that the taxpayer had not cooperated with the auditors during the assessment.

On these grounds, the tax authorities alleged that there was an "actual operation", consisting in the direct sell from the Brazilian company to the consumer. In other words, the transaction with the "reinvoicing centres" should be disregarded, and the "actual operation" (i.e. the direct sell to consumers) taxed accordingly.

In the first case of the company analysed by the CARF,[73] the reporting judge accepted the auditor's reasoning and expressly addressed the conflict between this understanding and TP legislation. The company managed to prove that it had fully complied with TP legislation when exporting the chassis to the foreign subsidiaries. There was no evidence that any revenue had been omitted in the books of the company. Nonetheless, the judge, reproducing the inconsistencies of the CARF's case law, as described in section 9.2.3., considered that "given the occurrence of a sham", namely the fact that the transactions "did not occur in fact, but only on paper", TP legislation would not be "necessarily applicable". In this sense, the judge considered that tax authorities should be able to, by means of interpretation of the facts, prove that, even though the taxpayer had complied with TP legislation, the operations were "underpriced". The reporting judge understood that, upon assessment, it was shown that the operations "had not actually existed" and were used as a means to mask the actual operation, which was a direct export to the final consumers. On these grounds, the court expressly accepted that there were other means of evaluating controlled transactions, besides the application of TP legislation.

In this first case, a dissenting judge considered that the only situation in which controlled transactions could be reviewed was in case of violation to TP legislation, given that the referred rules expressly referred to the case of transactions with companies in tax havens. Accordingly, the referred legislation includes the adequate provisions to combat tax avoidance in situations involving tax havens. For this judge, the tax authorities would not be entitled to analyse the organizational structure of the company, the existence of employees or other general aspects of the business of the company. In his understanding, these were offshore companies that obviously do not have the same structure as an ordinary commercial company. In this sense, the form elected by Brazilian tax law to deal with such situations would be the control of TP, and not the disregarding of legal transactions by means of substance-over-form considerations.

In four subsequent cases concerning the same company and operations,[74] but referring to other periods, the understanding of this initially dissenting vote prevailed. Even though other aspects were considered, the change in the decision was mainly due to the interpretation of how TP rules and

73. CARF, Judgment 105-17.084, decided on 25.06.2008.

74. CARF, Judgment 1402-00.752, decided on 30.09.2011; Judgment 1402-00.753, decided on 30.09.2011; and Judgment 1402-00.754, decided on 30.09.2011. The understanding was confirmed by a decision of the Superior Chamber of the CARF (CSRF), Judgment 9101-01.402, decided on 17.07.2012.

the CARF's doctrine should interact. In these judgments, the court decided that one may not speak of sham in such cases if the companies have fully complied with TP legislation. One of the judges argued that TP legislation would be specific anti-avoidance rules. Thus the only way by which tax authorities could assess the operation would be by proving that the prices between related parties were in breach of TP rules.

Hence, despite the fact that the court expressly denied that the facts under consideration were a sham, one may conclude that the court opted for a hierarchy between the application of TP legislation and the application of the CARF's sham doctrine: where the taxpayer fully complies with TP legislation, there is no need to analyse the substance and purpose of the operations involving offshore companies.

Even though there are no procedural rules relating to the application of the CARF's doctrine in cases covered by SAARs (which include TP legislation), the approach adopted by the Superior Court of the CARF in the *Marcopolo* case is correct. If the taxpayer complied with the specific anti-avoidance legislation (the TP rules in the case), there is no need for further consideration with respect to the "abusiveness" of his transactions. TP rules offer an objective solution to the problem of mispricing of controlled transactions and there is no need for further consideration of the economic substance of such transactions. This fact becomes even clearer when the existence of other SAARs is considered, simultaneously applicable with TP rules.

9.5.2. The interaction between TP and limits on the deduction of interests

As from the enactment of the limits on the deduction of interests in 2010, the deductibility of interest payments to related parties abroad became subject not only to TP control, but also to the threshold set by Law 12,249/2010, as described in section 9.4.2.

At first glance, one could believe that such a provision would conflict with TP legislation. Further analysis reveals that this is not the case: while an antinomy would require an opposition between two (total or partially) contradictory provisions placing the interpreter in a position where no solution

is found in the existing rules,[75] it was the legislation itself[76] that clarified that the limits established to thin capitalization apply "without prejudice to the provision of Art. 22 of Law No. 9,430", providing for the TP auditing of interests. Unlike in the *Marcopolo* case, where no clear provision regarding the hierarchy of the rules could be found, in the conflict between TP rules and thin capitalization rules, due to the choice of the legislator himself, the rules are not in conflict but coexist. The question is how the application of both provisions should be harmonized.

When investigating the relation between the two legal provisions, it does not seem adequate to segregate the same amount of interests given different criteria in a way that, once the non-deductibility of a certain portion was recognized by the TP rules, the remaining (deductible) quota would be tested under the thin capitalization rules, or vice versa.

Such a position, moreover, would meet considerable practical difficulties. It is sufficient to say that while TP auditing is carried out on a contract-by-contract basis, the application of thin capitalization rules deviates from the monthly weighted average of debt and the equity's share.

Although no understanding on the matter has ever been derived from the courts, a more reasonable solution is to submit the whole amount of interests to both rules and consider, from the two limits arising thereof, the one indicating the lower deductibility. By considering the lower limit, the threshold set by the other rule is also met. Obviously it is not possible to sum both limits, since this could cause the non-deductibility found to exceed the amount of interests themselves.

9.6. Conclusion

In Brazil, the absence of a legislative decision introducing a GAAR was not seen as an obstacle for the tax authorities to apply anti-avoidance criteria, thus creating an uncertain environment for investments. The inconsistencies of CARF's case law subject similar structures to different solutions. The negative impact on free trade is immediate.

75. *See* T.S. Ferraz Jr., *Introdução ao Estudo do Direito* [Introduction to the Study of Law] (São Paulo, Atlas, 1991), p. 189.
76. Law 12,249/2010, art. 24.

The REFIS have successfully induced taxpayers to refrain from litigating for more than a decade. As a consequence, the final decisions on these questions have been handed down by the Administrative Court, and not by the judiciary. The path dependency entailed by more than one decade of CARF tax planning case law over the future decisions of the judiciary is still to be confirmed. One may expect the judiciary to be strongly influenced by the CARF's reasoning when analysing tax planning cases, or, at least, to be faced with the need to confront the arguments addressed therein.

Action 12 of the BEPS Project takes for granted that all G20 countries have enacted effective and comparable means of combating tax avoidance, which is not the case. Brazil still struggles in terms of legislation and institutional capacity with this regard.

The rationality developed within the administrative court is not shared by the legislative branch, which makes clear that there is a need to further discuss the issue of tax avoidance in Brazil. The Brazilian tradition in tax law demonstrates a strong rejection of open clauses that grant wide interpretation attributions to tax authorities. The current scenario shows that the alleged evolution in the Brazilian approach to tax avoidance is actually unsustainable. If the government agrees with the doctrine applied, the legislative authorities surely do not and the judiciary is still to be heard on this issue.

As a consequence, SAARs are a preferable solution when compared to GAARs, due to the Brazilian legal tradition based on the principle of legality. The introduction of SAARs, however, must be followed by the statement that, whenever a SAAR is applicable, there is no space for a residual application of a GAAR.

As seen in the *Marcopolo* case, if the taxpayer complies with TP legislation, no discussion whether there was an "anti-avoidance intention" on a taxpayer's pricing is necessary, provided that the requirements established by the legislation have been met. If anti-avoidance rules are inevitable, one should support the adoption of SAARs, all of them clearly stating standards that, once met, are enough for the anti-avoidance practice to be accepted or denied. GAARs should have a residual application, never being applicable when SAAR standards are met.

Chapter 10

Croatia*

Nataša Žunić Kovačević

10.1. The meaning of avoidance and aggressive tax planning and the BEPS initiative

10.1.1. The meaning of tax avoidance in national legal systems

The Croatian tax system does not define tax avoidance. Moreover, a cohesive approach to the problem of tax avoidance cannot be found in the legal system as a whole, including the relevant sub-division – the tax system. Although, under the influence of some wider and global actions and initiatives, it might be noted that certain steps to combat financial and tax non-discipline have been made.

Since the Croatian tax system is founded on the principle of legality, administrative regulations should not be expected to clarify the meaning of tax avoidance due to the lack of a legal basis and legislative framework and strong adherence of the Croatian judiciary to the constitutional principle of legality.

Croatian tax law has adopted the practice of advance tax rulings through the General Tax Act[1] amendments in 2015, after a previous failed attempt in 2009. Advance tax rulings are recognized as an important part of modern tax systems that aims at the protection of taxpayers' rights and achieving consistency in tax authorities' actions. Thus, the rule of law and legal certainty are the main objectives to be reached. It is noted that advance tax rulings might have other implications that should be analysed further. This analysis should also focus on the relationship between tax rulings and tax avoidance. For example, it is clear from the literature that taxpayers do

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1. General Tax Act (GTA), Official Gazette of the Republic of Croatia "Narodne novine" (OG), Nos. 147/08, 18/11, 78/12, 136/12, 73/13, 26/15, 44/16.

not request tax rulings, since they still prefer a wide range of tax planning arrangements, which sometimes includes tax avoidance behaviours. Since the Croatian tax system has just recently introduced advance tax rulings, it is not yet possible to determine any practice in this field, same as with the impact on tax avoidance.

As could be expected from the above-mentioned lack of legislative or other coherent approach to tax avoidance, there is no settled or any case law on the meaning of tax avoidance. The existing case law might be found only on tax evasion issues, and is still rare and non-settled.

Considering the developments relating to the OECD BEPS Report, it has not been a topic of debate in the Croatian tax community, therefore it might be said that BEPS had no repercussion on the meaning of avoidance in the Croatian legal system. Perhaps the impact could be seen through some procedural and institutional amendments during 2012 and 2016. That is to say, some "mandatory" changes of the legal framework regarding the exchange of information happened, from which it is possible to conclude that the BEPS initiatives opened the path to Croatian tax legislation amendments and finally the adoption of advance tax rulings. This led to the establishment of a special sector for tax fraud as part of the Croatian Ministry of Finance.[2] Also, the GTA's provisions regulating piercing the corporate veil have been first introduced by amendments, which were effective from 1 January 2013. These provisions contain a special procedure for proving abuse of rights concerning, for example, a director, shareholder or related party, presenting the provisions that facilitate the piercing of the corporate veil in the tax procedure and for tax purposes. The 2012 GTA amendments introduced new categories of statutory guarantors for the tax liabilities of companies. This refers to company members, board members, and executive directors and associated parties, whose abuse of rights and authority has resulted in the company's incapacity to pay a tax debt. The liability of the aforementioned persons must be determined in a special form of tax procedure, exhaustively regulated as part of the tax procedure. The GTA provisions that introduced the piercing of the corporate veil have caused problems in their application.[3] Under similar conditions, in 2016, the Corporate Income Tax

2. Regulation on the internal organization of the Ministry of Finance, OG, Nos. 32/2012, 67/2012, 124/2012, 78/2013, 102/2013, 24/2014, 134/2014, 154/2014. The amendments in 2014 established the independent sector for detecting tax frauds.
3. Chapter VIa of GTA: Special provisions for determining abuse of rights, Art. 158a to 158f.

Act[4] was amended. This was done by implementing Council Directive (EU) 2015/121[5] amending Directive 2011/96/EU on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States, which opened some discussion on the tax avoidance issue. Reasons for the CITA 2016 amendment were provided by the Ministry of Finance in the text of the Law on Amendments to the CITA with the final draft of the Act, the reasoning of which is presented below.[6]

10.1.2. The meaning of tax planning, abusive tax planning and aggressive tax planning in national legal systems

In the context of tax planning, it is useful to underline that this term is used *stricto sensu*, meaning planning targeted at the avoidance of taxation, since it is obvious that this term might be understood also as a general action of the taxpayer without any intention other than the pure estimation of tax consequences that will arise with future activities of the taxpayer.[7]

The discourse on tax avoidance issues mentioned above applies equally to the tax planning, abusive tax planning or aggressive tax planning determinations. There is no legal definition or administrative regulation that clarifies the meaning of tax planning, abusive tax planning or aggressive tax planning in the Croatian legal system. The same applies to case law, since no case has even been registered yet. Seeing that no study has been conducted on the matter of the compliance of Croatian tax legislation with ECJ case law, in general, it is not possible to predict its influence on the development of Croatian anti-avoidance tax policy. In view of the latest developments at the EU and international level, it is advisable to follow the tax avoidance concept delimited by the ECJ that could serve as an appropriate interpretative guideline to the tax administration and the national judiciary.

4. Corporate Income Tax Act (CITA), Official Gazette of the Republic of Croatia, Nos. 177/04, 90/05, 57/06, 146/08, 80/10, 22/12, 148/13, 143/14.
5. OJ L 21, 28 Jan. 2015, pp. 1-3, available at http://data.europa.eu/eli/dir/2015/121/oj.
6. Working Paper of the Croatian Parliament, available at http://www.iusinfo.hr/Appendix//RDOCSB_HR//entid_2002062.PDF.
7. Markus Diller and Pia Vollert, *Economic Analysis of Advance Tax Rulings*, Arqus Diskussionsbeiträge zur Quantitativen Steuerlehre [arqus Discussion Papers in Quantitative Tax Research] no. 122 (August 2011), p. 2, available at http://www.arqus.info/mobile/paper/arqus_122.pdf.

10.2. The reaction to avoidance and aggressive tax planning in the BEPS context

10.2.1. Domestic general anti-avoidance rules (GAARs)

The Croatian tax system does not contain a GAAR. Although the rationale behind this is examined in several academic studies,[8] it should be mentioned that opposing viewpoints might be found in the literature as well. As pointed out in publications,[9] such a view can be attributed to a misunderstanding of the "economic approach principle", as introduced in Art. 10(1) of the GTA. That is to say, Art. 10(1) of the GTA sets out that "[T]ax facts shall be determined according to their economic essence". In addition, Art. 10(2) of the GTA prescribes that "[I]f the revenue, income, profit or other assessable benefit was acquired without a legal basis, the tax authority shall determine the tax liability in accordance with a special law regulating certain types of taxes".[10]

It seems that, although the purpose of these provisions is comparable to those of a GAAR, they cannot be defined as general rules enabling the tax administration to fight efficiently against tax avoidance. The economic approach principle of the GTA presents a codification of the substance-over-form approach and a useful, legitimate tool for the tax administration in the process of determining and classifying tax facts.

Even though these provisions on the economic approach principle have been part of Croatian tax law since 2001, with the first codification of tax procedural rules in Croatia when the GTA entered into force, there is little

8. *See* N. Žunić Kovačević, *A Comparative Look at Regulation of Corporate Income Tax Avoidance*, Chapter 5: Croatia (K.B. Brown ed., Springer 2012), p. 127; R. Prebble, *Does Croatia Need a General Anti-Avoidance Rule? Recommended Changes to Croatia's Current Legislative Framework*, 29 Financial Theory and Practice 3 (2005), p. 212; Z. Prebble et al., *Comparing the General Anti-Avoidance Rule on Income Tax Law with the Civil Law Doctrine of Abuse of Law*, 62 Bulletin for International Taxation 4 (2008), p. 154; T. Rogić Lugarić et al., *Pravni status poreznih izdataka: stanje i perspektive*, Zbornik radova s konferencije Skrivena javna potrošnja, Institut za javne financije (2012), p. 190; N. Žunić Kovačević and S. Gadžo, *Institut zakonskog poreznog jamstva nakon novele Općeg poreznog zakona 2012.: "Proboj pravne osobnosti" trgovačkih društava u slučaju zloporabe prava*, 34 Zbornik Pravnog fakulteta u Rijeci 1 (2013), p. 410.

9. *See further* Nataša Žunić Kovačević, Stjepan Gadžo, Sabina Hodžić and Irena Klemenčić, *Croatia*, in: Michael Lang, Jeffrey Owens, Pasquale Pistone, Alexander Rust, Josef Schuch and Claus Staringer, (eds.), *GAARs – A Key Element of Tax Systems in the Post-BEPS World* (IBFD, Amsterdam 2016), pp. 205-218.

10. Translation by Croatian tax administration, available at http://www.porezna-uprava.hr/en_propisi/_layouts/in2.vuk.sp.propisi.intranet/propisi.aspx#id=pro117.

case law available, both on the administrative and judicial level. It is possible to find several cases where the jurisprudence underlines the economic approach. As for administrative cases, where tax authorities refer to the economic approach, it is usually cause or reason for judiciary control. Nevertheless, it is worth mentioning that tax authorities have published their standpoints as public rulings and interpretations (there are only two available) with reference to the same economic approach from Art. 10 of the GTA. The first addresses the issue of tax deductible expenses in the assignment of receivables with an unusually big commission.[11] The second opinion referred to the issue of the tax treatment of leasehold improvements in the case of termination of contract.[12]

Following from the rules described above, Art. 11 of the GTA regulates additionally, as the principle of tax procedure, a mechanism targeted at preventing the abuse of legal form. It is prescribed that "[I]f a sham transaction conceals another legal transaction, the basis for the assessment of tax liability shall be that concealed legal transaction". For that reason, Art. 11 of the GTA empowers tax authorities to change the qualification of transaction.[13]

The term "sham" applies to a situation where the genuine intentions of the relevant parties do not match what they have reported to the tax authorities with respect to relevant transactions.[14] Croatian jurisprudence has had a few opportunities to recognize the importance of the reviewed GTA provisions. There are some examples of case law in this field where courts confirmed the administrative standpoints – the tax authorities' conclusion: for example, a case where it was determined that in such circumstances where the sales contract conceals the other legal business loan agreement – then input VAT cannot be recognized (input invoices), because it is a sham transaction,[15] or a case where it was confirmed that tax authorities shall assess whether another transaction is concealed behind the concluded legal transaction, is concealed other transaction which is the real basis for tax assessment.[16] Similarly, in a case where the administrative court confirmed the findings of the tax audit on the concealment of the sales agreement where the partnership agreement

11. Ruling class: 410-01/11-01/2470, no. 513-07-21-01/11-2, available at http://www.iusinfo.hr/OfficialPosition/.
12. Ruling class: 410-01/10-01/1551, no. 513-07-21-01/10-2, available at http://www.iusinfo.hr/OfficialPosition/.
13. S. Kapetanović, *Prividni pravni poslovi*, Porezni vjesnik (Tax News) 3 (2010), pp. 40-42.
14. R. Prebble (2005), *supra* n. 8, p. 215.
15. Judgment of the Administrative Court Us-10297/2004 of 4 June 2008.
16. Judgment of the Administrative Court Us-6583/2005 of 2 July 2008.

was a sham transaction,[17] it was underlined by the tax authorities (and by the court through the judgment) that, in accordance with Art. 10, para. 1 of the GTA with regard to determining the tax facts considered important to determine the effects of the agreement, the findings of tax facts would have to be dealt with from the economic point of view, regardless of how the parties have formally entitled this agreement or transaction.[18]

Considering the fact that Croatia has legislation allowing the tax authorities to combat shams, some find a GAAR superfluous for combating such transactions.[19] Tax avoidance and shams are different concepts, so a GAAR should be applied when the sham doctrine is lacking or is not strong enough. Sham transactions or simulations and tax avoidance are encompassed by the broader term of abuse of law. It is necessary to allow the tax authorities to reject behaviours proven to be a sham or motivated by tax avoidance. It is stressed in the literature that the Croatian tax system should regulate this matter through the provision intended to prevent fraudulent behaviour, especially in special or material tax legislation, for example the rules of the Profit Tax Act that apply for TP issues, thin capitalization and hidden profit payments.[20]

In favour of the view that the implementation of a GAAR in Croatian tax legislation is necessary, it is important to point out some contributing factors of the Croatian tax system and the Croatian legal system in general. Art. 51 of the Croatian Constitution[21] accordingly provides a general obligation to pay taxes by prescribing that everyone should participate in the defrayment of public expenses, in accordance with their economic capacity. The same article in paragraph 2 stipulates that the tax system should be based upon the principles of equality and equity. The GTA expands on these provisions in more detail, in particular through the provision on the principles of taxation procedure that is in Part II of the GTA.[22]

17. Judgment of the Administrative Court, Us-1792/2007 of 20 January 2010.
18. Id.
19. Id.
20. T. Rogić Lugarić et al. (2012), p. 190.
21. Constitution, Official Gazette of the Republic of Croatia, Nos. 56/1990, 135/1997, 113/2000, 28/2001, 76/2010, 5/2014.
22. Accordingly, Art. 9 GTA obliges the parties in the tax relationship to act in good faith, which is the basis for previously mentioned advance tax rulings. The principle of good faith conduct is further elaborated on by the Ministry of Finance Ordinance (Official Gazette of the Republic of Croatia, No. 59/09), but also advance tax rulings in the Regulation on advance tax rulings, correction of tax returns, statistical reports and tax settlement (agreement), OG; Nos. 78/15, 16/16.

Since Art. 19 of the Constitution sets out the principle of legality as the key principle of the Croatian legal and tax system, it is a prerequisite that any action undertaken by the tax administration targeting tax avoidance should be based on the law. Therefore, legislative interventions in this field are of great importance because the Croatian legal system is strongly devoted to the constitutional principle of legality. A long tradition of the literal interpretation of the law by the courts has similar consequences.[23]

In the period when the GTA was amended during 2015, inter alia, implementing advance tax rulings was seen as complying with EU legislation. As it was known that a GAAR would be required as an amendment, it was the unofficial standpoint of the Ministry of Finance that some rules might be taken as GAARs. It was obviously misunderstood as a principle.

There have been proposals from authorities recently on revising the tax system as a whole, to become more competitive, efficient and equal, but there is no official proposal on the introduction of a GAAR at the time this chapter was written. If policymakers opt for the introduction of such an anti-avoidance instrument, it is likely that its elements and wording will take into account developments at the EU level.

A GAAR should be considered as something larger and stronger than laws: it is a declaration or confirmation of the fundamental principle and rule on the issue at hand – whether the legislature or the judiciary has the principal competence to determine the absence of economic interest or, in general, on the distribution of competence for determining the abuse of rights and avoidance of taxation.

The proposal for the uniform regulation of GAARs in EU Member States' legislation, even the adjustment of already present GAARs, should be considered, since we believe it might become useful by enabling national courts to participate and follow comparative practices and case law in its application.

It seems that in the civil law countries there is a dominance of the doctrine of abuse of rights that target combating the abuse of law in general, and this dominance similarly applies in the area of tax law. In the field of tax law, these rules prohibiting the abuse of rights are based on the principle of equality and the equal treatment of all tax payers. Therefore, in this

23. Irena Klemenčić and Stjepan Gadžo, *Time to stop avoiding the tax avoidance issue in Croatia? A proposal based on recent developments in the European Union*, 38 Financial Theory and Practice 3 (2014), p. 290.

way, equity in taxation means that everyone has to bear the tax burden and pay taxes in accordance with the ability to pay or according to economic strength.

Within such a framework, tax planning or abuse of law, where a taxpayer bears less of a burden in proportion to its economic strength, constitutes a violation of the general principle of equality. The importance of this principle is clear since the principle of equality in taxation is a constitutional principle in a great number of countries.

10.2.2. EC Recommendation C(2012) 8806 of 6 December 2012 and subject-to-tax rule

At the time of the signing of the DTC between Croatia and Spain, an additional Protocol was signed containing the limited subject-to-tax rule referring to Art. 17 of the DTC:[24] "…the provisions of this Article shall not apply if the recipient of the income, being a resident Croatian, do not pay taxes or is exempted from paying tax on that income in accordance with Croatian law. In this case, such income may be taxed in Spain".[25] However, it seems that there is no official policy attitude towards introducing a subject-to-tax rule as proposed by the EC in the DTCs with Croatia.[26]

10.3. Transfer pricing rules, GAARs, specific anti-avoidance rules (SAARs) and linking rules

The first TP regulation in Croatia was established in 2005. OECD guidelines are implemented in the CITA and Regulation.[27] The tax administration published the Manual for TP audit in 2009.

24. Croatia-Spain DTC, the Official Gazette of the Republic of Croatia, where the international agreements are published "Narodne novine – međunarodni ugovori", (OG – MU), No. 3/06.
25. Croatia-Spain DTC, Art. 17 regulating pensions taxation, reads as follows "Subject to the provisions of paragraph 2 of Article 18, pensions and other similar remuneration paid to a resident of a Contracting State in consideration of past employment shall be taxable only in that State".
26. H. Arbutina and N. Žunić Kovačević, *The history of double tax conventions in Croatia*, 38 Financial Theory and Practice 2 (2014), pp. 221-245.
27. Corporate Income Tax Regulation, OG, Nos. 95/05, 133/07, 156/08, 146/09, 123/10, 137/11, 61/12, 146/12, 160/13, 12/14, 157/14, 137/15, 50/16.

Art. 13 of the CITA and Art. 40 of the CIT Regulation prescribe arm's length pricing as the basic principle to be followed and define the methods allowed and the documentation required to support prices between related parties. In general, arm's length pricing is required only for cross-border transactions between related parties. However, in line with the amendments to the CITA (in force as of 1 July 2010), the obligation to comply with TP rules is extended to transactions between domestic entities if one of the entities is either in a tax loss position or has a special tax status (paying tax at lower rate or exempt from paying corporate income tax). Croatian regulations do not provide detailed rules on how to arrive at the arm's length price that should be applied in related-party transactions. However, the CITA prescribes the following methods that can be used by taxpayers to determine the arm's length price: comparable uncontrolled price (CUP), resale-minus, cost-plus, profit split and transactional net margin method (TNMM). All five standard methods are allowed; however, traditional transactional methods (CUP, resale-minus and cost-plus methods) should have priority when establishing whether the conditions imposed between related parties are at arm's length. If possible, the CUP method should be applied and other available methods should be used on occasions when traditional methods cannot be reliably applied.

In the past few years, the tax authorities have increased their focus on prices applied in transactions with related parties and the frequency of TP audits. Due to limited experience in TP, the tax authorities tended to dispute service charges between related companies. However, tax inspectors have become more knowledgeable about TP. The tax authorities issued a manual containing instructions for tax inspectors to follow in TP audits, which also provides a translation of the OECD Guidelines. Therefore, the OECD Guidelines should represent a good theoretical basis for defining transfer prices and for preparing the documentation that supports them. Croatia has not implemented legislation concerning advance pricing agreements (APAs), but they are expected to be introduced in the near future as advance tax rulings have been implemented only recently, in 2015. There has been no litigation raised on the application of TP rules.

Croatia has included limitation on benefits clauses in several of its DTCs to prevent treaty shopping, e.g. in the case of the interpositioning of a company resident in a state that is party to a DTC by non-resident persons in order to take advantage of the benefits envisaged in the convention for certain income obtained in the other contracting state. That is the case with Croatia-Spain

DTC.[28] Similarly, the DTC concluded with the Netherlands prescribes that no relief shall be available under the DTC if the main purpose or one of the main purposes of any person concerned with the creation or assignment of the shares or other rights in respect of which the dividend is paid, is to take advantage of this DTC by means of that creation or assignment.[29]

Controlled foreign company (CFC) regimes are used in many countries as a means to prevent the erosion of the domestic tax base and to discourage residents from shifting income to jurisdictions that do not impose tax or that impose tax at low rates, but Croatian tax legislation does not contain CFC provisions.

Croatian tax legislation includes limits on the deduction of interest. Interest on loans granted by a shareholder, shareholder's related party or third party and guaranteed by the shareholder is not deductible if the shareholder holds 25% or more of the shares or voting rights of the taxpayer and the value of the loan exceeds four times the value of the shareholder's share in equity of the taxpayer. If the loans to which thin capitalization rules are applied exceed the 4:1 ratio, then the amount of interest exceeding this ratio is not deductible. The thin capitalization rules do not apply to loans granted by banks or financial institutions even in cases where the shareholder is the guarantor of a loan. Accordingly, for Croatian corporate profit tax law purposes: (i) the maximum amount of deductible interest on loans from a Croatian tax non-resident to a Croatian tax resident related party will also decrease from 7% per annum to 3% per annum; and (ii) the minimum acceptable interest rate on loans from a Croatian tax resident made to a Croatian tax non-resident related party for corporate profit tax purposes also decreases from 7% per annum to 3% per annum. These rules further apply to loans between two Croatian tax residents if one of them is in a "favourable" tax position.

While Croatia does not have a GAAR, various SAARs have been adopted over the years. It may be concluded from the previous legislative activity in this area that the introduction of a GAAR was considered to be unnecessary and that the policy choice was to rely on SAARs as cornerstones of anti-avoidance legislation. However, a more detailed analysis reveals that the special rules have often been adopted without a consistent underlying policy, leading to the conclusion that Croatian tax policymakers do not have a clear and coherent anti-avoidance approach.

28. Croatia-Spain DTC, *supra* n. 24.
29. Art. 10, para. 9, Croatia-Netherland DTC, OG – MU, No. 3/01. Art. 10/9.

SAARs are predominantly found in corporate tax legislation. For instance, the rules on withholding tax – a tax levied on certain items of passive income paid by Croatian residents to non-residents, subject to treaty restrictions – follow a similar design to other European countries, recognizing the existence of the "low tax" jurisdictions. Consequently, Art. 31(10) of the CITA sets out that the withholding tax must be levied at a higher rate (20%) if the recipient of the pertinent income is resident in a tax haven country, i.e. resident in one of the 50 countries enumerated in the special list issued by the Ministry of Finance and published on its website.[30]

In the Croatian tax system, there are provisions that enable a legal reduction of taxes, introduced with the intention of benefiting certain areas[31] and encouraging certain activities, e.g. corporations employing a certain number of employees, scientific activities, education and the training of employees. Until 2001, the allowance for corporate equity (ACE) and the use of an accelerated depreciation allowance were employed as measures against tax avoidance.[32] After the CITA entered into force in 2001, legal tax avoidance was possible through provisions on tax exemptions for investment in capital assets and allowances for the employment of new staff. This was abolished in 2006.[33] A number of special rules as SAARs, introduced with the aim of curbing tax avoidance, can be found in the CITA *de lege lata*.[34]

Similarly, the other SAAR is targeted at the abuse of options to reduce the corporate tax base via reinvesting the company profits, i.e. increasing the capital of the company for investment and development purposes. While this special tax benefit – under Art. 6(1)(6) of the CITA – was introduced in 2012 with the goal of helping the real economy in times of economic crisis to make new investments and contribute to economic growth,[35] the legislator recognized its possible use as a tax avoidance instrument.[36] Therefore, the taxpayer who uses this tax benefit must, within six months after the expiry of the deadline for the filing of a corporate income tax return, present to the competent local office of the Tax Administration evidence of the increase

30. *See* http://www.porezna-uprava.hr/hr_propisi/_layouts/in2.vuk.sp.propisi.intranet/propisi.aspx#id=pro22.
31. R. Prebble (2005), *supra* n. 8, p. 213.
32. N. Žunić Kovačević (2012), *supra* n. 8, p. 127.
33. N. Žunić Kovačević (2012), *supra* n. 8, p. 127.
34. *See* CITA, Art. 20p, Art. 31.d, as implementing Directive 90/434/EEZ i 2005/19/EZ.
35. K. Cipek et al., *Porezna olakšica za reinvestiranu dobit*, Porezni vjesnik (Tax News) 12 (2012), p. 53.
36. *See* Š. Jozipović, *Tendencies in Croatian Tax Law regarding CFC Legislation*, European Tax Studies 1 (2013), p. 6.

of registered capital effected by the profit earned in the tax period for which the reduced tax base has been declared. Moreover, the entitlement to reduce the corporate income tax will not be granted if it is obvious that the intention behind the increase of the company's capital was tax fraud or tax evasion. The latter provision, in Art. 6(7) of the CITA, is especially significant because it is an explicit SAAR. Although the term "tax avoidance" is not defined in the CITA, it can be assumed that this provision targets not only illegal tax avoidance, i.e. tax fraud, but also the activities aimed at the reduction of the tax burden that are not intended to produce a reinvestment effect but just tax relief.[37] It is difficult to make assumptions about the approach of the Tax Administration in determining the purpose of the capital increase.[38]

As in most civil law countries, the corporate income tax base in Croatia is calculated using the company's financial accounts as the starting point. Art. 8 of the CITA contains a thin capitalization rule, providing that the taxpayer's accounting profit/loss must be increased by the interest on shareholder loans. The conditions are that the shareholder holds at least 25% of the taxpayer's capital/voting rights and the loan exceeds four times the amount of his holding. For these purposes, the loans received by the company from third parties, guaranteed by the shareholder, are considered to be shareholder loans, as it is mentioned above. Finally, there are the CITA's rules amended during 2016.

The CITA stipulates, in line with Council Directive 2011/96/EU, regulations regarding the taxation of income from dividends and share in profits and taxation of dividend payments and profit sharing to withholding tax, subject to certain conditions, and the elimination of double taxation. However, as stated exemption might be mismanagement, Council Directive (EU) 2015/121 prescribes a minimum rule against abuse. This rule prescribes that the use of the exemptions prescribed by the Directive will not be allowed in the case of the establishment of an arrangement or set of arrangements that are not authentic.

Thus, the amendments to the CITA introduced a minimum rule against abuse to curb aggressive tax planning, which will be applied in the case of the establishment of an arrangement or series of arrangements that, with regard to all the relevant facts and circumstances, is not authentic, i.e. that do not reflect economic reality. According to the amended CITA,

37. Id., p. 10.
38. TPA Horwath, *Bez poreza na dobit – unos dobiti u temeljni kapital*, Newsletter 04/2013, available at http://www.tpa-horwath.hr/sites/default/files/newsletter/downloads/tpa_horwath_newsletter_04_-_2013_1.pdf.

in accordance with the application of the Directive, an arrangement or set of arrangements is considered to be inauthentic to the extent that it is not established for legitimate commercial reasons that reflect economic reality, that is, if they are established in order to evade or avoid tax. Thus, the CITA stipulates provisions according to which it would be possible to deny the right to use certain benefits for reducing the tax base, exemptions from the payment of corporate income tax and withholding tax, or tax credits, in cases where it is established that the taxpayer has set out to achieve those benefits as the main purpose or one of the main purposes of the arrangement or set of arrangements that, with regard to all the relevant facts and circumstances, is not authentic.

With regard to corporate income tax liabilities determined for the tax period, which is typically the calendar year,[39] according to the tax base determined for the tax period and the tax rate in accordance with the provisions of the CITA,[40] the proposed law is to deny the right to use certain benefits in terms of a reduction of the tax base. Since income tax is determined for the tax period, which is typically the calendar year, beginning on 1 January, the CITA stipulates the retroactive application of this provision, which will include the tax period from 1 January 2016. Namely, a justified reason, in accordance with Art. 90, para. 5 of the Croatian Constitution, for which it provided for the retroactive effect of the provisions of amended CITA rules, are reflected in the need for data collection, while respecting the rules of reporting in relation to establishing the income tax liability that is prescribed by law. In fact, when checking the abuse of an arrangement or set of arrangements, the tax administrations of the Member States should carry out an objective analysis of all relevant facts and circumstances, which can be determined by taking into account data from annual income tax returns, as well as from data contained in accounting books kept in accordance with accounting regulations, accounting standards and financial statements, which are compiled on the basis of special regulations.[41]

Furthermore, the CITA's minimum rule against abuse will not only be applied to prescribed exemptions and benefits regarding the taxation of dividends and share in profits, but will also be applied in other cases when it is observed that the taxpayer, with a view to the use of certain rights prescribed by law, in connection with the impairment of the tax base or tax liabilities, established an arrangement or set of arrangements that is not authentic. The

39. Art. 29, para. 1 CITA.
40. Art. 32, para. 1 CITA.
41. Balance sheet, profit and loss (which are an integral part of the annual income tax returns) in accordance with Art. 33, para. 1 CITA.

establishment of a non-authentic arrangement or set of arrangements is seen in situations where an arrangement or set of arrangements includes elements that have the effect of mutual set-off or cancellation; circular transactions, when the arrangement or set of arrangements is implemented in a way that would not otherwise be used in reasonable business practices; or when the legal characteristics of individual measures that make up the package are not in accordance with the legal content of the arrangement as a whole; or when it is determined that the intention of the taxpayer is contrary to the objective, essence and purpose of certain benefits under the CITA. It seems that the Croatian legislator expanded the application of the Directive so this minimum anti-avoidance rule will be applied not only in the case of parent companies and subsidiaries of different Member States, but to all taxpayers defined by CITA.[42] The retroactive effect of these provisions of the amended CITA rules points to a possible solution to the tax avoidance phenomenon.[43]

10.4. Application of GAARs, TP rules and SAARs

Since Croatia does not have a GAAR, it is hard to imagine what the relation between a GAAR and the above-mentioned SAARs would be. It is arguable whether there is a place to apply rules in accordance with the *lex specialis* doctrine. It could be pointed out that in an approach where specific anti-avoidance rules co-exist alongside a GAAR, the former should apply, excluding the application of a GAAR – which would be in accordance with legal certainty requirements.

The relationship between GAARs and tax treaties has always been a controversial issue. Considering the absence of a GAAR in the Croatian tax system, it is only possible to give a hypothetical view that the application of a domestic GAAR should be recognized as a prerequisite, in line with the Commentary on Art. 1 of the OECD Model Convention (para. 9.2.). It should be emphasized that the situation is much clearer with regard to those tax treaties that expressly allow the application of domestic anti-avoidance rules.[44] In this context, it is important to mention the fundamental principle of the prohibited retroactive application of tax provisions, as prescribed in Art. 5 of the GTA.

42. Art. 5a CITA.
43. Art. 3 Act on the CITA Amendments, OG *No.* 50/16.
44. Such provisions are in the DTC with Israel (2006) and Portugal (2014).

Chapter 11

Czech Republic

Dana Nerudová and Veronika Solilova

11.1. The meaning of avoidance and aggressive tax planning and the BEPS initiative

11.1.1. The meaning of tax avoidance in national legal systems

There is no legal definition of tax avoidance in the Czech legal system. Despite this, tax administrators apply the general concept of tax avoidance (in accordance with the abuse of law doctrine). The Czech tax judiciary has used the term tax avoidance since 2005, when the Supreme Administrative Court defined tax avoidance as the following: "Abuse of law is a situation when someone carries out a subjective right to unjustified harm of someone else or society; such behaviour, through which illegality is achieved, is only seemingly allowed".[1] Two years later, the Constitutional Court made the following remark about the abuse of law:

> Abuse of law (abusus iuris) is a behaviour seemingly allowed, which is intended to achieve an illegal result the specific case of abuse of law is a vexatious behaviour, which lies in the fact that someone has exercised his right with the intent to cause disproportionate harm to another one. The behaviour is seemingly allowed by objective law while it is simultaneously illegal; the principle of lex specialis derogat generali shows that the prohibition of abuse of law is stronger than what is allowed by law.[2]

In tax law, tax avoidance can be considered an action of taxpayers to reduce their tax liability in a way that is not inconsistent with the linguistic interpretation of legal norms, but inconsistent with the purpose of the legislation.[3]

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1. Supreme Administrative Court, Case no. 1 Afs 107/2004-48 on 10 November 2015. Author's translation.
2. Constitutional Court, Case no. III. ÚS 374/06 on 31 October 2007. Author's translation.
3. *See* M. Kohajda, *Zneužití práva v aktuálním českém daňovém právu a judikatuře*, in R. Boháč, et al., *Aktuální otázky financí a finančního práva z hlediska fiskální a monetární podpory hospodářského růstu v zemích střední a východní Evropy v roce* 2010, IX, International scientific conference, Praha: Leges, pp. 300-311.

In Czech case law, the abuse of law doctrine was first applied in a case where there was a deduction of gifts based on Art. 15(8) of the Income Tax Law no. 586/1992 (ITL), where a taxpayer made a gift to a civic association that was consequently used as a deductible item in the tax return.[4] This behaviour was considered by the judge to be an abuse of law, regardless of whether the taxpayer received benefits from the gift. Other case law concerning the abuse of law doctrine was related to value-added tax and the tax code.[5]

In respect of ECJ case law on the abuse of law, the Supreme Administrative Court and Constitutional Court, like the ECJ, make use of the "two limb test". Using this test, it is determined whether the law was abused, which would mean that the main purpose of the transactions concerned was to obtain a tax advantage that is inconsistent with the purpose of the legislation.[6] However, contrary to the ECJ, the Supreme Administrative Court is considering the fairness of social relationships, i.e. examining a question, whether the taxpayer caused unjustified harm to someone else or society through the abuse of law.[7] Thus the basic elements of abuse of law are the purpose of the transaction and the consequence of behaviour.

The Czech Republic uses general anti-abuse rules (GAARs) in the form of substance over form, the abuse of law doctrine, and the categorization of a legal action as illegal and as a deliberate reduction of the tax liability. Except for GAARs, there are TP rules and thin capitalization rules set out in the ITL as specific anti-abuse rules (SAARs). Moreover, the Czech Republic uses anti-abuse rules in its tax treaties.[8]

As mentioned above, the abuse of law doctrine was developed through case law. However, the professional community does not share a unified view on this issue of whether it would be better to define the concept precisely in the ITL or Tax Code.[9] Notwithstanding, the prevailing opinion is that omitting

4. For example, Supreme Administrative Court, Case nos. 2 Afs 7/2007-101; 1 Afs 10/2012-38; and 1 Afs 107/2004-48.
5. For example, Supreme Administrative Court, Case nos. 8 Aps 2/2007-6; 1 Afs 50/2007-06; 2 Afs 101/2007-49; and 8 Aps 2/2007-61.
6. For example, Supreme Administrative Court, Case no. 2 Afs 178/2005-64, which defines the main purpose of the transaction and uses the tests on tax abuse, particularly from the *Halifax* case.
7. Supreme Administrative Court, Case no. 2 Afs 173/2005-69.
8. Namely, general anti-abuse provisions, limitation on benefits, arm's length principle and others in the form of general principles/rules.
9. T. Sejkora, *Institut zneužití práva v právní úpravě daně z přidané hodnoty*, Acta Universitatis Brunensis, Juridica vol. 527, pp. 326-339. J. Zachová, *Vývoj daňové judikatury*

the abuse of law doctrine in law should leave flexibility for it to be used on a case-by-case basis, which would not be true if the legal provision existed.[10] This opinion has not changed in the BEPS era.

11.1.2. The meaning of tax planning, abusive tax planning and aggressive tax planning in national legal systems

The distinction between tax avoidance and tax planning seems to be difficult to determine, as both involve tax reduction provisions that may comply with the law.[11] Moreover, it is possible to view tax planning as compliant behaviour, while tax avoidance represents behaviour in the grey area.[12] Generally, if tax planning gets beyond an acceptable level so that it may fall under tax avoidance, then it is considered to be aggressive tax planning.

However, as in the previous instance (the definition of tax avoidance and abuse of law), tax planning, abusive tax planning and aggressive tax planning are also not explicitly defined in the Czech legal system. The Czech Republic does not distinguish between tax planning, abusive tax planning or aggressive tax planning. Generally, they are all considered to be planning, and if the behaviour of a taxpayer falls outside the wording of tax law, then it is classified as tax evasion.

The Czech Republic uses GAARs (such as those mentioned in section 11.1.1.) and specific anti-abuse rules (i.e. TP rules and thin capitalization rules) in the domestic legal framework. Further, the Czech Republic also uses anti-abuse rules in its tax treaties. However, BEPS will not have any repercussions for the above-mentioned, since the Czech Republic is not planning to introduce these concepts into its legislation.

v oblasti zneužití práva, Acta Universitatis Brunensis, Juridica vol. 527, pp. 382-394. J. Šefl, *Institut zneužití práva v právu daňovém*, in *Days of Law: the Conference Proceedings*, Brno: Masaryk University (2009).

10. J. Zachová, *Vývoj daňové judikatury v oblasti zneužití práva*, Acta Universitatis Brunensis, Juridica vol. 527, pp. 382-394.

11. Canada Revenue Agency, *Tax avoidance*, available at http://www.cra-arc-gc-ca/gncy/lrt/vvw-eng.html.

12. Institute of Business Ethics, *Tax avoidance as an Ethical issue for business*, available at http://www.ibe.org.uk/index.asp?upid=51&msid=8.

11.2. The reaction to avoidance and aggressive tax planning in the BEPS context

11.2.1. Domestic general anti-avoidance rules (GAARs)

The Czech Republic uses a GAAR, namely the substance-over-form rule, which is mentioned in Art. 8(3) of the Tax Procedural Code no. 280/2009 (Tax Procedural Code) for all taxes indicated in Czech tax law since the birth of the Czech Republic. However, its current wording is the result of interpretative disputes led by the Czech courts over several years. Currently, this substance-over-form provision entitles the tax authorities to look through any transaction and assess tax according to the real substance of the transaction, relevant for the tax administration.

Moreover, the Czech tax administration can use other provisions, namely (i) the abuse of law doctrine mentioned in case law and in Art. 8 of the new Civil Code,[13] based on which the clear abuse of law does not enjoy legal protection; and (ii) determining a legal action as illegal (Art. 580 of the Civil Code) provided that the legal action is contrary to the principles of morality or to the law (if the meaning and purpose of the law requires it), and finally the qualification of a legal action as an illegal reduction of the tax liability based on Art. 23(10) of the ITL, which is considered to be a principle of abuse of law according to the decision of the Supreme Administrative Court.[14]

11.2.2. EC Recommendation C(2012) 8806 of 6 December 2012, subject-to-tax rule and the ATAD

The Czech Republic as an EU Member State considers the EC Recommendation (8806) proposing a subject-to-tax rule aimed at dealing with double non-taxation, as follows:

> 3.2.….Member States are encouraged to include an appropriate clause in their double tax convention ("DTC")…it could read as follows: Where this DTC provides that an item of income shall be taxable only in one of the Contracting States ("CS"), the other CS shall be precluded from taxing such item if this item is subject to tax in the first CS.

13. Act no. 89/2012 of Coll.
14. Decision no. 1 Afs 35/2007-108.

> 3.3. 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 the item is not subject to tax, Member States are encouraged to ensure that the item is taxed.
>
> 3.4….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.

From a tax treaty point of view, the subject-to-tax rule is generally set out in all Czech tax treaties, specifically in the context of the person to whom the tax treaty is applied, i.e. the resident of one or both of the contracting states. Currently, this rule is also used in relation to the exemption method resulting in double non-taxation, provided that the subject-to-tax rule is not applied. Of course, this situation is contrary to the intended purpose of the tax treaty.

The Czech Republic uses the credit method for the elimination of double taxation or double non-taxation in almost of all its tax treaties. It means that if the foreign income is not taxed in the source state, then the whole income is subject to tax in the residence state (i.e. in the Czech Republic) without resulting in double non-taxation. Further, in cases where the foreign income is taxed in the state of source, then the Czech Republic grants the deduction of the amount equal to the tax paid (as a maximum amount) in the source state from the amount of tax computed on such a base. Moreover, proof of the tax paid in the source state must be provided to the Czech tax authority, otherwise the credit method cannot be applied. Therefore, the risk of double non-taxation is minimal in Czech tax treaties, as only the oldest tax treaties include the exemption method with the risk of double non-taxation. In those cases, the Ministry of Finance welcomes the subject-to-tax rule that eliminates the double non-taxation and will try to include it during the negotiation of the new tax treaties, which shall be updated.

With respect to the GAARs and SAARs suggested by the Anti-Tax Avoidance Directive (ATAD), two GAARs and one SAAR have been applied in the Czech Republic, namely the substance-over-form rule, the abuse of law doctrine and interest limitation rule. The rest of the tools suggested by the ATAD have not been applied in the Czech Republic.

The two GAARs that can be found in the legislation of the Czech Republic are as follows: (i) the substance-over-form rule, which is comprised in Art. 8(3) of the Tax Procedural Code;[15] and (ii) the abuse of law doctrine, which

15. Daňový řád (Tax Procedural Code) 2009, Art. 8 (amended 2014).

was developed by the Supreme Administrative Court under the influence of the ECJ and constitutional court.

The non-existence of the abuse of law doctrine as a provision in the Tax Procedural Code,[16] but rather as a doctrine developed by the Supreme Administrative Court, leads us to the opinion that the domestic GAAR does not correspond to the GAAR proposed under the ATAD and will have to be redrafted. However, the Czech Republic does not see the intrinsic value of introducing or revising its GAAR on the basis of the 2012 EC Recommendation C(2012) 8806 of 6 December 2012 and the ATAD, as the current GAAR works well and is very similar in effect to the GAAR proposed in the EC Recommendation. Therefore, the introduction or revision of the GAAR is not expected in the Czech Republic in the near future.

With respect to the SAARs suggested by the ATAD, existing domestic SAARs will have to be redrafted and new ones introduced. Currently, the interest limitation rule is covered in Art. 25(1) of the ITL and sets the maximum debt-to-equity ratio on 4:1, and in the case of bank and insurance companies on 6:1. In this respect, the thin capitalization SAAR will have to be redrafted and the limit will have to be tied to earnings before interest, taxes, depreciation and amortization (EBITDA).

The exit taxation suggested by Art. 5 of the ATAD is currently not applied in the form of a SAAR in the Czech Republic, nor the switchover clause in Art. 6 of the ATAD or CFC rules suggested by Art. 8 of the ATAD.

The provision in reaction to hybrid mismatch problems has been suggested in the Czech Republic already in connection with the amendment from the Parent-Subsidiary Directive in the form of Art. 19(2)(c) of the ITL. Further, Government Decree no. D-286 comprises a similar rule as in BEPS Action 2. It stipulates that benefits from the treaties cannot be granted to non-transparent entities. Moreover, the suggested wording in BEPS Action 2 of Art. 4(3) of double taxation treaties (on which Art. 10 of the ATAD is based) has already started to be used in some of the treaties concluded – e.g. double taxation treaty with Mexico[17] and Canada.[18]

16. Id.
17. Treaty no. 7/2003 of Coll.
18. Treaty no. 83/2002 of Coll.

11.3. Transfer pricing rules, GAARs, specific anti-avoidance rules (SAARs) and linking rules

11.3.1. Transfer pricing rules

The Czech Republic has used TP rules in the form of the arm's length principle since 1 January 1993, when the ITL containing the TP provisions for related parties in Art. 23(7) entered into force. TP rules are stipulated both for cross-border transactions between related parties and domestic transactions between related parties situated in the Czech Republic without any exception. In this way, any price resulting in non-compliance with the arm's length principle by the related persons is affected by this provision, i.e. if the agreed price differs from the fair market price and this difference is not satisfactorily explained, then the tax base of the taxpayer is adjusted by the ascertained difference.

Except for the TP provision in Art. 23(7) of the ITL, a similar provision is also set out for PEs in Art. 23(11), which contains the arm's length principle for the determination of the tax base of a non-resident's PE situated in the Czech Republic, i.e. the tax base shall not be lower (or the tax loss higher) that the tax base (or the tax loss) of a resident taxpayer performing the same or similar activities under similar conditions. Moreover, the provisions stipulate the methods for the determination of the tax base.

The ITL does not contain any provisions related to the TP methods or the preparation of TP documentation. For this purpose, the Ministry of Finance and the General Financial Directorate issued guidelines concerning the interpretation and application of the TP rules mentioned in the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations (TPG). Currently, the following four guidelines are in force:

(a) Decree D-332 on the Communication by the Ministry of Finance in respect of international standards application in taxation of transactions between associated enterprises – TP. The decree covered the basic principles of TP, such as the arm's length principle, TP methods, comparability analysis, the relevance of the TPG and tax treaties.

(b) Decree D-333 on the Communication by the Ministry of Finance in respect of §38nc of Act no. 586/1992 Coll., on income taxes – binding consideration over the TP policy used in related-party transactions.

(c) Decree D-334 on the Communication by the Ministry of Finance in respect of the scope of TP documentation.

(d) Decree D-10 on the Low Value Adding Intra-Group Services, which clarifies that cost plus margin in the range of 3% up to 7% is arm's length, provided that it is applied for low value-adding intra-group services fulfilling criteria set out in the decree.

The Czech tax administration is fully aware of the complexity of TP and therefore the *binding consideration over the TP policy used in related-party transactions* can be requested from the tax authorities for a fee of CZK 10,000. This tool could be considered the unilateral APA. Moreover, the Czech tax administration also offers bilateral or multilateral APAs. However, it is not possible to appeal against a decision issued by the tax administration.

TP documentation is not mandatory in the Czech Republic. Notwithstanding, there is an indirect obligation to prepare it, based on Art. 92(3) and Art. 97(2) of the Tax Code Law,[19] i.e. the taxpayer must be able to substantiate all facts resulting from its tax return and its tax position. Therefore, the TP documentation is deemed to be part of the taxpayer's general administration and is usually requested during the tax audit. Moreover, since 2015, the Czech tax administration set out a new obligation for reporting of the related parties and their related-party transactions (e.g. transactions of tangible and intangible property, services, interest, royalties and goods) when filing a tax return. Only taxpayers whose financial statements are subjected to a statutory audit are obliged to disclose this new report. The new information received can be used to identify taxpayers for a potential tax audit in the area of corporate taxation and thus also in TP.

TP documentation and APAs are being used more frequently in the Czech Republic as a result of the specialized tax office for large taxpayers and stronger focus of the Czech tax administration on TP issues. Moreover, APAs and TP documentation are suitable tools for the elimination of TP disputes that arise mainly because the only definition of the arm's length principle and related parties together with binding considerations over the TP policy used in related-party transactions are set out in ITL and other TP rules and principles are mentioned in decrees with references to the TPG.

19. Act no. 280/2009 of Coll.

From the viewpoint of the burden of proof – the Supreme Administrative Court (Decision no. 7 Afs 74/2010-81 of 27 January 2011) states that the burden of proof generally rests on the taxpayer; however, regarding TP the tax authorities must demonstrate that the price agreed between related parties differs from the price that would have been agreed on by independent parties in substantially similar circumstances, i.e. non-compliance with the arm's length principle. The claim of the taxpayer cannot only be impugned.

However, it is important to highlight that by submitting supplementary tax returns, previous statements in tax returns are denied. In this case, the burden of proof in TP disputes again rests with the taxpayer based on the decision of the Supreme Administrative Court (no. 1 Afs 99/2012-52 of 13 March 2013). A similar statement can be found in case no. 7 Afs 94/2012-74 on the investment incentives including tax relief. In this case, the compliance with the arm's length principle is a necessary condition for claiming tax relief and the taxpayer has to demonstrate that the arm's length principle has been followed.

From the viewpoint of the determination of the arm's length price – the Supreme Administrative Court (Decision no. 7 Afs 74/2010-81 of January 2011) emphasized that the tax authorities must carefully examine whether the prices in controlled transactions were agreed to under the same or similar conditions, and must make appropriate adjustments if needed (i.e. to receive comparables). Moreover, this decision was consistent with the previous case law (e.g. no. 8 Afs 80/2007) about the determination of the arm's length price in the form of a range and an adjustment of the taxpayer's transfer price to the end of the range that is the most beneficial for the taxpayer.

Another case of the Supreme Administrative Court (no. 8 Afs 51/2009) states that one arm's length price based on one comparable company is not sufficient probative means for the determination of the arm's length price. Moreover, tax authorities have to submit to the taxpayer all information about the way of the determination of the arm's length price so that the taxpayer received an opportunity to react and explain the difference. The obtaining space (time and material) was further emphasized in Decision no. 1 Afs 101/2012. The same requirements are used in the case of a valuation report.

In respect of the valuation report, the Supreme Administrative Court emphasized in case no. 2 Afs 67/2012-40 of 11 February 2014 that the valuation report prepared for the purpose of real estate transfer tax cannot be used for

the determination of the arm's length price for income tax purposes. Further, in another case (no. 7 Afs 53/2010) the court states that tax authorities are not entitled to decide which of two valuation reports shall be used, if they include different results. They need to eliminate differences through interviews with valuation experts or by a new valuation report.

11.3.2. LOB rules or anti-abuse provisions in tax treaties

Besides the above TP rules, the Czech Republic applies other principles/rules that aim to protect tax bases. The most common principles that can be found in Czech tax treaties include the definition of resident, place of effective management and beneficial ownership. Further, the Czech Republic introduced anti-abuse provisions in the form of general anti-abuse provisions and limitation on benefits (LOB). In respect of LOB, the Czech tax administration also issued Decree D-286 on taxing the income of non-residents arising from sources in the Czech Republic, which stipulates that benefits from treaties cannot be granted to non-transparent entities.

However, the Czech tax administration takes the position that it is better to focus on the GAARs than on the LOB alone in tax treaties, which only attempts to combat treaty shopping. Therefore, the new Czech tax treaties[20] or the Protocol[21] amending the tax treaty include statements about LOB to any person or company together with a statement on using domestic anti-abuse rules in the articles on LOB or miscellaneous provisions/rules or preventing improper use of the agreement, as follows:

> Benefits provided under this Agreement shall not be granted also to companies of either Contracting State if the purpose of the establishment of such companies was solely to obtain benefits under this Agreement that would not otherwise be available. […][22] The competent authority of a Contracting State may, after consultation with the competent authority of the other Contracting State, deny the benefits of this Convention to any person, or with respect to any transaction, if in its opinion the granting of those benefits would constitute an abuse of the Convention according to its purpose.[23]

20. United States, Panama, New Zealand, Luxembourg, Jordan, Columbia, Kuwait, Bahrain, Syria, Uzbekistan, Hong Kong, Saudi Arabia, Barbados, China, Ethiopia and Armenia.
21. Cyprus, Philippines, Azerbaijan, Belgium and Switzerland.
22. In tax treaties agreed with China, Armenia, Columbia and others. *See* Table 11.1. "To company".
23. In tax treaties agreed with China, Armenia, Columbia, Ethiopia, Luxembourg and others. *See* Table 11.1. "To person".

Some of the tax treaties include a mixed statement of LOB to any person or company, as follows:

> The competent authorities upon their mutual agreement, may deny the benefits of this Agreement to any person, or with respect to any transaction undertaken by such a person, if in their opinion the main purpose of the creation or existence of such a person or of the transaction undertaken by that person, was to obtain the benefits under this Agreement that would not otherwise be available.[24]

Moreover, almost all those tax treaties include the statement about using domestic anti-abuse rules, as follows:

> The provision of this Convention shall in no case prevent either Contracting State from the application of the provisions of its domestic laws aiming at the prevention of fiscal avoidance or evasion, in particular, but is not limited to, the provisions on thin capitalisation, TP and substance over form.[25]

Table 11.1. provides a reference for how LOBs and anti-abuse rules are used in Czech tax treaties.

Table 11.1. Summary of limits of benefits and anti-abuse rules in Czech tax treaties

LOB	Tax Treaty	Protocol amending the tax treaty
To person	China, Ethiopia, Armenia, Barbados, Uzbekistan, Bahrain, Columbia, Panama, Luxembourg, United States	Cyprus, Belgium, Switzerland
To company	China, Armenia, Saudi Arabia, Syria, Kuwait, Columbia, Jordan, United States	Philippines, Azerbaijan
Using domestic anti-abuse rules	Hong Kong, New Zealand, Jordan, Saudi Arabia, Ethiopia, Barbados, Panama, China, Armenia, Syria, Columbia	Philippines, Azerbaijan

11.3.3. SAARs and linking rules

With respect to SAARs, which include CFC legislation, thin capitalization rules, anti-tax haven rules, anti-hybrid rules and earning stripping or interest barrier rules, the Czech Republic applies only thin capitalization rules as a

24. In tax treaties agreed with Bahrain. *See* Table 11.1.
25. In tax treaties agreed with Hong Kong, Panama, China, Barbados and others. *See* Table 11.1. “Using domestic anti-abuse rules”.

common rule aimed against base erosion through the excessive deduction of interest.

Thin capitalization rules have been introduced in Art. 25(1)(w) of the ITL since 1993. The Czech Republic uses the debt-to-equity safe harbour approach, which is based on a fixed debt-to-equity ratio of 4:1.[26] According to this provision, financial costs including interest and other related expenses in respect of credits and loans provided by related parties in excess of the ratio of 4:1 between the aggregate value of debt and all equity of the company are not deductible for tax purposes. The practical procedure for thin capitalization rules is explained in Decree GFŘ-22 on a uniform procedure for the application of certain provisions of the ITL. Based on it, thin capitalization rules also apply to financing costs with regard to credits and loans between related parties arranged through a third-party intermediary. The deduction of financing costs accrued on profit-participating credits and loans is not permitted. In addition, loans used for the acquisition of fixed assets and any interest-free loans are not treated as debt for thin capitalization purposes. Generally, interest agreed between related parties needs to follow the arm's length principle.

There are no other rules limiting the deduction of interest or SAARs in the Czech Republic. However, the Czech Republic has introduced (in 2017) a linking rule for hybrid loan structures under the Parent-Subsidiary Directive. The Czech Republic prefers this option when the state of the payee is affected by the new rule and it is the simplest option from an administrative point of view.

Under the proposed linking rule, the dividends received in one of the Member States (in the Czech Republic) can be exempted under a participation exemption if it cannot be deducted from the tax base in the other Member State. This rule ensures that companies are obliged to pay a tax from the payments received that were deducted as debt payments in the other Member State, and eliminates the base erosion through hybrid loan mismatches. The proposed linking rule has been supplemented into the provision of Art. 19(2) of the ITL. Further, from the OECD's point of view, this rule is considered to be a primary rule. The secondary rule as a defensive rule, i.e. with the aim to refuse the deduction of loan payments if this remuneration is treated as a tax-exempt profit distribution in the other Member State, has not been introduced in the Czech Republic thus far.

26. The ratio for banks and insurance companies is set at 6:1.

In addition, the Czech Republic applies a restriction applicable to payments to tax haven entities in Art. 36(1)(c) of the ITL, i.e. dividends paid to non-residents are subjected to withholding tax at a rate of 35% (the standard rate is 15%) provided that dividends derived by recipients who are not resident in another EU Member State or an EEA country, or a country with which the Czech Republic has concluded (i) a tax treaty; (ii) a TIEA; or (iii) a multilateral agreement providing for exchange of information to which both the Czech Republic and that country are parties. This withholding tax is always final.

11.4. Application of GAARs, TP rules and SAARs

In the Czech Republic, GAARs in the form of substance-over-form provisions are set out in Art. 8(3) of the Tax Procedural Code.[27] Transfer pricing rules in the form of the arm's length principle, definition of related parties and APAs are directly mentioned in the ITL. However, the other rules and recommendations are set out in separate decrees issued by the Ministry of Finance or by General Financial Directorate.[28] Thin capitalization rules and the linking rule are set out in the ITL. Furthermore, the practical procedure is explained in Decree GFŘ-22 on a uniform procedure for the application of certain provisions of the ITL. Although all decrees are recommendations of the tax authority and are considered to be soft law, their implementation is nevertheless required by the tax authority.

27. Act no. 280/2009 of Coll.

28. Decree D-332 on the Communication by the Ministry of Finance in respect of international standards application in taxation of transactions between associated enterprises – TP. Decree D-333 on the Communication by the Ministry of Finance in respect of §38nc of Act no. 586/1992 Coll., on income taxes – binding consideration over the TP policy used in related party transactions. Decree D-334 on the Communication by the Ministry of Finance in respect of the scope of TP documentation and Decree D-10 on the Low Value Adding Intra-Group Services.

Chapter 12

Denmark

Jakob Bundgaard and Peter Koerver Schmidt

12.1. The meaning of avoidance and aggressive tax planning and the BEPS initiative

12.1.1. The meaning of tax avoidance in national legal systems

Avoidance generally means the arrangement of a transaction so as to keep it consistent with the letter of the law, but not with the presumed contents or intention of the law.[1] No interpretation according to the purpose of a tax provision can set aside the wording of the law.[2] This poses a problem for tax authorities in relation to avoidance because it effectively prevents the application of the desired purposive construction, as such a construction would set aside the opposed literal interpretation. Thus, the problem of avoidance arises when the possibilities for interpreting a statute are exhausted.[3]

Danish tax law does not contain any general legal definition of tax avoidance. The treatment of tax avoidance is determined on the basis of case law and specific anti-avoidance rules (SAARs), which has recently been supplemented by an international GAAR.

Generally the terms tax avoidance, tax evasion and tax fraud are relatively well established in Danish legal theory and appear to follow the terminology frequently applied internationally.[4] The term tax avoidance covers acceptable or ordinary tax planning, but is also used to refer to tax planning that is considered undesirable, such as tax optimizations that are within the letter of the law, but contrary to the spirit of the law. In contrast, tax evasion may be characterized as behaviour that is not in line with the applicable tax law,

1. *See*, for comparison, Jan Pedersen, *Skatteudnyttelse*, 1989, p. 264, and same author in *Skatteorientering*, 2002, Ø.5, p. 19. This section is partly based on Jakob Bundgaard & Arne Møllin Ottosen, European Taxation, 2008, vol. 48, pp. 59-69.
2. *See*, for comparison, Jan Pedersen, *Skatteorientering*, 2002, Ø.5, p. 18.
3. Pedersen, *supra* n. 1, *Skatteudnyttelese*, 1989, p. 292.
4. *See* V. Uckmar in Cahiers de droit fiscal international, 1983, vol. 68a, p. 15 et seq. and Julie Roger-Glabush (ed.), IBFD International Tax Glossary (online version).

and tax fraud is a form of deliberate evasion of tax that is generally punishable by law.

The above statement also holds true in terms of administrative regulations, which do not contain any clarification on the meaning of tax avoidance in Danish tax law.

It is possible to obtain tax rulings in Danish tax law, so-called binding rulings.[5] It is the view of the authors that the tax ruling regime does not have a significant impact on the tax avoidance carried out.

Although the tax treatment of tax avoidance is primarily handled by case law, no actual definition or meaning of the notion of tax avoidance can be derived. The legal tradition is to describe the concept of tax abuse and circumvention by identifying the contours as decided by the courts. In essence, the definition then becomes case specific. Moreover, legal theory does not agree on what is the correct interpretation of case law that deals with tax avoidance.

It is firmly assumed in tax law literature that no such general avoidance clause exists. Nevertheless, there are Supreme Court judgments in which avoidance-like deliberations play a part, *see* TfS 1998, 199 H, TfS 1998, 99 H and TfS 2002, 460 H.

TfS 1998, 199 H concerned a taxpayer with a number of non-interest-bearing claims against companies owned by him. The tax authorities wanted to tax him on a fixed-interest income, but the Supreme Court found that it must be so that a lender cannot be taxed on a fixed-interest income unless the transactions made were intended to circumvent tax law.[6]

TfS 1998, 99 H concerned a taxpayer who used the special business taxation regime and contributed personal debts into it at the start of the year, just to withdraw them again at the end of the year and thereby avoid the special rules on adjustment of interest on personal debts. It is clear from the legislative history of the business taxation regime that the legislators

5. *See*, for comparison, secs. 21-25 Tax Administration Act.
6. *See* Erik Overgaard, Journal of Danish Tax Law, 1998 (TfS 1998, 207), who with reference to this judgment argues the following: "It is hard to take the Supreme Court's choice of words to be anything other than an indication that reference to a general avoidance clause is made to provide statutory authority to the taxation of a fixed interest rate. It is, presumably, the first time the Supreme Court has ever used the term 'avoidance' separately in any judgment to provide legal basis for taxation."

presupposed that a person using the business taxation regime would not be able to abuse the regime to obtain full deductibility of the interest payable on any personal debt contributed. Consequently, in a judgment later affirmed by the Supreme Court, the Western Division of the Danish High Court laid down:

> Taking into account the purpose of the Business Taxation Regime [*virksomhedsskatteloven*] and the fact that the taxpayer's transactions were clearly abusing the rules of the Act, the Court finds the assessment authorities justified in setting aside the arrangement.

The case TfS 2002, 460 H concerned two taxpayers who had made a loan-financed investment in bonds to obtain tax-exempt capital gains and deductions for interest payable on the loan. But new rules were introduced making capital gains on claims acquired on borrowed funds taxable. At the same time, however, an exemption was introduced saying that capital gains would not be taxable if the taxpayer proved that the total result after tax of the loans and the claims combined was negative. Having learned about the bill, taxpayers rearranged their loan-financed bond investments to make the total result after tax negative, and thereby claiming exemption. But the Supreme Court ruled against the taxpayers and stated that the exemption was intended to include only cases where there is no tax speculation involved.

Pursuant to a doctrine of "substance over form", it has been argued that fictitious or artificial transactions may be set aside for tax purposes if the actual substance of the transaction conflicts with its private law form, resulting in a tax advantage.[7] In this case, tax will be imposed in accordance with the actual substance of the transaction based on an overall assessment. The applicability of the doctrine of "substance over form" is limited, however, and in order for the doctrine to apply there must be an evident conflict between form and substance.

In addition to the substance-over-form doctrine, the doctrine of the "*rightful recipient of income*" plays a significant role. The doctrine prescribes that the subject having the (legal) right to the basis of the income – e.g. a shareholding, a claim or a business activity – should also be considered the proper recipient for tax purposes of the gain or return on the shares/claim/activity.[8]

7. The principle was originally explained by Jan Pedersen in *Skatteudnyttelse*, 1989, p. 435 et seq.
8. The doctrine – it is argued – can be deduced from sec. 4 State Tax Act. *See* Aage Michelsen in Aage Michelsen et al., *Lærebog om indkomstskat*, 2015, p. 675 et seq. and Henrik Dam: *Rette indkomstmodtager: Allokering og fiksering*, 2005.

The interaction between these doctrines is somewhat unclear, but for many practical purposes they seem to be overlapping.[9] However, the doctrines should normally not be considered to be a sufficient tool when it comes to preventing erosion of the Danish tax base.

The substance-over-form doctrine was first described by Jan Pedersen's 1989 doctoral thesis entitled Tax Exploitation, particularly p. 435 et seq. and in *Skatteorientering Ø.5*, p. 23, where it is stated that the main element of the general clause is that fictitious or artificial transactions may be set aside for tax purposes if its actual contents clashes with its external civil law form, resulting in a tax advantage. Tax will then be imposed in accordance with the actual substance of the transaction such as it appears on an overall assessment. Thus, a chain of transactions, each of them plausible enough, forming part of a larger transaction ("step-by-step transactions"), may be subject to one overall assessment. For tax law purposes, the transaction is therefore assessed not on the merits of each step individually, but on the basis of the overall impression of the transaction as a whole.

There are limits, however, to the applicability of the substance-over-form doctrine. Thus, according to leading commentators, it is important to bear in mind that the substance-over-form doctrine cannot be applied to all transactions with an element of fiction.[10] It is a further condition that there is a clear conflict between form and substance. Therefore, although by their very nature they are only of formal significance, the formation of companies and the conclusion of marriages and divorces for tax purposes only, etc. cannot be set aside.

So far, there is very little in case law to support the setting aside of transactions resulting from company law rules.[11] In SKM2006.69.ØLR (concerning the facts of a transfer to a limited partnership) the Eastern Division of the Danish High Court ruled that the formation of the partnership could not be set aside as it had been in line with all applicable company law rules, and as the taxpayer had contributed funds and assumed a risk. The fact that it was a dormant company with a little accounting discrepancy etc. was not

9. *See*, for comparison, Jakob Bundgaard, *Skatteret & civilret*, 2006, p. 558 et seq. In the literature, a debate has taken place between proponents for the doctrine of "substance over form" and advocates of the doctrine of the "rightful recipient of income".
10. Pedersen, *supra* n. 2, p. 24.
11. *See*, for comparison, Hans Severin Hansen, Journal of Danish Tax Law, 2004 (TfS 2004, 88) and Jakob Bundgaard, Journal of Danish Tax Law, 2004 (TfS 2004, 68), but contra Morten Jappe & Lars Bo Nielsen in Journal of Danish Tax Law, 2004 (TfS 2004, 315), arguing that the use of company law rules can become so unusual that company law transactions and financial reality begin to clash.

enough, the High Court said, to "deprive the limited partnership structure of tax relevance". Also the decision of the Supreme Court in SKM2006.749. HR *Finwell* supports the finding that transactions owing their existence to company law rules and procedures cannot be set aside.

The closest thing so far to the setting aside of legal company law transactions seems to be the judgment rendered in Journal of Danish Tax Law 2003, 889 H *Over-hold ApS,*[12] in which the High Court – but not the Supreme Court – came very close to reclassifying a company law transaction. The company was denied deduction of interest in a financing transaction involving an element of exploitation of losses, based on a specific assessment of the facts of the case. Because of the close connections between the raising of a loan, a capital increase and a subsequent capital reduction, the High Court was not satisfied that the company did actually have free disposal of the borrowed funds. Likewise, the High Court held that the loss-making company did not have free disposal of its equity as, in the High Court's opinion, the loan of DKK 120 million had been designated in advance to be lent to the consolidated company. Further, the High Court did not find that the inter-company loans represented any real risk for the companies. And lastly, because, according to the information submitted, the company earned no profit on the arrangement, the High Court found that the loan *was not a usual business transaction* for the company and consequently could not be given any tax relevance.

As can be seen, the setting aside of company law transactions is only an indirect consequence of wanting to disallow deductibility of interest costs. The High Court must have assessed that there was no capital increase, or that the capital increase had been made by the foreign parent company directly, despite the fact that for company law purposes it was the company itself subscribing for shares as part of the capital increase. The Supreme Court later overruled the High Court's judgment, stating that the company had legally applied the then express exemption applicable to financial loss-making companies in sec. 15(7), no. 3, of the Danish Tax Assessment Act.

The recent Supreme Court decision SKM2014.422.HR *Topdanmark A/S* may have altered the above to a certain extent. Accordingly, the decision implied that certain capital increases should be disregarded with respect to finding the acquisition price for shares in a tax planning arrangement. Moreover, the Supreme Court's decision in SKM2016.16.HR *Færø-sagen*

12. The judgment is commented on by Aage Michelsen, *Revision og Regnskabsvæsen* 2004 (RR 2004 SM 9), by Hans Severin Hansen in Journal of Danish Tax Law, 2004 (TfS 2004, 88) and by Jan Guldmand Hansen, *SR-Skat*, 2004, p. 50 et seq.

has caused additional uncertainty, as the court actually set aside a structure involving a merger of two holding companies. In the authors' view, the decision is somewhat controversial and among other things it should be kept in mind that the case concerned the tax system in place on the Faroe Islands.

A *tax savings motivation* underlying the taxpayers' activities will not in itself lead to a reclassification of the transaction in question according to court case law. However, it seems that the Danish tax authorities as well as lower courts are of the opinion that such a motive in itself is sufficient to set aside a transaction. However, the Supreme Court has stated on several occasions that tax saving is a valid and commercial motive that should be upheld for tax purposes if the transaction in question stands up to a closer scrutiny. In other words, it must be considered to be current law in Denmark that no specific requirement for a business motive applies insofar as the transactions are in substance what they appear to be in form. In fact, the business purpose test is to be understood as a test of economic reality. If there is no such substance, the transactions are considered empty from the perspective of substance. Moreover, a tax saving motive will increase the substance test, and accordingly, is a prerequisite for reclassifications according to the substance-over-form doctrine.

In a few rare cases, where the taxpayer has acted aggressively (for example, where the tax motive is the sole motive) it has been seen that the Danish Supreme Court has set aside a transaction (rather than merely adjusting the terms and conditions of it), *see* TfS 1999, 950 H.

In the view of the authors, case law is not fully consistent among the courts and the Danish Tax Tribunal. In fact, certain leading cases demonstrate a different view from the Supreme Court in the approach to tax avoidance, although the Supreme Court generally does not rule more often in favour of the taxpayer. Case law demonstrates some remarkable examples that show that the Supreme Court is willing to decide on tax avoidance cases in favour of the taxpayer where the result is heavily supported by the legal doctrine as being correct. The former – now retired president of the Supreme Court – has stated that taxpayers' positions will gain support if they are right.

In Danish law, the legal, administrative and/or case meaning of tax avoidance does not seem to be directly influenced by its meaning in other jurisdictions, OECD, soft law or the case law of the ECJ.

The BEPS discussions generally, and to a large extent, are already included in the Danish tax system. Consequently, not many of the BEPS proposals

would lead to significant changes in the Danish tax system if it were decided to follow the BEPS recommendations closely.

The only direct examples of changes caused by the BEPS agenda are the introduction of an international GAAR in Danish law (*see* section 12.2.1.) and the recent adoption of a Bill introducing country-by-country reporting based on OECD's recommendations.[13]

12.1.2. The meaning of tax planning, abusive tax planning and aggressive tax planning in national legal systems

There is no legal definition of tax planning, abusive tax planning or aggressive tax planning in Danish tax law. In the political debate, however, it seems that aggressive tax planning is defined as any tax advantage that could be achieved by taxpayers and that has not been directly legislated against previously or if the existing legislation is too narrow to include certain transactions.

The above statement also holds true in terms of administrative regulations, which do not contain any clarification on the meaning of tax planning in Danish tax law.

A committee established by the government in 2013 – in order to facilitate stronger discipline among tax advisers against cross-border tax evasion and tax fraud – used the following definition of so-called "cross-border tax optimization" in its report:[14] "The use of actions that within the limits of the law bring the tax payer in a favourable tax position or eliminate double taxation".[15] However, this definition does not hold any formal authority.

As mentioned above, it is possible to obtain tax rulings in Danish tax law, so-called binding rulings. It is the subjective view of the authors that the tax ruling regime does not have a significant impact on the tax planning carried out. In fact, it has been observed on several occasions that whenever taxpayers submit requests for tax rulings in terms of specific tax planning techniques, such rulings may be granted, but with the simultaneously

13. *See* Law 1884 of 29 Dec. 2015, Bill L 46 (2015/2016).
14. *See* The Danish Ministry of Taxation, *Styrket rådgiver- og branchesamarbejde mod grænseoverskridende skatteunddragelse*, 6 November 2014.
15. Certain more general observations concerning tax planning etc. can also be found in recommendation nos. 1060 and 1985 (*Skatteflugtsbetænkningen*).

issuance of a Bill aiming at amending the legislation in order to prevent such tax planning techniques.[16]

Danish case law does not include any definition of the meaning of tax planning. The notion of tax planning does not trigger any legal consequences. Refer to the above case law regarding circumvention and abuse.

The BEPS discussions generally, and to a large extent, are already addressed by the Danish tax system. Consequently, only a few of the BEPS proposals are expected to lead to significant changes of Danish tax law.

12.2. The reaction to avoidance and aggressive tax planning in the BEPS context

12.2.1. Domestic general anti-avoidance rules (GAARs)

A GAAR in its wide sense does not exist in Danish law. However, an international GAAR was introduced in Danish tax law in 2015. This GAAR consists of the implementation of the recent abuse provision in the Parent-Subsidiary Directive, but with a wider scope as to also be applicable to the Merger Directive and the Interest and Royalty Directive. Moreover, the provision also introduces the OECD-based principal purpose test with respect to tax treaties.

To a certain extent, the Danish international GAAR is similar to the EC Recommendation. However, from a legal perspective, the provisions are not identical.

No thorough analysis has yet been made as to the conformity of the Danish international GAAR with the EU/EEA concept of abuse. During the official hearing process, it was stated that to a certain extent the provision should be interpreted in accordance with EU case law regarding abuse. Since there is no case law yet on this topic, the authors cannot assess whether the provisions will be interpreted fully in accordance with the EU/EEA concept of abuse.

16. *See*, for example, Bill L 84 (2010/2011), which introduced an amendment targeting the use of cross-border vertical mergers in order to circumvent the Danish rules on withholding tax of dividends. This could be seen as a direct reaction to two decisions from the Tax Assessment Council.

The assessment of the following elements in the Danish international GAAR are completely identical with the anti-abuse clause in the Parent-Subsidiary Directive and the OECD principal purpose test.[17]

(a) main objective test (the accrual of a tax advantage the grant of which is contrary to purpose of the legal provision);

The Danish international GAAR does include a requirement stating that the transactions should have been put in place for the main purpose, or one of the main purposes, of obtaining a tax advantage:

(b) the obtaining of a tax advantage as the essential aim of the transactions concerned;

Same as under 1):

(c) complementary business purpose test (under international tax law) or the genuine economic activity test (under EU law);

The Danish international GAAR includes a requirement for the transactions to not be genuine with regards to all relevant facts and circumstances:

(d) subjective element, consisting of the intention to obtain a tax advantage;

Subjectivity is included in the above-mentioned main objective test:

(e) the principle of proportionality.

The principle of proportionality is not, as such, included in the Danish international GAAR. However, it is assumed that the administration of the GAAR should be in accordance with the principle of proportionality. Due to the very recent introduction of the Danish international GAAR, no case law is yet available.

17. Even though the wording of the anti-abuse clause in the Parent-Subsidiary Directive and the OECD principal purpose test are not the same, it is the view of the Danish legislator that the two provisions should be interpreted in the same way, with respect to the preparatory remarks to Bill L 167 (2014/2015).

12.2.2. EC Recommendation C(2012) 8806 of 6 December 2012, the subject-to-tax rule and the Proposal for an Anti-Tax Avoidance Directive of 28 January 2016

It is not common for Danish treaty policy to include subject-to-tax rules as proposed by the EC. However, a number of tax treaties do include different forms of such provisions.[18]

12.2.2.1. General subject-to-tax provisions[19]

The multilateral Nordic treaty contains a general subject-to-tax provision in article 26(2).[20] Accordingly, if the right to tax income or capital is granted to a contracting state other than the state of which the person who derives income or capital is a resident, and the other contracting state, according to its laws, does not consider the income or the capital in its entirety as taxable, or only considers the income or capital in calculations under a progressive tax scheme, or in other tax computations, the contracting state where the person resides may tax that part of the income or capital that is not included under taxation in the other contracting state.

Likewise, the treaty between Denmark and Germany contains a general subject-to-tax provision in favour of the state of residence; *see* article 24(3).

12.2.2.2. Specific subject-to-tax provision

Other treaties signed by Denmark contain more specific subject-to-tax provisions.[21] An example can be found in article 29(1) of the treaty between Denmark and South Africa, which states that if one of the states

18. *See also* Jakob Bundgaard & Peter Koerver Schmidt in Cahiers de droit fiscal international, 2010, vol. 95a, pp. 261-279.
19. In the *2014 Commentary on Article 1 of the OECD Model*, no. 15, *general subject-to-tax provisions* are defined as provisions that provide that treaty benefits in the state of source are granted only if the income in question is subject to tax in the state of residence. However, in the following, the term “general subject-to-tax provisions” will also be used to describe provisions that grant the state of residence the right to tax if the income in question is not subject to tax in the state of source.
20. The contracting parties to the Nordic Tax Treaty are Denmark, Faroe Islands, Finland, Iceland, Norway and Sweden.
21. For a more thorough description and overview of subject-to-tax provisions in Denmark’s treaties, *see* Philip Noes, Danish Journal of International Taxation, 2003 (SU 2003, 3).

introduces legislation on lower or no taxation of offshore income derived by a company,[22] the other state shall not be obliged to apply any limitation imposed under the treaty.[23] Further, pursuant to article 29(2), it follows that if income according to the treaty should be exempt from taxation in the source state – as well as in the state of residence in spite of this refrain from taxing the income[24] – the source state can tax the income anyway. The existence of this clause results from the fact that South Africa applies the principle of territoriality. For the same reason, article 25 of the treaty between Denmark and Vietnam states that where any person derives income from a source situated outside Vietnam and such income is exempt from tax under the laws of Vietnam and also exempt from tax in Denmark under the treaty, Denmark may tax such income under its own laws.[25]

The treaty between Denmark and Cyprus, article 23(3), states that if income according to the treaty is relieved from tax in one of the states – e.g. Denmark – and the income pursuant to Cypriot law is subject to tax by reference to the amount that is remitted to or received in Cyprus and not by reference to the full amount, then the relief to be allowed under this convention in Denmark shall apply only to so much of the income as is remitted to or received in Cyprus. Almost similar provisions can be found in Denmark's treaties with Malta (article 24),[26] Singapore (article 22), Jamaica (article 24(4)) and Thailand (article 24(4)). Article 28(1) in the treaty between Denmark and the United Kingdom also contains a subject-to-tax provision, which, however, has a more limited scope. Accordingly, the provision states that if an *individual* resident in the United Kingdom is subject to tax by reference to the amount thereof that is remitted to or received in the United Kingdom and not by reference to the full amount, the relief to be allowed

22. The company should be involved in one of the following industries: (a) shipping; (b) banking, financing, insurance, investment or similar activities; or (c) being the headquarters, coordination centre or similar entity providing administrative services or other support to a group of companies that carry on business primarily in other states.

23. Art. 26(1) in the treaty between the Danish Trade Organization's Taipei office and the Taipei Representative Office in Denmark contains a somewhat similar provision targeted at companies that derive income primarily from outside the territory from banking, financing and insurance activities or from being a coordination centre. Further, an additional subject-to-tax provision appears in art. 26(2) concerning interest, dividends and royalty paid from e.g. a company where more than 50% of the capital or votes is owned or controlled directly or indirectly by a person or any other legal person not being residents of one of the territories or of the European Union or the European Economic Area.

24. In terms of any provision of the treaty other than art. 10 on dividends.

25. Art. 25 should be applied without prejudice to the participation exemption concerning dividends in art. 24(1)(f).

26. Moreover, the treaty does not apply at all to certain persons that are entitled to certain tax benefits according to Maltese law; *see* the notes on 13 July 1998.

under the treaty in Denmark shall apply only to so much of the income as is taxed in the United Kingdom.[27]

Finally, it should be mentioned that some of Denmark's tax treaties contain specific subject-to-tax provisions concerning among other things income from employment[28] and independent personal services.[29] The authors are not aware of any plans to introduce subject-to-tax rules as proposed by the EC.

12.2.2.3. The proposal for an Anti-Tax Avoidance Directive (ATAD) of 28 January 2016

As mentioned above, a GAAR in its wide sense does not exist in Danish law, but an international GAAR was introduced in Danish tax law in 2015. However, the international GAAR is only applicable with respect to transactions covered by the Parent-Subsidiary Directive, the Merger Directive, the Interest and Royalty Directive and tax treaties. Accordingly, if the ATAD proposal is adopted in its original form, it will be necessary to introduce a statutory GAAR in Danish law applicable to all corporate taxpayers.

Besides the GAAR the ATAD proposal includes an interest limitation rule, a rule on exit taxation, a switch-over clause, a CFC rule and a rule on hybrid mismatches. Except for a general switch-over rule, Denmark already has such SAARs in place.[30] However, as current Danish SAARs do not exactly match the SAARs in the ATAD proposal, certain amendments of the Danish provisions will have to be made if the ATAD proposal is adopted in its original form, to ensure that the Danish rules at least cover the situations encompassed by the SAARs in the ATAD proposal.[31]

27. Art. 28(1) was amended according to the Protocol to the Convention on Double Taxation between Denmark and the United Kingdom signed 15 October 1996.
28. *See*, for example, art. 15(2)(d) in the treaty between Denmark and Australia, art. 14(2)(d) in the treaty between Denmark and Malaysia and art. 26(3) in the Nordic Tax Treaty.
29. *See*, for example, art.14(1)(b) in the treaty between Denmark and Greece and art. 26(3) in the Nordic Tax Treaty.
30. *See* section 12.3. below.
31. *See* Jakob Bundgaard & Peter Koerver Schmidt, *SR-Skat*, 2016, pp. 151-163.

12.3. Transfer pricing rules, GAARs, SAARs and linking rules

Danish tax law encompasses a relatively high number of SAARs, and the extent of such legislation has increased significantly during the last two decades. Section 12.3.1. addresses some of the most significant SAARs, and the aims of the provisions are briefly explained.[32]

12.3.1. Transfer pricing

Danish TP legislation – which dates back to 1960 – was reformed in 1998, following a number of judgments by the Supreme Court on "interest fixation", which the tax authorities had lost.[33] The aim of the reform was to provide a clear legal basis for TP adjustments, in order to avoid erosion of the Danish tax base and to ensure equal tax treatment of Danish and foreign-owned companies.[34] The current regime sets forth the arm's length principle, which should be interpreted in line with the article 9(1) of the OECD Model and the OECD Transfer Pricing Guidelines.[35] The TP rules apply to "controlled transactions" and cover cross-border transactions, as well as domestic transactions.[36]

The TP rules have in recent years been more frequently used to prevent or combat avoidance, and in general it is the impression that the tax authorities' TP audits have become more thorough.[37] Accordingly, TP has for a number of years been a focus area for the tax authorities and more resources have been allocated to the units dealing with TP. The effect has been a rise in the number of cases, which increased from 27 finalized cases in 2008 to 77 finalized cases in 2013.[38]

32. This section is based on Peter Koerver Schmidt, Nordic Tax Journal, 2014, pp. 113-131, and Bundgaard, *supra* n. 18. GAARs are not dealt with in this section. *See* instead section II. 1 above.
33. *See* TfS 1996, 642 H, TfS 1998, 199 H and TfS 1998, 238 H.
34. *See* the explanatory notes to Bill L 101 (1997/1998).
35. *See* Jens Wittendorff, *Armslængdeprincippet i dansk og international skatteret*, 2009, p. 262 et seq.
36. *See* sec. 2 Tax Assessment Act.
37. *See* Jens Wittendorff, International Transfer Pricing Journal, 2012, vol. 19, pp. 324-329.
38. *See* SKAT, *Kontrolaktiviteter 2015 – Styrket regelefterlevelse på skatteområdet*. In 2009, the number of finalized cases was 32, in 2010 it was 40, in 2011 it was 47 and in 2012 it was 67.

As a result of the increase in the number of TP cases, more and more TP-related litigation also seems to be happening. One of the court cases that has received quite a lot of attention is the Supreme Court's decision in SKM2012.92.HR (*Swiss Re*). The case – which the tax authorities won – clarifies that the extended statute of limitation regarding controlled transactions is applicable with regard to all types of adjustments.[39] However, the most controversial aspect of the decision was the reasoning adopted by the Supreme Court regarding the scope of the arms' length principle laid out in section 2 of the Tax Assessment Act. Thus, the Supreme Court made the following statement:

> The authority to make an adjustment covers all economic elements and other terms of relevance for taxation purposes including, for example, also due date, recognition of interest and capital losses and the legal qualification of the transaction. A loan agreement on zero-coupon terms concluded between related parties with retroactive effect may thus be adjusted by the tax authorities on the basis of section 2(1) of the Tax Assessment Act.

This statement is troublesome, as the prevailing opinion in the Danish literature has been that section 2 of the Tax Assessment Act does not govern the legal qualification of the transaction. Accordingly, if the above-mentioned statement should be interpreted to mean that the legal qualification of the transaction is also covered by section 2 of the Tax Assessment Act, the scope of applicability appears significantly larger than originally expected in the literature. However, as the reasoning of the court seems rather ambiguous, it has been argued that the precedence value of the decision may be limited.[40]

In addition to the material TP legislation, information and documentation requirements also apply.[41] Accordingly, when taxpayers file their tax returns, the tax authorities should be informed about the nature and scale of the controlled transactions. Moreover, the taxpayer is obliged to prepare and hold written TP documentation. On request, the TP documentation must be handed over to the Danish tax authorities. Recently, the government has put forward a draft bill aiming at introducing country-by-country reporting based on OECD's recommendations.[42]

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39. The extended statute of limitation for controlled transactions follows from sec. 34(5) Tax Administration Act. According to this provision, the deadline is 1 May of the sixth year after the end of the income year.
40. *See* Jens Wittendorff, International Transfer Pricing Journal, 2012, pp. 203-221, who is very critical of the decision.
41. *See* sec. 3B Tax Control Act. For smaller corporate groups, the documentation requirements are less restrictive.
42. *See* Draft bill, 18 Sept. 2015, J. nr. 15-1342223.

If sufficient TP documentation exists, it is the tax authorities that have the burden of proof concerning whether or not the transactions are at arm's length.[43] However, if the TP documentation is insufficient, the tax authorities are allowed to disregard the originally applied prices or rates as the burden of proof is then shifted to the taxpayer.[44] In line with this, the Supreme Court recently found – *see* SKM2015.296.HR – that the tax authorities were entitled to make a discretionary assessment of the value of the sales price concerning an intra-group transfer of shares. Moreover, the Supreme Court stated that the discretionary asssessment could only be set aside if the taxpayer could substantiate that the discretionary assessment was made on an incorrect basis or was clearly unreasonable.

12.3.2. LOB clauses

Normally, Denmark's tax treaties do not include limitation of benefit (LOB) rules. However, LOB rules can be found in a few of Denmark's tax treaties. Accordingly, article 26(3) of the treaty between the Danish Trade Organization's Taipei office and the Taipei Representative Office in Denmark contains a LOB clause with a broad and general scope. The article states that a resident of a territory shall not receive the benefit of any reduction in, or exemption from, tax provided for in the treaty by the other territory if the main purpose, or one of the main purposes, of such a resident or a person connected with such a resident was to obtain the benefits of this agreement.

In article 22 of the treaty between Denmark and the United States, a more specific LOB clause appears.[45] This very detailed and complex clause lists several conditions that must be met if a resident of the contracting states should be entitled to benefit from the treaty. In short, the LOB clause should ensure that persons who are not resident in one of the contracting states

43. *See* Jane Bolander & Jakob Graff Nielsen in Gerard Meussen (ed.), *The Burden of Proof in Tax Law*, 2011, p. 95.
44. *See* the decision of the National Tax Tribunal in SKM2014.53.LSR. The decision constitutes the first published case concerning a cash-pooling arrangement. Among other things the Tribunal found that the interest applied to inbound and outbound loans in a cash-pooling arrangement should be the same. Moreover, the Tribunal found that the assessment should be based on the group credit rating and not on an individual credit rating of the company. *See also* Eduardo Vistisen, Danish Journal of International Tax Law, 2004 (SU 2014, 107).
45. Art. 22 in the treaty was amended following the ratification of the protocol which entered into force on 28 December 2007. The LOB clause is standard in US treaties.

cannot benefit from the provisions of the treaty.[46] Individuals resident in the United States or Denmark are under all circumstances entitled to benefit from the provisions of the treaty. In addition, public authorities in the two states, religious and charitable organizations as well as pension funds[47] are per se entitled to the benefits. However, legal entities, such as companies and trusts, have to meet certain requirements regarding, among other things, ownership, cash flows and business activity.[48]

12.3.3. CFC legislation

Denmark introduced controlled foreign company (CFC) legislation in 1995. The objective behind the introduction of CFC legislation was to prevent erosion of the Danish tax base caused by the increasing openness of borders to flows of capital.[49] More specifically, the aim was to prevent Danish companies from establishing subsidiaries in low-tax countries and moving income and assets hereto.[50]

According to the Danish CFC regime, a Danish company is liable to tax on the income of a Danish or foreign subsidiary if: (i) the subsidiary is controlled by the affiliated group of companies; (ii) the tainted income ("CFC income") of the subsidiary amounts to more than 50% of the total taxable income; and (iii) the financial assets of the subsidiary exceed 10% of the total assets.[51]

If the CFC rules apply, the Danish parent company should include the total income of the subsidiary, provided that the income of the subsidiary is positive. If the parent company does not fully own the subsidiary, only a proportional part of the subsidiary's income should be attributed to the parent company. Furthermore, only income generated by the subsidiary in the

46. The LOB clause is analysed by Carina Korsgaard & Kristoffer Kowalski, Danish Journal of International Taxation, 2008 (SU 2008, 130).
47. If more than 50% of the pension recipients are resident in one of the two states.
48. Moreover, art. 4(1)(d) of the treaty states that an item income, profit or gain derived through an entity that is fiscally transparent under the laws of either contracting state shall be considered to be derived by a resident of a state to the extent that the item is treated for purposes of the taxation law of such contracting state as the income, profit or gain of a resident.
49. *See* the explanatory notes to Bill L 35 (1994/1995).
50. *See* Peter Koerver Schmidt, *Dansk CFC-beskatning i et internationalt og komparativt perspektiv*, 2013, and Peter Koerver Schmidt, Cahiers de droit fiscal international, 2013, vol. 98a, pp. 259-277.
51. *See* sec. 32 Corporate Tax Act. Sec. 8(2) Corporate Tax Act contains a CFC rule for foreign PEs.

period during which the parent company had "deciding influence" should be included. A tax credit is granted for taxes paid by the subsidiary.

It should be noted that the scope of the Danish CFC regime for companies was expanded in 2007 in order to bring the rules in line with EU law following the European Court of Justice's decision in case C-196/04 *Cadbury Schweppes*, namely in Bill L 213 (2006/2007). However, it has been argued that different treatment still exists, as the application of the CFC rules only entails an additional tax burden for the Danish parent company if the subsidiary is resident in another country in which the level of taxation is lower than the Danish level of taxation.[52] Despite this criticism, the OECD's BEPS recommendations suggest that Member States should consider applying CFC rules equally to both domestic subsidiaries and cross-border subsidiaries. In this context, the Danish rules are explicitly mentioned as an example.[53]

12.3.4. Linking rules

Denmark already had linking rules in place before the OECD initiated the BEPS Project. Accordingly, Denmark has introduced provisions on hybrid as well as reverse hybrid entities, which entails that the domestic tax treatment in some situations depends on the tax treatment in other jurisdictions.[54] Both provisions could be seen as a reaction to tax planning based on the US check-the-box rules.[55]

Accordingly, if a company or association should be treated as a transparent entity according to the tax rules of a foreign state, with the effect that the company's income should be included in the income of an affiliated company in this foreign state, the company should – if certain conditions apply – be reclassified as a transparent entity for Danish tax purposes. The objective of the provision is to mitigate the possibility of "creating" deductible interest expenses in Denmark in situations where the foreign recipient is not taxable for the interest payments, as these payments should be

52. *See* Peter Koerver Schmidt, European Taxation, 2014, vol. 54, pp. 3-9.
53. *See* OECD, *BEPS Action 3: Designing Effective Controlled Foreign Company Rules*, 2015, pp. 17-18.
54. *See* secs. 2A and 2C Corporate Tax Act.
55. For more on the Danish rules on hybrid entities and hybrid financial instruments, *see* Jakob Bundgaard, Bulletin for International Taxation, 2013, vol. 67, pp. 200-204, who demonstrates the frequent Danish use of coordination rules based on a principle of correspondence.

considered internal transfers within the same entity pursuant to the tax rules in the foreign state.[56]

Conversely, certain tax transparent entities should be reclassified as separate taxable entities if more than 50% of the shares or voting rights are held directly by foreign investors and the tax domicile of such foreign investors is in a country in which the Danish entity is treated as a taxable entity or in a non-EU Member State that does not have a tax treaty with Denmark.[57] Here the aim is to prevent taxpayers from exploiting different entity qualification to "create" double non-taxation.[58]

Cross-border tax arbitrage by way of using hybrid financial instruments has been curbed inbound and outbound. Accordingly, if a company or association etc. is indebted or similarly obligated to an individual or company resident in another country and the claim according to foreign tax rules is considered paid in capital, the debt shall also be regarded as equity with respect to the Danish tax computation.[59] The objective of this provision is to abolish the potentially asymmetrical tax treatment of certain hybrid financial instruments.[60]

In addition, the applicability of the inbound dividend participation exemption has been limited to situations where the foreign paying company is not allowed under the tax laws of the country of its residence to deduct the payments that are considered dividends under Danish tax law.[61] The provision will prevent Danish companies from receiving tax exempt dividends in situations where the foreign paying company can deduct the payment.[62]

56. *See* the explanatory notes to Bill L 119 (2003/2004).
57. *See* sec. 2C Corporate Tax Act.
58. *See* the explanatory notes to Bill L 181 (2007/2008).
59. *See* sec. 2B Corporate Tax Act. The provision only applies if the foreign individual or company has decisive influence on the Danish company or the companies that are considered to be in a group of companies; *see* the principles in sec. 2 Tax Assessment Act. The classification means that interest payments and capital losses are considered to be non-deductible dividend payments. *See* Jakob Bundgaard, Bulletin for International Taxation, 2008, vol. 62, p. 33 et seq. For a more general analysis of debt-flavoured equity investments in Danish tax law as well as in international tax law, *see* Jakob Bundgaard, Intertax, 2014, vol. 42, pp. 416-426.
60. *See* the explanatory notes to Bill L 110 B (2006/2007).
61. *See* sec. 13(1)(2) Corporate Tax Act.
62. *See* the explanatory notes to Bill L 23 (2008/2009) and to Bill L 84 (2010/2011) where the scope of the provision was expanded to cover situations where a lower-tier foreign subsidiary obtains the deduction. Originally, this rule was introduced in 2006 as part of another provision with regard to declared dividends, *see* the former sec. 31 D(2) of the Corporate Tax Act. *See* Bill L 110 A (2006/2007).

In general, the Danish linking rules described above are not entirely the same as the rules suggested by the OECD,[63] as the effect of the Danish rules often is a requalification of the entire entity or payment, and not merely the deprivation of a deduction or an exemption.

12.3.5. Rules limiting deduction of interest

The deductibility of financing expenses may in general be restricted under three sets of rules for corporate taxpayers:[64]

(1) The thin capitalization test. A company is thinly capitalized if the debt-to-equity ratio exceeds 4:1, provided that the controlled debt exceeds DKK 10 million. If a company is considered thinly capitalized, interest expenses and capital losses, on the part of the controlled debt that should have been converted to equity to avoid the limitation, are not deductible. However, if the company is able to substantiate that similar financing could have been obtained without security from other group companies, the company will be allowed to deduct interest expenses even though the 4:1 ratio is exceeded.

(2) The asset test. Net financing expenses may be deducted only to the extent the expenses do not exceed a standard rate of presently 4.1% (2015) of the tax base of certain qualifying assets.

(3) The EBIT test. Net financing expenses may not exceed 80% of earnings before interest and tax.

All three rules apply both domestically and internationally. The aim of the thin capitalization rules is to counter the shifting of tax revenue from Denmark caused by intra-group loans made from foreign group companies to Danish subsidiaries on terms that could not have been achieved between independent parties.[65] The thin capitalization rules therefore only apply to controlled debt.

The asset test and the EBIT test were introduced in 2007 as the legislator found that the CFC rules and the thin capitalization rules in force at the time

63. *See* OECD, *BEPS Action 2: Neutralising the Effects of Hybrid Mismatch Arrangements*, 2014.
64. *See* secs. 11, 11B and 11C Corporate Tax Act. *See* Michael Tell, *Fradragsbeskæring af selskabers finansieringsudgifter*, 2012.
65. *See* the explanatory notes to Bill L 101 (1997/1998).

did not provide sufficient protection of the Danish tax base in situations where Danish companies were acquired by private equity funds in highly leveraged buyouts.[66] Both the asset test and the EBIT test only apply to net financing expenses exceeding DKK 21.3 million (2015). The two limitations apply to all kinds of debt – not only controlled debt.

Also elements of the rules on limitation of interest deductions have been criticized for being in breach of the fundamental freedoms in EU law.[67]

12.3.6. Other SAARs

If a resident company ceases to be fully liable to tax in Denmark, or if a resident company becomes resident in a another state according to a tax treaty, the company should be considered as having disposed of all assets and liabilities that are no longer subject to Danish tax. The assets and liabilities should be considered as sold at fair market value at the time of emigration.[68] Likewise, the transfer of assets and liabilities within a company to a foreign PE or a foreign headquarter, with the result that the assets and liabilities are no longer subject to Danish taxation, is treated as a sale at fair market value at the time of the transfer.[69]

Companies now have the option of deferring payment of the exit tax subject to certain conditions.[70] The exit tax balance must be settled by annual installments equal to the higher of the income relating to the assets multiplied by the applicable Danish corporate tax rate, or 1/7 of the exit tax balance at the time it was established. Accordingly, deferred exit taxes will be paid within a maximum period of 7 years. An interest of minimum 3% is charged on the remaining deferred exit tax every year.

Finally, a number of other provisions protecting the Danish tax base should briefly be mentioned:

(a) Companies that are subject to full Danish tax liability, but are domiciled in another country according to the provisions in a tax treaty, can only

66. *See* the explanatory notes to Bill L 213 (2006/2007).
67. *See* Tell, *supra* n. 64, pp. 323-331.
68. *See* secs. 5(7) and (8) Corporate Tax Act. *See* Bill L 35 (1994/1995).
69. *See* sec. 8(4) Corporate Tax Act. *See* Bill L 121 (2004/2005).
70. *See* secs. 26 and 27 Corporate Tax Act. *See* Bill L 91 (2013/2014).

deduct expenses that are related to income that can be taxed in Denmark due to the tax treaty.[71]

(b) A "net principle" applies concerning double taxation relief, unilaterally or according to a double taxation treaty. The principle states that expenses that relate to the foreign-source gross income must be deducted when computing net foreign-source income.[72]

(c) An anti-double dip provision prohibits deduction of expenses, which due to foreign tax rules can be deducted from income that is not included when calculating the Danish tax.[73] The provision moreover prevents double dips arising from double depreciation of leasing assets.

(d) If a debt claim is acquired for borrowed funds, and interest or capital gains on the debt claim should not be included in the income by virtue of a tax treaty, interest, capital losses, commission, premiums and other expenses incurred in connection to the loan cannot be deducted.[74] This also applies if shares are acquired for borrowed funds, provided the shares in question are shares in a company that directly or indirectly holds a significant amount of the aforementioned debt claims.

(e) A provision prohibits deduction of payments for accrued interest paid in connection with a purchase of interest-bearing debt claims if interest or capital gains on the debt claim by virtue of a tax treaty should not be included in the taxable income.[75]

(f) Losses on debt claims are not deductible if interest or gains related to the debt claim should not be included in the taxable income as a result of a tax treaty.[76]

(g) Recently, a number of new provisions have been enacted in order to ensure that Danish dividend withholding tax cannot be avoided by structuring the transactions differently, for example, by migration of a Danish subsidiary, a tax-exempt cross-border merger, liquidation or

71. *See* sec. 9 Corporate Tax Act.
72. *See* sec. 33F Tax Assessment Act.
73. *See* sec. 5G Tax Assessment Act.
74. *See* sec. 5F Tax Assessment Act.
75. *See* sec. 5C(3) Tax Assessment Act.
76. *See* sec. 5 Act on Taxation of Gains and Losses on Debt Claims, Debts and Financial Instruments.

share redemption, and other kinds of reorganization of the ownership of a Danish subsidiary.[77]

12.4. Application of GAARs, TP rules and SAARs

The Danish GAARs and SAARs (including TP rules and linking rules) form a patchwork of anti-avoidance measures. Accordingly, there does not seem to be a distinct hierarchy and the legislator has generally not prioritized the coordination of the anti-avoidance rules introduced by law. Instead, it appears that the legislator has just continuously added new SAARs or amended the existing SAARs whenever a (political) need has arisen to close a "loophole" or mitigate certain tax planning schemes/ideas.[78]

The lack of coordination has inter alia given rise to discussions on the interaction between the Danish TP legislation and the specific thin capitalization rules. The question is whether the rules can be applied simultaneously with respect to the same loan. Administrative case law – which is not publicly available – suggests that this is the case.

In addition, the lack of coordination has given rise to discussions on whether specific anti-avoidance provisions under Danish law are applicable when assessing the conditions for Danish taxation of CFCs (CFC taxation) and when calculating the income to be attributed to the Danish parent company according to the CFC rules (e.g. whether the thin capitalization rules, TP rules and so on have to be applied when making the CFC taxation calculations).[79] The CFC rules do not address this issue directly, but it is clear that the calculations as main rule should be carried out based on

77. *See* secs. 5(5) and 2D Corporate Tax Act, secs. 9(2), 15(4-5), 15a(10) and 15b(4) of the Merger Tax Act, secs. 16 A(3)(1), 16 B(1) and 16 B(2)(2) Tax Assessment Act and sec. 36(1) Act on Taxation of Gains on Shares. *See* Bill L 202 (2008/2009), Bill L 84 (2010/2011), Bill L 10 (2012/2013) and Bill L 81 (2013/2014).
78. Recently an "anti-tax haven package" has been adopted, *see* Bill L 167 (2014/2015). The bill was based on recommendations made by an interdisciplinary departmental task force. This task force was established in 2013 and its purpose was to go through the existing legislation and case law in order to come up with possible initiatives to fight tax evasion and avoidance with respect to the use of foreign tax havens, *see* the Danish Ministry of Taxation, *Afrapportering fra den tværministerielle task force mod skattely*, 6 Nov. 2014. For an overview of the relatively few new measures included in the bill, *see* Lars Kjærgård Terkilsen, Nordic Tax Journal, 2015, vol. 2, p. 67 et seq. Officially, a broader and more systematic analysis of international tax avoidance in a Danish context has not been carried out since 1985, *see* recommendation nos. 1060 and 1985.
79. *See* Peter Koerver Schmidt, *Dansk CFC-beskatning*, 2013, p. 338 et seq.

Danish tax rules. The question then is whether this also includes all or some of the other SAARs in Danish tax law.

In the preparatory remarks to some of Denmark's SAARs, it is explicitly stated whether the SAAR in question should or should not be applicable under the CFC rules. However, in most cases, the relationship with other SAARs is not dealt with in the preparatory remarks (or the wording for that sake). In this regard, the decision made by the Danish Tax Assessment Council in SKM2014.577.SR is interesting.[80]

The decision concerned whether a new rule limiting the possibility of utilizing tax losses carried forward was also applicable under the CFC rules.[81] Neither the wording of the new rule, nor the preparatory remarks addressed this issue. However, the Council stated that the new rule should also apply under the CFC rules, as the Council argued that all Danish SAARs should be considered applicable under the CFC rules unless it follows directly from the wording of the SAAR or its preparatory remarks that the SAAR in question does not apply under the CFC rules.

The decision from the Tax Assessment Council concerned a rather specific situation and does not generally solve the problems concerning overlapping or uncoordinated SAARs in Danish tax law. However, it clearly illustrates some of the diffuculties that may arise when the continuous addition of new SAARs is not very well coordinated.

80. The decision has been commented on by Peter Koerver Schmidt, *SR-Skat*, 2014, pp. 255-260.
81. *See* sec. 12(2) Corporate Tax Act.

Chapter 13

Finland

Raimo Immonen and Juha Lindgren

13.1. The meaning of tax avoidance in the national legal system

13.1.1. Legal definition of tax avoidance

Finland has a long tradition of applying general anti-avoidance rules/provisions (general anti-avoidance rule – GAAR). The origins of the provisions can be traced back to the 1930s. The most recent provision in the Act on Assessment Procedure (1558/1995; hereinafter VML), Sec. 28(1), allows the Finnish Tax Administration or courts to re-characterize any transaction and accordingly to tax based on the real nature of the arrangement, irrespective of its legal form. According to the provision, if a transaction has been assigned a legal form that does not correspond with its real nature and purpose, taxation should take place as if the correct form had been adopted. In addition, it must be evident that the transaction has been entered into in order to avoid Finnish tax.

The provision in VML Sec. 28(2) states explicitly that the provision may only be applied if the taxpayer cannot prove that the form of a transaction corresponds to its substance, or that the real purpose of the transaction was not to avoid taxes. Therefore the GAAR cannot be applied if genuine commercial reasons for the transactions are shown.

In addition to this GAAR, there are in the Finnish tax law special anti-avoidance rules (SAARs), for instance in the Act on Business Taxation (1968/360; hereinafter EVL) Sec. 52h, concerning business restructurings, in the Act on Value Added Tax (1501/1993; hereinafter AVL) Sec. 181, in the Act on Transfer Tax (1996/931; hereinafter VSVL) Sec. 37, and in the Act on Inheritance and Gift Tax (1940/378; hereinafter PerVL) Sec. 33a.

According to EVL Sec. 52h, the statutes in EVL Sec. 52 and 52a-52g do not apply if it appears to be evident that the operations have tax avoidance as their exclusive or one of their principal objectives.

According to AVL Sec. 181, the legal form of the arrangement is irrelevant for taxation if the form does not correspond with the real nature and purpose of the matter. Furthermore, if the measures have clearly been taken to avoid tax, the amount of tax can be estimated.

According to VSVL Sec. 37, if a transaction has been assigned a legal form that does not correspond with its real nature and purpose, taxation should take place as if the correct form had been adopted. In addition, it must be evident that the transaction has been entered into to avoid Finnish tax.

According to PerVL Sec. 33a, if the legal form given to the agreement concerning the sharing-out of the estate, disposal action or any other legal proceeding with impact on the inheritance or gift tax does not correspond with the real nature and purpose of the matter, or if the measures have clearly been taken to avoid tax, the taxation should take place according to the real nature and purpose of the matter.

13.1.2. Administrative regulations

The Tax Administration regularly gives instructions to its units on various tax questions to ensure uniform tax law interpretations throughout the whole country. The tax authorities have also given their instructions on applying the GAAR in VML Sec. 28 (*see* Instruction 24.10.2014 A126/200/2014). According to these instructions, applying the GAAR in VML Sec. 28 is always exceptional, and, therefore, the circumstances of the matter and the purpose and grounds of the taxpayer’s arrangements have to be examined. If the arrangements are based on valid commercial reasons, the GAAR cannot be applied. If the valid commercial reasons are missing, the GAAR can be applied, but only in case the arrangement has given an evident tax benefit to the taxpayer.

13.1.3. Tax rulings

In Finland it is not possible for the Tax Administration and the taxpayer to agree on the duty to pay or the amount of taxes.

However, there is an advance tax ruling procedure available, according to which the taxpayer can, in advance, request a binding interpretation of the law, in case he executes the arrangement described in the petition. Advance

tax rulings are handled by the tax authorities or a certain board, called *Keskusverolautakunta* (Central Tax Board; hereinafter KVL).

Advance tax rulings are commonly used, especially in connection with mergers and divisions and other business restructurings. The advance tax ruling helps to estimate the amount of the transaction costs of the planned arrangement. However, the ruling is normally denied in case there is uncertainty on tax avoidance in the taxpayer's plans.

The advance tax ruling can be requested regarding various taxes, as income tax (VML Sec. 85), AVL Sec. 190, PerVL Sec. 39a, VSVL Sec. 39 and Act on Withholding Tax (1978/627; *LähdeveroL*) Sec. 12a.

It is possible to appeal against the advance tax ruling given either by the Tax Administration or KVL. The right of the tax recipients in tax matters and also in appeals is overseen by the Tax Recipients' Legal Services Unit (VOVA). This unit is independent of the tax authorities.

KVL will give advance tax rulings only concerning income tax and value added tax.

13.1.4. Case law

According to the Finnish Constitution, taxes must always be based on law. However, the nature and role of the GAAR in VML Sec. 28 has seldom been questioned as part of the Finnish tax system. On the contrary, concerning the application of the general anti-avoidance provision there is an abundance of case law dealing mainly with domestic situations. It seems that the general provision leaves room for judicial interpretation to a considerable extent. The wide variety of decisions of the KHO (Supreme Administrative Court) nevertheless covers the interpretation on most of the questions that have arisen so far.

Tax avoidance has been identified most commonly in situations where reaching for tax benefits has occurred in connection with various sale, donation or rental arrangements, and business restructurings. Because the taxation of capital gains differs compared to earned income, achieving tax benefits is often attempted through transforming earned income, such as salaries, to capital gains or another kind of income from capital.

In the case law, tax avoidance has been identified, for example, in the following decisions from the KHO:

- KHO 1999:63 concerns the division of a limited company that performed auditing and tax consulting. The division was said to be necessary for recruiting new auditing experts for the business. Although there were valid commercial reasons for the arrangement, the court held, however, that the principal objective in the arrangement was tax avoidance according to EVL Sec. 52g (currently EVL Sec. 52h).

- KHO 2012:56 concerns the back-and-forth selling and buying of shares in a listed company. Because of tax avoidance, the sales losses could not be deducted in taxation from the sales profits.

- KHO 2013:44 concerns the division of a company operating in the tourism industry. The division was said to be necessary for the realization of the property after the business activities had been wound up. The court held that, under the circumstances of the case, the division could not be accepted in taxation because one of the principal objectives for the division was tax avoidance according to EVL Sec. 52h.

- KHO 2014:66 concerns the share-based incentive system for the senior management of a listed company (hereinafter PLC). Part of the shares of PLC was acquired by a holding company owned by the management. The acquired shares were financed partly by the management with equity investments and partly by a loan granted to the holding company by PLC. The shares would remain in the possession of the holding company until the arrangement was dissolved, e.g. by selling the shares in some way or by merging the holding company with PLC. The court held that the arrangements could be assessed, as a whole, on the grounds of the tax avoidance rules and, because of this, the income that the member of the management had gained through this incentive system could, with certain limitations, be taxed as earned income on the basis of the employment relationship and not as capital income.

- The SAC has on given two published decisions (KHO 2016:71 and KHO 2016:72) on 19 May 2016 regarding companies. In both decisions, the SAC did not allow the Finnish branch of a foreign company to deduct the interests that were originated from the financial intragroup loan arrangements after the acquisition of the shares of the Finnish company. In one of these decisions (KHO 2016:72), the SAC applied the Finnish GAAR in VML Sec. 28. In the other decision (KHO

2016:71), the SAC considered that neither the shares, loan nor interest belonged to the branch at all. Therefore, the interest was not deductible from the start on the basis of the general rules of the Act on Business Taxation (EVL). The SAC thus considered that there was no need to apply the GAAR.

Both of these decisions also relate to the actual business and location of the branch in Finland. Furthermore, the Finnish provisions of taxation of group of companies as well as application of them and possible mismatches in cross-border arrangements had an effect on these cases. However, the decisions have caused public debate among tax experts on whether the scope of interpretation of GAAR has become wider.

See more case law on tax avoidance: KHO 28.4.2010/926, and KHO 28.4.2010/927.

13.1.5. Other eventual judicial bodies

In Finland, judicial competence is not exercised by arbitration or economic-administrative instances or similar bodies.

13.1.6. Influence of the interpretation in other jurisdictions, OECD soft law or the case law of the ECJ

The GAAR in VML Sec. 28 is of national origin. This statute has long roots in history (*see* section 13.1.1.). The SAAR in EVL Sec. 52h is, for its part, based on the Merger Tax Directive (Council Directive 2009/133/EC of 19 October 2009 on the common system of taxation applicable to mergers, divisions, partial divisions, transfers of assets and exchanges of shares concerning companies of different Member States and to the transfer of the registered office of an SE or SCE between Member States), Article 15(1)(a), and so it is of EU origin. The scopes of application of these two statutes are not congruent. However, the basis in both statutes is to emphasize valid commercial reasons (genuine economic activity).

When applying the GAAR in VML Sec. 28, tax avoidance has been limited to situations in which the taxpayer tries to achieve tax benefits that are contrary to the purpose of the tax law in question. Notice is taken of the circumstances in casu, and, especially, whether the arrangement is wholly artificial or economically meaningless without these tax benefits, and whether the

arrangement is based on valid commercial reasons. Unjust tax benefits are denied by taxing the arrangement as if a proper form were used.

When applying the SAAR in EVL Sec. 52h, the central element in the assessment is whether the arrangement, as merger (EVL Sec. 52a), division (EVL Sec. 52c), transfer of business (EVL Sec. 52d) or exchange of shares (EVL Sec. 52f) is lacking valid commercial reasons. Because of the EU origin of these statutes, the interpretation is strongly influenced by EU case law (e.g. ECJ, 17 July 1997, Case C-28/95, *Leur-Bloem*; ECJ, 5 July 2007, Case C-321/05, *Hans Markus Kofoed v. Skatteministeriet*; and 10 Nov. 2011, Case C-126/10, *Foggia*).

In Finnish case law, as regards the TP, a stand has been taken on the situations where the legal problem has concerned the possibilities of re-characterizing the transaction (*see* section 13.3.). The Finnish national legislation contains a statute on the arm's length principle in VML Sec. 31. Conditions agreed upon between related or controlled parties (normally groups of companies) that are against the arm's length principle can be corrected and adjusted in taxation.

According to VML Sec. 31, if in a transaction between a taxpayer and a related party, these parties have agreed on terms or imposed terms that differ from those that would have been agreed upon between independent parties, and for this reason the taxpayer's business profits or income from other activity remain smaller or the taxpayer's loss becomes greater than it otherwise would have been, the income is increased by the amount that would have been accrued when the terms had corresponded to what would have been agreed on between independent parties.

The principle also applies to transactions between an enterprise and its PE.

The arm's length principle is interpreted by paying attention, among other things, to the OECD Transfer Pricing Guidelines (TPG) (*see*, for example, KHO 2013:36 and KHO 2014:33). However, the court held in the decision KHO 2014:119 that it was not allowed to re-characterize the loan from the parent company, and handle the loan as equity in taxation of the subsidiary. The court summarized that the principles in the TPG, paragraphs 1.64 and 1.65, could not be applied because the statute in VML Sec. 31 does not contain sufficient legal authorization for the re-characterization of the transaction. The court also held that the interpretation of Article 9 in the tax treaty in question could not overrule domestic tax regulations. Thus, the Finnish tax law had priority and sovereignty over the TPG.

As a whole, without the support of the GAAR in VML Sec. 28, the re-characterization of a transaction is not possible. On the basis of the statute in VML Sec. 31, the Tax Administration can only require that the arm's length principle shall be followed. It is important to know that in case KHO 2014:119 it was not at all claimed that the transaction had been carried out in order to avoid tax. Therefore, applying the GAAR in VML Sec. 28 was out of the question in that case.

The case KHO 2014:119 concerned a hybrid instrument. These instruments have, among other things, a BEPS connection. Finland will, at the moment, implement the rules of the amendment (Directive 2011/96/EY) to the Parent-Subsidiary Directive (Directive 2014/86/EU). The government bill concerning the amendments to EVL Sec. 6a(9)(1) has been given to the parliament (*see* Government Proposal No. 59/2015). According to this proposal, the dividends can exceptionally be taxed to the extent that such profits are deductible by the subsidiary in the other state.

Finland will also implement the rules of Directive 2015/121, which contains a special anti-abuse clause. The government bill concerning the amendments to EVL Sec 6a(9)(2) and (10), has been given to the parliament in the same legislative proposal no. 59/2015. According to this proposal, dividends are taxable income if it concerns an arrangement or series of arrangements that has as its main purpose or one of the main purposes to obtain a tax advantage that defeats the object or purpose of the paragraph (i.e. EVL Sec. 6a), and that is not genuine having regard to all relevant facts and circumstances. In addition, an arrangement or a series of arrangements shall be regarded as not genuine to the extent that they are not put into place for valid commercial reasons that reflect economic reality. This anti-abuse clause does not, however, preclude the application of other statutes in law or agreement-based provisions, the purpose of which is the prevention of tax avoidance or tax evasion.

13.1.7. Influence of BEPS

As explained above (*see* section 13.1.6.), the proposed legislation (amendment to EVL Sec. 6a) tries to tackle the arrangements, which are aimed at obtaining unjust base erosion advantages. The legislation is based on the revision of the Parent-Subsidiary Directive, and it is part of measures proposed in the Action Plan 6.12.2014 of the Commission for a more effective EU response to tax evasion and avoidance. The new legislation would also be in line with a more global goal in order to prevent group companies

from benefiting from hybrid mismatch arrangements (*see* OECD/G20 BEPS Project, BEPS 2015 Final Reports, Action 2: Neutralising the Effects of Hybrid Mismatch Arrangements).

Concerning interest on loans, it is worth noting that in Finland there are no thin capitalization rules, as in many other countries. Normally, interests on loans obtained for business purposes are deductible in full, and on an accrual basis. However, according to EVL Sec. 18a, the deductibility of interest is limited in a certain way. These limitations are explained below (*see* section 13.7.) and recent case law above (*see* section 13.1.4.).

13.1.8. Amendments to tax law

Finnish tax law has not, so far, contained any special provisions to intervene in benefiting hybrid mismatch arrangements. By applying the GAAR in VML Sec. 28 this might be, in casu, possible but there is no case law of the application of VML Sec. 28 to hybrid instruments. As mentioned in section 13.1.6., in the decision KHO 2014:119, the court only held that the application of the TP rules in VML Sec. 31 was not sufficient in order to re-characterize a hybrid instrument, but in that case the court did not at all take a stand on the application of GAAR in VML Sec. 28.

The proposed amendment to EVL Sec. 6a would certainly give the Tax Administration more effective means of preventing double non-taxation benefits through hybrid loan instruments. However, these measures would not tackle the whole problem, because not even this new legislation would justify the re-characterization of a hybrid instrument in taxation.

13.2. The meaning of tax planning, abusive tax planning and aggressive tax planning in national legal systems

13.2.1. Legal definition of tax planning, abusive tax planning or aggressive tax planning

The legislation in Finland does not contain any definition of tax planning, abusive tax planning or aggressive tax planning.

13.2.2. Administrative regulations

Nor have these concepts been defined in administrative regulations. Tax authorities have in their instructions (*see* section 13.1.2.: Instruction 24.10.2014 A126/200/2014) emphasized that the taxpayer has the right to tax planning. The instructions summarize as follows:

> The taxpayer is allowed to minimize his taxes by planning. The circumstances and means are chosen in order to obtain an optimal result, as regards for instance the amount of taxes. If the transactions are based on genuine commercial reasons, the taxpayer can choose such course of action, which may yield him fewer taxes than some alternative arrangement. In tax planning normally only such alternatives will be chosen the consequences of which are acceptable both in taxation practice and case-law.

13.2.3. Tax rulings

As explained above (*see* section 13.1.3.), it is possible for the taxpayer to ask an advance tax ruling. If the ruling given by the KVL is not appealed, the ruling becomes final and binding in the taxation of the taxpayer, provided that the taxpayer pleads the ruling. Normally and quite naturally, if the advance tax ruling is unfavourable from the taxpayer's point of view, the ruling will not be pleaded. Therefore the case law concerning the interpretation of tax planning or aggressive tax planning consists solely of the decisions of the KHO.

13.2.4. Case law

Tax planning has not been explicitly defined as a concept in the case law. According to the established practice, if various alternative means for arrangements are given in the law, the taxpayer is allowed to choose the one that he feels is best suited to his plans. The taxpayer is not obliged to choose such an alternative, which will lead to the heaviest tax burden. However, the border for acceptable tax planning will be crossed if the taxpayer tries to achieve that kind of tax benefit, which is contradictory to the purpose of the law, or if the legal form that is used in the arrangement does not correspond with the economic substance of the arrangement. The border for acceptable tax planning can thus be best defined in the negative: if this border is crossed, the question can be of tax avoidance (*see* section 13.1.4.).

13.2.5. Overlap

There is no significant overlap between the concept of tax planning in the legislation, tax regulations and case law.

13.2.6. Other judicial bodies

Because judicial competence is not exercised by bodies that are not strictly judicial (for instance arbitration courts or economic-administrative), there is no problem of inconsistency.

13.2.7. Influence of the interpretation in other jurisdictions, OECD soft law or the case law of the ECJ

As explained above (*see* section 13.2.4.), the definition and interpretation of tax planning is not specified in the law. The case law of the ECJ has influenced the interpretation of the concept of tax avoidance (EVL Sec. 52). Hence, this case law has influenced the definition of tax planning, as well.

13.2.8. Influence of BEPS

Due to BEPS, the Finnish tax law will be changed (*see* sections 13.1.6. and 13.1.7.). The amendments may have, in the future, influence on tax planning, as to the cross-border distribution of dividends.

13.2.9. Legislative amendments

See sections 13.1.6. and 13.1.7.

13.3. The reaction to avoidance and aggressive tax planning in the BEPS context

13.3.1. Domestic general anti-avoidance rules (GAARs)

13.3.1.1. GAAR in Finnish legal system

As explained above (*see* section 13.1.1.), there is a GAAR in Finnish law (in VML Sec. 28) and various special provisions (SAARs) concerning tax avoidance in certain tax situations (business restructuring, value added tax, transfer tax, and inheritance and gift tax).

13.3.1.2. Similarity with respect to the GAAR proposed by the EC

The EC Recommendation C(2012) 8806 of 6 December 2012 proposes that EU Member States adopt a GAAR in their domestic law that reads as follows: “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”.

Although the GAAR in VML Sec. 28 is by structure different from the GAAR proposed by the EC, the clause is, in spite of that, interpreted in practice by quite similar criteria (*see* section 13.1.4.) as mentioned in the wording of the EU proposition: artificial arrangement, genuine economic substance, and purpose of avoiding tax.

The provision in EVL Sec. 52h, which concerns business restructuring, like mergers, divisions, transfers of assets and exchanges of shares, follows in wording and purpose the EU Merger Tax Directive (2009/133/EU), article 15.

13.3.1.3. Compatibility with the EU/EEA concept of abuse

The GAAR in VM Sec. 28 has, in the case law, proven to be quite functional in identifying tax avoidance, mostly due to its nature: the statute has been, on purpose, enacted as a flexible norm. Considering the essential criteria in applying the statute, it is obvious that the GAAR in VML Sec. 28 is quite compatible with the EU/EEA concept of abuse. The Finnish GAAR effectively tackles fully artificial arrangements that are lacking in sufficient

economic reasons, or that are carried out by using a legal form that is contradictory to the economic substance of the arrangement.

13.3.1.4. Analysis of the Finnish national GAAR

In the analysis of the GAAR in VML Sec. 28, the following elements are relevant:
(a) Main objective test (the accrual of a tax advantage, the grant of which is contrary to the purpose of the legal provision);
(b) obtaining a tax advantage as the essential aim of the transactions concerned;
(c) complementary business purpose test;
(d) subjective element, consisting of the intention to obtain a tax advantage; and
(e) the principle of proportionality.

13.3.1.5. Interpretation in the case law

The wide variety of decisions of the KHO covers the interpretation on most of the questions that have arisen so far. As explained above (*see* section 13.1.4.), KHO has confirmed three cornerstones for the interpretation: (i) tax planning is allowed; but (2) the means that the taxpayer uses in his arrangement have to be in line with the purpose of the law; and (3) the form has to correspond to the economic substance of the arrangement. For instance, in the decision KHO 2014:66, the court points out as follows:

> It is evident that one goal in this structure is an arrangement where the benefit on the basis of employment relationship would avoid the taxation as earned income. The taxpayer has, on the one hand, right to choose between various alternatives a most favorable course of action. On the other hand, the actions ought to be assessed in taxation according to their real economic nature.

13.3.1.6. Differences of opinion

In some of the cases referred to concerning the GAAR in VML Sec. 28 (*see* section 13.1.4.), the opinion of the Tax Authority has been different from the result in the final decision. Thus, the Tax Administration does not always “win the case”. This is quite natural, because when the GAAR is interpreted and tax avoidance eventually assessed, various elements in the substance of the case can be emphasized in different ways. As a whole, it seems to us that the Tax Administration has tried to apply the GAAR in a quite disciplined

way and paid attention to the long tradition in interpretation of the GAAR. It is obvious, however, that especially the rapidly growing number of TP cases can increase pressure to differences in opinions. This vision concerns above all the problem of re-characterization of business transactions (*see* section 13.1.6.).

On cross-border arrangements, EU law restricts the application of the GAAR in VML Sec 28 in part. EU law requires that the transaction should be regarded as a "wholly artificial arrangement" as characterized by the ECJ in C-196-04 (*Cadbury Schweppes*). The effect of these ECJ cases has been strong on the Finnish provisions aiming especially to protect the tax base in cross-border situations, such as CFC rules. These cases have also initiated some changes in Finnish provisions concerning CFC (the Act on the Taxation of Shareholders in Controlled Foreign Corporate Entities; 1217/94, hereinafter VYL; *see* section 13.5.). Nevertheless, the GAAR in VML Sec. 28 still seems to have an effect and it could also be applicable to cross-border arrangements in the EU tax regime.

13.3.1.7. Replacement of GAAR

As far as we know, there are no propositions in order to replace the GAAR in VML Sec. 28 with the GAAR proposed by the European Union. The proposed and updated version (30 June 2016) of ATAD seems to be more defined in detail, and this might cause some need for redrafting.

13.3.2. EC Recommendation C(2012) 8806 of 6 December 2012 and subject-to-tax rule

13.3.2.1. Introducing a subject-to-tax rule as proposed by the EC in its DTCs

EC Recommendation (8806) proposes also a subject-to-tax rule aimed at dealing with double non-taxation:

> 3.2 …Member States are encouraged to include an appropriate clause in their double tax convention ("DTC")…it could read as follows: Where this DTC provides that an item of income shall be taxable only in one of the Contracting State ("CS"), the other CS shall be precluded from taxing such item if this item is subject to tax in the first CS.

> 3.3. 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 the item is not subject to tax, Member States are encouraged to ensure that the item is taxed.
>
> 3.4…. 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.

So far no final measures have been taken in Finland for introducing the proposed subject-to-tax rule in EC Recommendation (8806).

13.3.2.2. Eventual introduction

Finland has reviewed the proposal of the EC. Finland is not planning to introduce the subject-to-tax clause as in most of the tax treaties concluded by Finland the credit method is used for the elimination of double taxation.

13.3.2.3. Does your domestic GAAR correspond to the proposed GAAR?

The Finnish GAAR corresponds rather well with the proposed GAAR. The main difference might be that the Finnish GAAR VML Sec. 28 applies both CIT and personal income taxation. It seems also that the updated ATAD version (17 June 2016) corresponds even better with the Finnish one than the original version. The proposed and updated version seems to be more defined in detail. Therefore, it might cause more open questions while implemented, and especially later in the phase of interpretation.

The SAC has given two published decisions on 19 May 2016 regarding the interest deduction and "debt push down" arrangements within international groups of companies (about decisions, *see* section 13.1.4.).

13.3.2.4. Will your SAARs have to be redrafted/amended according to the rules in the ATAD Proposal?

At least partly, the Finnish SAARs ought to be redrafted because of the ATAD Proposal.

On the whole, the provision of limitation on the deduction of interest in Finland (EVL Sec. 18a) is quite similar to the proposed ATAD

(17 June 2016). It is also based on the calculation of earnings before interest, taxes, depreciation and amortization (EBITDA). Instead of having the proposed limits of EUR 3 million and 30%, in Finnish provisions the limits are EUR 500,000 and 25%. However, the Article 4 in the updated proposal includes so many details and definitions that the need for redrafting has to be considered carefully.

Even more obvious is the need for a redrafting of the Finnish exit tax provisions. The elements of the right to defer the payment, interest to be charged and requirement to provide a guarantee should be implemented also to be part of the Finnish exit taxation. These changes were also proposed in 2013 in the memorandum of the Finnish tax expert group, set by the Ministry of Finance. The lack of these amendments is already causing conflict between the Finnish exit taxation and the EU tax law.

Articles 8 and 9 in the proposal include such definitions and amendments that the implementation may cause a need for redrafting of the Finnish CFC provisions both concerning detailed definitions of the CFC and computation of their income. Also, implementing Article 9 on hybrid mismatches may necessitate the redrafting of Finnish tax provisions.

13.4. Transfer pricing rules, GAARs, specific anti-avoidance rules (SAARs) and linking rules

13.4.1. National TP rules

According to the Finnish TP rules (both national legislation and tax treaties), intragroup transactions (associated enterprises) should be valuated, for tax purposes, corresponding the comparable price used in arrangements between independent, non-related parties, i.e. according to the arm's length principle (VML Sec. 31, *see* section 13.1.6.). The adjustment of the conditions has always to be based on sufficient analysis of pricing in comparable transactions between unrelated parties. In TP cases it is not relevant to examine the motives of the parties, for instance whether the parties have tried to avoid tax.

The taxpayer must state in its tax return whether it has made related-party transactions. As regards to intragroup cross-border transactions, the taxpayer has to produce transfer pricing documentation (VML Sec. 14a-14c). The Tax Administration has 16 April 2009 given instructions in English on the TP documentation requirements (abbreviated version in English; *see*

also the original and more thorough Finnish instruction No. 1471/37/2007 from 19.10.2007, *Siirtohinnoittelun dokumentointi*).

In some cases it may be possible to apply the GAAR in VML Sec. 28 instead of or together with the TP adjustment rule in VML Sec. 31. The scopes of application of these two statutes are overlapping for some part. As explained above (*see* section 13.1.6.), re-characterization of the transaction is allowed only by applying the GAAR in VML Sec. 28. The condition for applying the GAAR in VML Sec. 28 is the purpose to avoid tax.

In the Tax Administration, the TP matters are handled by a special project, Transfer Pricing Program, in the Large Taxpayers' Office (called KOVE). According to the statistics of this KOVE project, the amounts of adjustments of tax during the period 2012-2014 are set out in Table 13.1. as follows:

Table 13.1. Amounts of adjustments of tax during the period 2012-2014

	2012	2013	2014
Number of cases	32	28	35
Adjustment (in EUR)	310 384 958	877 835 105	827 497 814

13.4.2. Litigation

The TP rules raise litigation quite often, and the adjustment of the TP quite often leads to an appeal. The reason for this may be the fact that the tax-payer can ask the enforcement of the adjustment decision to be prohibited only in case he appeals the decision. It is worth noticing that in Finland it is not possible to appeal the results achieved in MAP procedures (mutual agreement procedure).

There are no statistics on appeal cases, but the number concerning the MAP cases can be found in the Annex 1.

13.4.3. Case law

Tax adjustments have resulted in a lot of questions about the interpretation of domestic law, the TPG and tax treaties, and especially about the mutual relation between these rules. In the legislation there is no reference to the TPG. In the case law, the reference has been confirmed (*see* section 13.1.6.).

Also, the methods of the Tax Administration, the TP programme and tax audits have been inquired about. Because listed companies have strict rules on giving press releases on all information that may affect stock prices, some of the cases have been vividly discussed in the media.

We reviewed above (*see* section 13.1.6.) the decision KHO 2014:119, which concerns a hybrid loan to a Finnish limited liability company from its main owner based in Luxembourg. According to the KHO, the loan could not be treated – re-characterized – as an equity instrument in taxation based purely on VML Sec. 31, and therefore, in that case, the interest was tax deductible.

The decision KHO 2014:33 concerns the TP related to valuation of shares sold within the group of companies.

The decision KHO 2010:73 concerns the arm's length interest in intragroup financing structure.

Many of the recent KHO decisions are still from the time before the TP programme.

13.4.4. LOB rules in double taxation conventions

At the beginning of 2015, Finland had a double taxation avoidance treaty covering income tax, with 77 states. As a rule, these tax treaties do not contain any LOB clauses. Only the mutual tax treaties agreed between Finland and the United States (3/2008) and Barbados (79/1992) contain such clauses.

In the tax treaty with the United States (Article 16, Limitation of Benefits) only such taxpayers are entitled to benefits by the treaty (Convention) who are genuinely located in the contracting state (*see* Government Proposal 95/2006). Nevertheless (Article 16.6), a resident of a contracting state that is not entitled to benefits pursuant to the preceding paragraphs of Article 16 shall be granted benefits of the convention if the competent Administration of the other contracting state determines that the establishment, acquisition or maintenance of such person and the conduct of its operations did not have as one of its principal purposes the obtaining of benefits under the convention. The competent Administration of the other contracting state shall consult with the competent Administration of the first-mentioned state before denying these benefits.

The treaty between Finland and Barbados contains the same kind of limitations (Article 27, Limitation of Benefits).

Furthermore, the benefits by a tax treaty may be denied in Finland by applying the GAAR in VML Sec. 28, if these benefits have been tried to obtain by fully artificial arrangements.

13.4.5. CFC rules

The Act on the Taxation of Shareholders in Controlled Foreign Company Entities (1994/1217; *Väliyhteisölaki*, hereinafter VYL) came into force at the beginning of 1995. The purpose of this special law is to prevent avoiding the Finnish taxation through artificial arrangements by utilizing companies in tax haven countries or certain low-tax states. The law may apply if one or more Finnish residents control a foreign corporate entity registered in a state, which does not impose tax or imposes tax only at low rates. According to VYL, a resident shareholder with a share in a controlled foreign company is liable to pay tax on his share in the CFC's income if certain conditions are met. When applying the CFC regime the controlled foreign company is assessed on the whole. The scope of application does not cover industrial production or similar activities or ship owning (VYL Sec 2.3).

During the last decade the change of some of these conditions was triggered by the decision made on 12.9.2006 by EU Court C-196-04 (*Cadbury Schweppes*). Although the decision concerned the CFC rules of the UK, the case clearly brought up the contradiction between the Finnish CFC regime and the EC Treaty and the EEA Agreement principle of the freedom of establishment. The VYL was, therefore, changed, and the changes came into force in 2009 (680/2008).

According to VYL Sec. 2, a resident entity of an EU, EFTA or a tax treaty state falls outside the scope of CFC treatment when the following conditions are met:

(a) exchange of information in tax matters between the states' administrations is arranged sufficiently,
(b) the entity is actually established in its state of residence; and
(c) the entity carries out genuine economic activities in that state.

The decisions of the Supreme Administrative Court after the changes to the scope of the CFC rules have concerned countries like Singapore (not treated as a CFC according to KHO 2011:42), Hong Kong (treated as a controlled

foreign company according to KHO 2012:118 because the planned production was to be established in continental China instead of Hong Kong) and Malaysia (the subsidiary offering technical support globally in the field of information technology was not to be treated as a CFC according to KHO 2014:198).

According to VYL Sec. 2(1) a company is a qualified CFC only if the rate of income tax levied in the residence state is, de facto, lower than 3/5 of the income tax levied in Finland. Because the current level of the corporate tax rate in Finland is 20%, the CFC conditions can only apply to countries with an actual rate of income tax for CFC less than 12% (3/5 of the 20% tax rate of a corporate body resident in Finland).

Although the VYL is aimed, as a special regime, at tackling international tax avoidance, it still is possible to apply, together with VYL or separately, the GAAR in VML Sec. 28 or VML Sec. 31 on TP adjustment, provided that the requirements for applying these statutes are met. On the other hand, applying VYL does not demand the purpose of avoiding tax.

13.4.6. Introducing linking rules as recommended in OECD/ BEPS Action 2

As explained in section 13.1.6., Finnish tax law does not contain any special statutes for tackling hybrid mismatch arrangements. As mentioned, the law will be changed soon with amendments to EVL Sec. 6a (*see* Government Proposal HE 59/2015; *see* sections 13.1.6. and 13.1.7.) in order to implement two EU directives (2014/86/EU and 2015/121). These new rules in EVL Sec. 6a do not, however, prevent applying the GAAR in VML Sec. 28 or VML Sec. 31. Nevertheless, VML Sec. 31 does not allow the re-characterization of an arrangement.

In addition, the statutes in VYL or in EVL Sec. 18a (limitations of interest deductibility) can also be applied in hybrid loan arrangements, for some part.

13.4.7. Limitation on the deduction of interest

In Finland, the law does not contain any rule concerning thin capitalization. The thin capitalization rules have been mentioned in some working group memorandums and government proposals. The Ministry of Finance did not,

however, take the action and give a proposal in order to amend thin capitalization rules as a part of the Finnish tax system. Instead, new provisions on interest deduction limitation were added to the Finnish tax system. This has had an impact on the vivid debate concerning the re-characterization in TP cases.

The right of corporate bodies, general partnerships and limited partnerships to deduct interest expenses has been limited in business taxation from the beginning of 2014. The objective of these statutes has been to safeguard the tax base in Finland and to discourage the tax planning of companies through directing the group's interest to low-tax jurisdictions.

According to EVL Sec. 18a (28.12.2012/983), interest expenses are deductible in full to a sum equivalent to interest income. Where net interest expenses, meaning interest expenses that exceed interest income, are no more than EUR 500,000 they can be deducted in full.

The amount of interest expenses exceeding EUR 500,000 is tax deductible to the amount corresponding to at most 25% of the business income tax result. Net interest expenses exceeding the 25% amount are non-tax deductible. However, the sum of non-tax deductible interest expenses based of the 25% limit is at the most an amount corresponding to intragroup net interest expenses. The deductible percentage was originally 30% but the interest deduction limitation rules were slightly tightened, as the maximum amount of deductible interest was reduced from 30 to 25% and the losses and changes in the value of financial assets were removed from the items added in the calculation base of this percentage share. These changes were made in 2013 and they came into force at the beginning of 2014, when the provisions were applied for the first time.

The restriction of the right to deduct interest expenses is a general restriction. It applies to both domestic and foreign corporate bodies and partnerships, and is imposed on both national and cross-border interest payments. Where a business provides documentation according to which the ratio of equity to the financial accounts balance sheet total is higher or equal to the same ratio in the confirmed group balance sheet, the restriction on the right to deduct interest expenses is not imposed.

Non-tax deductible net interest expenses can be deducted from the taxable income of successive fiscal years within the yearly limits of tax-deductible interest expenses.

It is possible to make an appeal on non-tax deductible net interest expenses for the fiscal year to which the decision on non-tax deductible net interest expenses pertains.

The KVL and KHO have given several published decisions on the interpretation of interest deduction limitation rules (*see*, for example, decisions KVL 10/2014, KHO 2015:11, KHO 2015:37, KHO 29.4.2014 T 1443 and KHO 14.1.2015 T 64). The appeals have, among other things, handled the questions relating to the interpretation of the ratios mentioned and how the ratio in the confirmed group balance sheet is defined in practice.

Interest deduction limitation rules do not apply to credit institutions or insurance and welfare institutions or, to a certain extent, to their affiliated bodies.

Although the right to deduct interest expenses can be limited by applying EVL Sec. 18a, also the GAAR in VML Sec. 28 and VML Sec. 31 may be applied, at least according to the preliminary works of the law (*see* Government Proposal 149/2012, 18), in case the requirements for the application of these statutes are met. The SAC has given two published decisions (KHO 2016:71 and 2016:72) on 19 May 2016 regarding the interest deduction and "debt push down" arrangements within international groups of companies (*see* section 13.1.4.).

13.4.8. SAARs in Finnish tax law

Finnish legislation contains various SAAR rules: in EVL Sec. 52h, concerning business restructurings; in AVL Sec. 181, concerning value added tax; in VSVL Sec. 37, concerning the transfer of real property or shares; and in PerVL Sec. 33a, concerning inheritance and gift tax. The contents of these rules were described above (*see* section 13.1.1.).

As far as the SAAR concerns income tax, like EVL Sec. 52h, the statute can be applied either separately or together with the GAAR in VML Sec. 28. According to the rule of *lex specialis*, the SAARs nevertheless derogate from the general GAAR in VML Sec. 28.

The statute in VML Sec. 29 is also a kind of SAAR. The statute covers so-called hidden dividend or hidden profit transfer (the Finnish term: *Peitelty osinko*) situations. VML Sec. 29 concerns an arrangement where a shareholder for instance will sell property or services to his company or buy property or services from the one. If the price in the deal does not correspond

to the fair market value, the price will be adjusted for tax purposes. The adjustment will be the difference between the fair market value and the price that was actually paid.

This adjustment leads to denying the deduction of payment to the amount of this difference, and the difference is included in the taxable income of the enterprise or the shareholder, respectively, depending on the contents of the deal, whether it was a purchase or sale of property or services.

In case the economic benefit in the form of over- or underpricing is obtained by a family member of the shareholder, tax will nevertheless be targeted to the shareholder.

Actually VML Sec. 29 is not, by nature, a SAAR at all. This is because the statute can be applied objectively: whether the taxpayer has tried to obtain tax advantages by mispricing the deal, is irrelevant. Also, the fact of whether the taxpayer has acted in good faith, bears no relevance.

The proposed new EVL Sec. 6a(10) (Government Proposal 59/2015, *see* section 13.1.6.), concerning the dividends from the subsidiary to the parent company, would be a SAAR by nature, although in the proposal the statute is described as a general anti-abuse statute covering the taxation of dividends.

13.5. Application of GAARs, TP rules and SAARs

13.5.1. Interaction of GAARs, TP rules, SAARs and linking rules in the Finnish legal system

When the court makes a choice between various competing rules, the *lex specialis* derogates from the *lex generalis*. This priority rule was referred to in the previous chapter. In the context of business restructurings, the rule means that the GAAR in VML Sec. 28 gives way to the SAAR in EVL Sec. 52h.

13.5.2. Hierarchy, coordination or overlapping of measures

Another perspective to the application of a GAAR is at hand when the statute is applied, together with another provision, such as the special profit adjustment provision in VML Sec. 31. An example of this would be the case where an intragroup transaction includes a clear tax avoidance purpose. The application of both of these provisions together may make it possible

for Finland to tax such profits in a TP situation; applying solely the special profit adjustment provision this result might not be possible. The theme is a question of the day in Finland: the current discussion concerns the problem of re-characterization of, for instance, a loan to equity or the whole business model of the taxpayer's enterprise (*see* section 13.1.6. and KHO 2014:119).

13.5.3. Procedural rules underlying application of the Finnish GAAR, TP rules and/or SAARs

The rules in VML form a procedural base on the income tax section.

13.5.4. Application of procedural rules

In Finnish case law (for example KHO 2012:56, KHO 2013:44 and KHO 2014:66), the main view is that the taxpayer is, basically, allowed to choose for his arrangement an alternative that he feels is economically most suitable for this purpose (*see* section 13.2.4.). In other words: the threshold in order to interfere with the arrangement by applying the anti-abuse rules is quite high. The Tax Administration must have a justifiable reason to doubt that the real motive has been tax avoidance. If this is the case, according to VML Sec. 28(2), the Tax Administration must carefully examine all the circumstances. The taxpayer should contribute to the result, because according to VML Sec. 26(4) both the Tax Administration and the taxpayer shall take part in clarifying the facts, both according to its possibilities and resources.

If the Tax Administration suspects that tax avoidance has taken place, according to VML Sec. 28(2) the taxpayer must be given the opportunity to clarify the facts and make a statement. At this stage the burden of proof will be turned: the taxpayer has to prove that the form of his transaction corresponds to its economic substance, and that the real purpose of the transactions was not to avoid taxes. In practice, the duty of clarifying the facts is, however, divided between the Tax Administration and the taxpayer, because, according to VML 26(4), the party who has the best resources for the investigation has to produce evidence.

The SAAR statutes do not contain any rules on hearing. The obligation of hearing nevertheless concerns these situations, as well. According to VML Sec. 26(3), the taxpayer always has to be heard in case he shall be taxed substantially against the tax return he has given. If the taxation is based on the tax avoidance rules, the question is always of a substantial conformity.

Chapter 14

France

Emmanuel Raingeard de la Blétière*

14.1. The meaning of avoidance and aggressive tax planning and the BEPS initiative

As a matter of introduction, it seems necessary to define the key concepts to be used in this chapter. Indeed, nowadays, terms such as "tax fraud", "tax evasion", "tax avoidance", "tax arbitrage", "tax optimization", "tax planning", "aggressive tax planning" and "abusive tax planning" are widely used but often undefined.

If the terms "tax fraud" and "tax evasion" in English are broadly synonymous, it seems that the former – but not necessarily the latter – is used to designate a criminal matter.

Looking at the IBFD International Tax Glossary, "tax fraud" may be considered as "a form of deliberate evasion of tax that is generally punishable by law. The term includes situations in which deliberately false statements are submitted, fake documents are produced, etc. Sanctions may include civil or criminal penalties".[1] The definition offered in the OECD Glossary of Tax Terms[2] is broadly similar but clearly states that "fraud" is "generally punishable under criminal law". The European Commission has used this definition.[3]

"Tax evasion" is defined by the IBFD International Tax Glossary as "intentional illegal behaviour, or as behaviour involving a direct violation of tax

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1. *IBFD International Tax Glossary*, 5th ed., p. 186 (B. Larking ed., IBFD 2005).
2. OECD, *Glossary of Tax Terms*, available at http://www.oecd.org/ctp/glossaryoftax-terms.htm (accessed 1 Feb. 2016).
3. European Commission, *Communication from the Commission to the European Parliament and the Council on concrete ways to reinforce the fight against tax fraud and tax evasion including in relation to third countries*, COM(2012) 351, p. 2, available at http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:52012DC0351 (accessed 1 Feb. 2016).

law, in order to escape payment of tax. Tax evasion is generally accompanied by penalties that may be, but are not always, criminal in nature. Deliberate underreporting of taxable income would generally be considered an example of tax evasion".[4] The OECD's definition adds that it is "a term that is difficult to define" but in general refers to "illegal arrangements where liability to tax is hidden or ignored".[5] The European Commission has adopted this definition as well.[6]

"Tax avoidance" is

> a term used to describe taxpayer behaviour aimed at reducing tax liability which falls short of tax evasion. While the expression may be used to refer to 'acceptable' forms of behaviour, such as tax planning, or even abstention from consumption, it is more often used in a pejorative sense to refer to something considered 'unacceptable', or 'illegitimate' (but not in general 'illegal'). In other words, tax avoidance is often within the letter of the law but against the spirit of the law. It generally contains elements of artificiality, e.g. as to the legal form adopted, and may often be considered to be contrary to the spirit of the law. However, its scope may vary from country to country, depending on attitudes of government, courts and public opinion. Some jurisdictions appear not to recognize the concept on the grounds *either that the behaviour is legitimate or, if illegitimate, that it constitutes evasion*. Examples of tax avoidance include locating assets in offshore jurisdictions [and] conversion of income to non- or lower-taxed gains.[7] [emphasis added]

According to the OECD, "avoidance" is "[a] term that is difficult to define but which is generally used to describe the arrangement of a taxpayer's affairs that is intended to reduce his tax liability and that although the arrangement could be strictly legal it is usually in contradiction with the intent of the law it purports to follow".[8]

"Tax planning" is defined by both the IBFD and the OECD glossaries as "[a] rrangement of a person's business and/or private affairs in order to minimize tax liability".[9]

Finally, the concept of "aggressive tax planning" does not appear in either of these glossaries. The European Commission, however, has offered a definition in its recent recommendation: "Aggressive tax planning consists in

4. *IBFD International Tax Glossary*, *supra* n. 1, at p. 157.
5. OECD, *supra* n. 2.
6. European Commission, *supra* n. 3, at p. 2.
7. *IBFD International Tax Glossary*, *supra* n. 1, at pp. 29-30.
8. OECD, *supra* n. 2.
9. *IBFD International Tax Glossary*, *supra* n. 1, at p. 407; and OECD, *supra* n. 2.

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. Aggressive 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)".[10] Further, it "includes the use of artificial operations or structures and the exploitation of mismatches between tax systems with the effect of undermining Member States' tax rules and exacerbating the loss of tax revenues".[11]

To make things more difficult, the French translations of these terms include many false cognates, and, in some cases, institutions have made mistakes in translating them from English to French. The IBFD International Tax Glossary stresses that "[t]he term 'evasion' tends to be used in French-speaking countries to refer to the concept of tax avoidance, while 'tax fraud' is used to refer to the concept of tax evasion".[12]

Looking at European Court of Justice (ECJ) decisions,[13] "*fraude fiscale*" is used as a translation for "tax evasion" and "*évasion fiscale*" is used as a translation of "tax avoidance". The same holds true for the EU legislator.[14] However, in its above-noted communication, the European Commission translated the terms "tax fraud" as "*fraude fiscale*" and "tax evasion" as "*évasion fiscale*".[15] Recently, the French parliament referred – in a report, not in legislation – to the definitions in the OECD glossary of "fraud", "evasion", "avoidance" and "planning" and translated them into French as "*fraude*", "*évasion*", "*évitement*" and "*optimisation*", respectively.

10. European Commission, Commission Recommendation of 6 December 2012 on aggressive tax planning, COM/2012/772/EU, recital 2, available at http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=celex%3A32012H0772 (accessed 1 Feb. 2016).
11. European Commission, *supra* n. 3, at p. 3.
12. *IBFD International Tax Glossary*, *supra* n. 1, at p. 157. *See also* B. Delaunay, *Où commence l'optimisation fiscale internationale? Fraude, évasion fiscale et tax planning*, Dr. fisc. 2013, no. 39, 437.
13. *See*, for example, UK: ECJ, 12 Sept. 2006, *Cadbury Schweppes plc and Cadbury Schweppes Overseas Ltd v. Commissioners of Inland Revenue*, [2006] I-07995, ECJ Case Law IBFD, paras. 27 and 50; NL: ECJ, 29 Nov. 2011, Case C-371/10, *National Grid Indus BV v. Inspecteur van de Belastingdienst Rijnmond/kantoor Rotterdam*, [2011] I-12273, ECJ Case Law IBFD, paras. 83 and 84.
14. *See*, for example, EU Merger Directive (2009): Council Directive 2009/133/EC of 19 October 2009 on the common system of taxation applicable to mergers, divisions, partial divisions, transfers of assets and exchanges of shares concerning companies of different Member States and to the transfer of the registered office of an SE or SCE between Member States (Codified Version), art. 15, para. 1, OJ L 310 (2009), EU Law IBFD.
15. European Commission, *supra* n. 3.

14.1.1. The meaning of tax avoidance in the French legal system

There is no definition of "tax avoidance" in French tax law, whether translated as *évasion fiscale* or *évitement*. Neither of those terms is defined. Administrative regulations also fail to provide any definition of this term, even where they sometimes refer to it.[16] The lack of definition is even more surprising taking into account the fact that the term "*évasion fiscale*" is used in the General Tax Code (*Code général des impôts*, CGI) and in the case law of the French Court of Cassation (*Cour de cassation*, Cass.) and the French Supreme Administrative Court (*Conseil d'Etat*, CE).

Tax "rulings" exist in France and cover different categories. They are generally optional.

For instance, under article L80 A of the Tax Procedure Code (*Livre des procédures fiscales*, LPF), any taxpayer can submit a request to the tax authorities for confirmation of the interpretation of a law. Furthermore, under article L80 B 1 of the LPF and some specific provisions such as article L80 B 6 (applicable in the case of a permanent establishment, PE) and L80 B 7 (on advance pricing agreements), a taxpayer may request the position of the tax authorities on the application of a provision to his factual situation.

Article L64 B of the LPF provides for a specific procedure for obtaining confirmation that a scheme is not an abuse of law. The taxpayer should provide to the French tax authorities (FTA) all relevant information necessary for assessing the abusive nature of the transaction. If the FTA do not reply within 6 months, the abuse of law procedure would not be applicable.

Even if they may not fall, *stricto sensu*, within the definition of "ruling", one should stress that French tax law also provides for "pre-authorization procedures", which are, in some cases, compulsory. They are required for companies to implement some transactions in the context of intra-group reorganizations. For instance,[17] in the case of a cross-border merger, demerger or contribution, article 210 C of the CGI obliges the taxpayer to request such

16. FR: DGFiP, BOI-SJ-AGR-20-10-20121203, para. 150; and BOI-SJ-AGR-20-20-20140716, para. 220. These administrative guidelines (and the others quoted hereafter) may be found at http://bofip.impots.gouv.fr/bofip/1-PGP.html (accessed 1 Feb. 2016).
17. Another example can be found in article 115 *quinquies* of the CGI. This provision (and the others quoted hereafter) may be found at http://www.legifrance.gouv.fr/.

an authorization from the FTA in order to benefit from a tax-neutral regime.[18] This approval will be delivered under a number of conditions, amongst which is that the operation does not have "as its principal objective or as one of its principal objectives tax evasion or tax avoidance".[19]

The administrative guidelines do not define the terms used but mention that the notion of a "principal objective of tax evasion or tax avoidance" is broader than that used in the French general anti-avoidance rule (GAAR), which is the "abuse of tax law".[20] Note that, in another guidelines, under the heading "non-tax principal objective", the FTA add that the operations should not have as an effect withdrawal of the French right to tax on the capital gains,[21] introducing the idea that it would reject a request having such a result, even where this would not be the objective of the transaction.

In one case related to those cross-border reorganizations, under article 210 C of the CGI, the Administrative Court of Appeal of Paris[22] confirmed that a reorganization could be seen as being motivated by "tax evasion or tax avoidance" when it has no valid "economic motivation". In the case at hand, this was deduced from the facts that (i) French real estate companies were merged – without taxation of unrealized capital gains due to the application of the tax-neutral regime that was applied by the taxpayer and without requesting the authorization of the tax authorities – in a Luxembourg-resident company and (ii) all real estate assets were then sold in a French tax-free manner as a result of the French interpretation of the applicable double tax treaty.

The court did not qualify the situation (i.e. specify whether it constituted tax evasion or tax avoidance). Notably, the penalties applied to the taxpayer were only the 40% penalties (and not the 80% penalty), and one should

18. This regime is provided for in the EU Merger Directive (2009). One should stress that, in a domestic context, those authorizations are not required if some conditions are met. This leads to a difference of treatment. The CE has recently raised a request for a preliminary ruling to the ECJ on its compatibility (FR: CE, 30 Dec. 2015, no. 369311, 369316, 369317, *Société Euro Park Service*). This decision (and the others quoted hereafter – except where another source is mentioned) may be found at http://www.legifrance.gouv.fr/ (accessed 1 Feb. 2016).

19. In French, "*comme objectif principal ou comme un de ses objectifs principaux la fraude ou l'évasion fiscales*" (art. 210 B 3 CGI). This provision is supposed to implement the EU Merger Directive (2009), and this sentence is actually the same as article 15(1)(a) of said directive. The translation in the main text is the one used in the directive.

20. FR: BOI-SJ-AGR-20-10-20121203, para. 150.

21. FR: BOI-SJ-AGR-20-20-20140716, para. 220.

22. FR: CAA Versailles, 11 Apr. 2013, no. 11PA03447, 11PA03448, 11PA03449, *Société Euro Park Service*.

also mention that the management of the Luxembourg company has been charged with criminal wrongdoing with respect to this scheme.[23] It is worth noting, too, that the case is pending before the CE, which has raised a preliminary question to the ECJ.[24]

The French Constitutional Council (*Conseil constitutionnel*, Cons. const.) does not seem to distinguish between tax evasion and tax avoidance. It has deduced from the constitutional principle of equality before tax[25] the legitimacy of the objectives of the fight against tax evasion and against tax avoidance. It then established that they rank as constitutional objectives.[26]

Moreover, the Cons. const. has recognized that the objective of avoiding tax optimization is of general interest and can, in some cases, justify a difference of treatment of comparable situations. For instance, the Cons. const. has considered that the legislator may close a choice that a taxpayer has in order to avoid tax optimization, even where this leads to difference of treatment.[27]

One can find some tentative definitions of tax avoidance (*évasion fiscale*) in a number of reports of the French parliament, but none of them clearly define the concept. Moreover, they do not always keep the same definition.

23. *See* FR: Cass., 22 Oct. 2014, no. 13-84419, *John-Charles X*. Please note, however, that the two procedures are completely independent, and one may not use the result of the criminal case to interpret the administrative one.
24. *Société Euro Park Service* (2015).
25. This principle is enshrined in article 13 of the Declaration of Human and Civil Rights of 26 August 1789 (which has the same legal value as the constitution). *See*, for example, FR: Cons. const., 29 Dec. 1983, no. 83-164 DC, *Loi de finances pour 1984*, paras. 26 and 27; Cons. const., 29 Dec. 1999, no. 99-424 DC, *Loi de finances pour 2000*, para. 52; Cons. const., 29 Dec. 2003, no. 2003-489 DC, *Loi de finances pour 2004*, para. 10; Cons. const., 21 Jan. 2010, no. 2009-598 DC, *Loi organique modifiant le livre III de la sixième partie du code général des collectivités territoriales relatif à Saint-Martin*, para. 2; Cons. const., 20 Apr. 2012, no. 2012-236 QPC, *Mme Marie-Christine J. (Fixation du montant de l'indemnité principale d'expropriation)*, para. 7; and Cons. const., 20 Jan. 2015, no. 2014-437 QPC, *Association française des entreprises privées et autres (AFEP)*, para. 9. *See also* the commentary on the *AFEP* decision, available at http://www.conseil-constitutionnel.fr/conseil-constitutionnel/root/bank/download/2014437QPC2014437qpc_ccc.pdf (accessed 1 Feb. 2016).
26. The *Conseil constitutionnel* has sometimes referred to the objective of "fighting tax evasion and tax avoidance" (in French: "*lutte contre la fraude et l'évasion fiscales*"); *see*, for example, FR: Cons. const., 17 Sept. 2015, no. 2015-481 QPC, *Époux B. (Amende pour défaut de déclaration de comptes bancaires ouverts, utilisés ou clos à l'étranger)*, para. 5.
27. FR: Cons. const., 26 June 2015, no. 2015-473 QPC, *Époux P. (Imposition des dividendes au barème de l'impôt sur le revenu - Conditions d'application de l'abattement forfaitaire)*, para. 5.

It is worth mentioning that, sometimes, the parliament considers that tax avoidance falls into a grey area between tax evasion and tax optimization.[28] A special administrative body has also stated that tax avoidance using illegal means is tax evasion but tax avoidance using legal means is tax optimization.[29]

14.1.2. The meaning of tax planning, abusive tax planning and aggressive tax planning in the French legal system

Tax planning (*optimisation fiscale*) has long been considered legitimate.

Indeed, a principle exists in France according to which the taxpayer is not obliged to choose the most onerous way from a tax point of view of running his business and performing operations. This principle is said[30] to be derived from the principle that the tax authorities should not interfere with the taxpayer's management of his business (the *principe de non-immixtion*). Legal doctrine is unanimous on the existence of this principle,[31] despite the fact that it is not enshrined in a provision of the CGI.

The principle was clearly articulated in an answer from the minister of finance to the National Assembly: "Facing two legal techniques whose results are identical, it is lawful to operate a choice based on a tax reason."[32]

28. FR: Assemblée Nationale, report no. 1243, *Rapport d'information déposé en application de l'article 145 du règlement par la commission des finances, de l'économie générale et du contrôle budgétaire en conclusion des travaux d'une mission d'information sur l'optimisation fiscale des entreprises dans un contexte international* (2013), available at http://www.assemblee-nationale.fr/14/pdf/rap-info/i1243.pdf (accessed 1 Feb. 2016).
29. FR: Conseil des prélèvements obligatoires, *La fraude aux prélèvements obligatoires et son contrôle* (La Documentation française 2007), available at http://www.ladocumentationfrancaise.fr/var/storage/rapports-publics/074000186.pdf (accessed 1 Feb. 2016).
30. P. Serlooten, *Droit fiscal des affaires*, 14th ed., para. 24. (Dalloz 2015).
31. Id.; *see also* M. Cozian & F. Deboissy, *Précis de fiscalité des entreprises*, 38th ed., paras. 226-228 and 2157 (LexisNexis 2015); Delaunay, *supra* n. 12, at para. 1; R. Mortier, *La donation avant cession in extenso*, Dr. fisc. 2014, no. 39, 540; and D. Gutmann, *Droit fiscal des affaires*, 5th ed., para. 630 (Lextenso 2014).
32. FR: Rép. min. no. 10603, JOAN Q, 25 Apr. 1970, quoted by F. Deboissy, *L'opposabilité à l'administration fiscale des montages contractuels*, RDC 2007, p. 1006, para. 3; and FR: Rép. min. no. 15603, JOAN Q, 20 Mar. 1971, quoted by P. Serlooten, *Liberté de gestion et droit fiscal: la réalité et le renouvellement de l'encadrement de la liberté*, Dr. fisc. 2007, no. 12, 301.

At one point in time, the FTA expressly shared this view in the administrative guidelines, relying, to that end, on CE case law.[33]

In a topical case,[34] the CE implicitly relies on this principle. A parent company had a subsidiary which was facing financial difficulties. The parent had only two choices: it could either liquidate its subsidiary or try to rescue it. For the latter option, it could either grant a loan, inject new funds through a capital increase or grant a financial subsidy and/or proceed to a debt waiver.

The tax consequences of those alternatives were very different: a loan or a capital increase would not be deductible from the taxable results, whereas a subsidy/debt waiver would be. The FTA considered that the parent chose the latter option only for tax reasons and that there was an abuse of law. The CE considered that helping its subsidiary was in the parent's own interest and that it acted in a normal way when it granted the subsidy and debt waiver, "even if it could have used other means".

As Cozian put it, "[w]e cannot find a better hymn to freedom nor pronounce a better eulogy to cleverness. Unfortunately, if tax cleverness is a virtue, excess of cleverness is a sin".[35]

This "freedom to choose the less taxed way" is also recognized by the *Cour de cassation*[36] and by the Cons. const. On 29 December 2013, the latter issued an important decision on tax planning and also, as will be analysed below (*see* section 14.1.2.), on abuse of law.[37] At stake was the Finance bill for 2014, which introduced an obligation to disclose a tax planning scheme (*schéma d'optimisation fiscale*). The obligation fell on the tax advisors and/or the companies inventing and implementing such a scheme. A tax planning scheme was defined as "any combination of process and legal tax accounting or financial instruments: whose principal object is to reduce the tax burden of a taxpayer, to postpone the liability or the payment or to obtain

33. FR: DGI, doc. adm., 13 L153120, 1 July 2002, para. 20: "*Dans certains cas, les contribuables ont la possibilité de choisir entre plusieurs solutions pour réaliser une opération déterminée. Le fait qu'ils optent pour la solution la plus avantageuse au plan fiscal ne permet pas de conclure à l'abus de droit s'il apparaît que les actes juridiques sur lesquels repose cette solution sont conformes à la réalité (CE, arrêt du 16 juin 1976, req. n° 95513).*" Distinguished authors also rely on this case law; *see*, for instance, Mortier, *supra* n. 31, at para. 15.
34. FR: CE, 27 June 1984, no. 35030, RJF 8-9/84, no. 937. This judgment has also been published in *Revue de droit fiscal* (Dr. fisc. 1985, no. 22-23, comm. 1063), accompanied by the conclusions of Advocate General (*rapporteur public*) M.-A. Latournerie.
35. M. Cozian, *Éloge de l'habileté fiscale*, RFP 2006, alerte 1.
36. FR: Cass., 7 Mar. 1984, no. 81-13728 and 81-16259.
37. FR: Cons. const., 29 Dec. 2013, no. 2013-685 DC, *Loi de finances pour 2014*.

the reimbursement of tax or contribution; and that fulfils criteria provided for" in a special decree to be adopted. Absent disclosure, the sanction was a fine equal to 5% of the fees of the tax advisors or, in the case of a "home-made scheme", 5% of the tax advantage for the companies.

This provision was considered to be unconstitutional, as it infringed the freedom of enterprise,[38] especially that of tax advisors. Indeed, the Cons. const. considered, looking at the sanction, that the legislator, who has the constitutional duty to adopt tax legislation[39] that is accessible and understandable, should precisely define the terms of such an obligation.

The commentary on this decision – which was published by the Cons. const. itself and is generally considered as an explanation of the decision – clearly states that "[a]ny taxpayer can legitimately look to reducing his tax burden and any tax lawyer can look to reducing the tax burden of his clients, without this leading to constitute a fraud".[40]

In the same bill, the legislator did adopt a provision that obliges including an annex in the finance bill that provides some information regarding the 20 most important reassessments for individual taxpayers for fraud and "international abusive tax planning", making those terms legal notions (although still undefined).[41]

Finally, the members of parliament, in their submission to the Cons. const. to denounce the unconstitutionality of another provision of the bill, raised the point that article 2 of the French Declaration of Human and Civil Rights guarantees "the freedom of the taxpayer to choose, for a given operation,

38. *See*, for a definition, FR: Cons. const., 22 May 2015, no. 2015-468/469/472 QPC, *Société UBER France SAS et autre [Voitures de transport avec chauffeur - Interdiction de la « maraude électronique » - Modalités de tarification - Obligation de retour à la base]*, para 4: "Considering that pursuant to Article 4 of the 1789 Declaration: 'Freedom consists in the ability to do anything which doesn't harm anyone; hence the exercise of each man's natural rights has no limits except those which guarantee the enjoyment of the same rights to other members of society. These limits can only be determined by law'; considering that the legislator is free to subject the freedom of enterprise, as resulting from Article 4 of the 1789 Declaration, to limitations associated with constitutional requirements or which are justified by general interest, provided that this does not result in any harm that is disproportionate to the objective pursued".

39. Under article 34 of the constitution, "Statutes shall determine the rules concerning: […] the base, rates and methods of collection of all types of taxes".

40. Available at http://www.conseil-constitutionnel.fr/conseil-constitutionnel/root/bank/download/2013685DCccc_684_685dc.pdf (accessed 1 Feb. 2016).

41. FR: *Loi de finances pour 2014*, 29 Dec. 2013, no. 2013-1278, art. 103.

the tax way that is the less onerous".[42] The Cons. const., however, did not rely upon this "freedom" in its decision.

Prior to this decision, the Cons. const. had already rendered an important decision concerning tax incentives voluntarily introduced by the legislator, which were part of an overall system which had became so complex that some taxpayers would not be able to enter into tax arbitrage: this was breaching the principle of equality before tax law.[43] In legal doctrine, this was considered to be a recognition of this freedom.[44]

With respect to tax rulings and pre-authorization requests, the author believes that, if they can be used to implement an optimization, the FTA would certainly not validate a tax planning that would qualify as an abuse of law or, in the case of an intra-group reorganization, for instance, would lead to depriving France of its right to tax.

There is no clear distinction in French tax law between tax planning and aggressive or abusive tax planning. These may be considered, to some extent, as legal concepts, since they are used in the CGI, but they are largely imprecise and highly subjective elements. To illustrate, one might refer to a recent a parliamentary report in which the notion of "tax optimization" was described in negative terms and identified as a breach of the equality-before-tax principle.[45] That is to say, what had always been considered as lawful is now being described in the same way that tax evasion was when it was banned!

14.1.3. Conclusion

To summarize, it seems that, at least in the French context, it is not necessary to have a full range of terms to define similar concepts. It would be sufficient, in the light of the definitions given in the introduction, to establish a distinction between:
(a) tax fraud, which is sanctioned by criminal law;

42. 2013-685 DC (29 Dec. 2013), para. 113. However the *Conseil constitutionnel* did not mention this as a ground for its decision.
43. FR: Cons. const., 29 Dec. 2005, no. 2005-530 DC, *Loi de finances pour 2006*, para. 61 et seq.
44. G. Blanluet, S. Austry & L. Ayrault, *Encadrement de la lutte contre la fraude et l'évasion fiscale*, Dr. fisc. 2015, no. 39, 582.
45. Assemblée Nationale, *supra* n. 28, at p. 24.

(b) tax evasion, which is sanctioned by a fine under the procedures and guarantees of the LPF and the CGI, either under a GAAR or a specific anti-avoidance rule (SAAR); and
(c) tax optimization, which is allowed.

Indeed, it seems confusing to use the terms "avoidance", which could be legal or illegal. Besides, as we will see in section 14.2., when the OECD and IBFD define tax avoidance as a practice that follows a literal interpretation of the law but goes against the intent of the legislator, it lays down one of the criteria of the French abuse-of-law theory, which falls under the category of tax evasion. Other concepts such as "aggressive" or "abusive" tax planning are, the author believes, not necessary – and are probably counterproductive, and indeed confusing – since they give the impression that there are many different legal classifications of tax planning behaviour.

Even if this reduces the number of qualifications, the dividing lines between those behaviours are unclear.

First, "tax fraud" and "tax evasion" are not mutually exclusive. A scheme may fall into both qualifications. In France, it has been stressed that tax fraud procedures are now used by the FTA as a deterrent to tax evasion.[46]

Second, it is often difficult to clearly identify the red line between what is legitimate tax optimization and what is tax evasion, at least when there are no SAARs to fix the limit. When it comes to GAARs, and especially the prohibition of abuse of law rule, legal certainty is difficult to ascertain.

In the end, the situation in France can be described in terms quite similar to those used by the OECD in the context of the BEPS project: "Considering the difficulties in precisely identifying the dividing line between what it is aggressive and what is not, domestic and treaty-based anti-avoidance provisions constitute the benchmark against which to decide whether a given strategy should be implemented (from the perspective of the taxpayer) or should be challenged (from the perspective of the revenue authorities)."[47]

46. F. Deboissy, *Abus de droit: quel est le risqué pénal?*, Dr. fisc. 2014, no. 46, 623.
47. OECD, *Addressing Base Erosion and Profit Shifting*, p. 43 (OECD Publishing 2013), International Organizations' Documentation IBFD.

14.2. The French reaction to avoidance and aggressive tax planning in the BEPS context

14.2.1. Presentation of French GAARs

As noted (*see* section 14.1.2.), tax optimization is lawful in France, but this does not mean that any tax scheme aimed at reducing a taxpayer's tax liability or at 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"[48] is allowed. French tax law provides the tax authorities with several tools for limiting taxpayers' "creativeness".

First, there is tax fraud, which, as noted (*see* section 14.1.), is a criminal offense and with which we will not deal in this chapter. Second there are two GAARs. Absent definitions of "tax evasion", "tax avoidance" and "tax planning", the boundaries between legal and illegal tax planning are drawn by those GAARs (unless a SAAR would be applicable).

The first GAAR is the "abnormal act of management" theory.[49] This is a praetorian theory that has been developed on the ground of general principles of French tax law. According to it, "corporate income tax is assessed on taxable profit arising from all operations realized by a company, except those which, with respect to its object or its modalities, are not linked to a normal commercial management".[50] For the purposes of this chapter, one can refer to this concept only where it addresses acts not performed in the interest of the company:[51]

(a) because expenses incurred by the company are not to the benefit of the company, i.e. they are not linked to the generation of profits[52] or are too high; or

48. European Commission, *supra* n. 10, at recital 2.
49. This rule is often considered as fighting against tax evasion; *see*, for instance, Delaunay, *supra* n. 12, at para. 7; Assemblée Nationale, *supra* n. 28, at p. 83; and B. Gouthière, *Les impôts dans les affaires internationales*, 10th ed., paras. 71800 and 72520 et seq. (Francis Lefebvre 2014).
50. FR: CE, 6 Mar. 2006, no. 281034, *Société Disvalor*; and CE, 30 June 2008, no. 291710, *Société civile du groupe Comte*. Those cases are quoted by Daniel Gutmann to define the abnormal act of management (Gutmann *supra* n. 31, at para. 631).
51. We set aside the act of management which is abnormal, since it may be considered as a fault in the management of the company, especially because there is a default of control of the operations by the management.
52. *See* P. Serlooten, *Liberté de gestion et droit fiscal: la réalité et le renouvellement de l'encadrement de la liberté*, Dr. fisc. 2007, no. 12, 301, para. 32.

(b) because the company has renounced income[53] (for example, when it does not invoice a service or a good or if it does so at below the market price).

The second GAAR, which appears to be more relevant to the scope of this chapter, is the prohibition of abuse of tax law (*abus de droit fiscal*), which is at origin a praetorian creation, now codified in article L64 of the LPF. A special procedure exists such that if the taxpayer disagrees with the tax reassessment, he can require a special committee (*Comité de l'abus de droit*) to analyse its case. This is also open to the FTA, which are in any case not bound by this body's consultative opinion but have to bear the burden of proof if they do not follow it. The sanctions attached to the abuse of tax law are heavy, since the FTA are entitled to reassess the tax which was avoided plus a late payment interest of 4.80% per year plus a penalty amounting to up to 80% of the avoided tax.[54]

14.2.1.1. Focus on the "abuse of tax law"

The French provision prohibiting the *abus de droit fiscal* could be said to be close to that proposed in point 4.2. of the EC Recommendation on aggressive tax planning (2012/772).[55] Indeed, the latter seems similar to the notion of "abuse of law" that has been built up by the case law of the ECJ, and there are strong ties with the French provision.

Looking at the history of the abuse-of-law theory in tax matters, one notices that it was built by judges in capital/stamp duty matters in order to set aside acts that abused the law by simulation.[56] Later, it was introduced by the legislator into the CGI, but only to prevent simulation for specific taxes.

53. In this meaning, it is close to TP rules.
54. This penalty could be reduced to 40% if the impugned transactions or acts were not performed on the main initiative of the taxpayer (i.e. he played a passive role) or if the taxpayer was not the main beneficiary of the transaction.
55. "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".
56. See FR: Cass., 20 Aug. 1867, *Legrand*. The case was quoted by Advocate General Laurent Olléon in his opinion in *Janfin* (L. Olléon, *L'administration peut-elle poursuivre la répression des abus de droit en dehors du champ d'application de l'article L 64 du LPF ?*, BDCF 2006, no. 156) and by Christophe de La Mardière (*JCl. Procédures fiscales*, Fasc. 375, para. 14). Laurent Olléon noted that the *Conseil d'Etat* did the same in a latter decision (FR: CE, 12 Dec. 1930, *Société X*, available at http://gallica.bnf.fr/ark:/12148/bpt6k5744066s/f1068.item.r=12%20decembre (accessed 1 Feb. 2016).

In 1981, the CE interpreted the latter provision, prohibiting simulation for specific taxes, as also prohibiting what would be called *fraus legis*,[57] extending, through its interpretation, the scope of the provision to cover and set aside acts that "could not have been inspired by any other purpose than that of avoiding or reducing the tax liability which, if these instruments had not been concluded, the taxpayer would normally have borne with respect to his actual situation and real activities".[58] In 1988, the Cass. did the same.[59]

However, the question remained as to whether or not there was a general principle prohibiting *fraus legis* that could apply when the above-mentioned special provision was not applicable. It is worth underlining that, in other areas of French public law, this prohibition of *fraus legis* was recognized absent specific provisions. In the *Janfin* case, the question was clearly raised. If one looks at the opinion of Advocate General Olléon, the *Halifax* case[60] of the ECJ was taken into account to recognize such prohibition under French law absent a specific provision. Indeed, the ECJ had ruled that abuse of law could be considered as prohibited using the same reasoning as that used by the CE when it developed the *fraude à la loi* theory. The Advocate General then wondered whether, if VAT were not included within the scope of the French provision prohibiting abuse of law, this would mean that *fraude à la loi* in VAT matters could not be challenged in France. Such an outcome was, in the Advocate General's opinion, doubtful. The CE clearly affirmed that, even where it was not explicitly prohibited through a specific provision, the tax authorities could rely on the *fraus legis* principle to set aside acts "*seeking the benefit of a literal application of texts or decisions against the objectives sought by their authors*, [and which] could not have been inspired by any other purpose than that of avoiding or reducing the tax liability which, if these instruments had not been concluded, the taxpayer would normally have borne in respect of his actual situation and real activities".[61] [emphasis added]

The emphasized text shows a new element in the definition of *fraude à la loi*, which has been imported from the EU notion. According to authorized

57. Previously, abuse of law could not apply if no fictitious act existed. The CE, sitting as a fiscal plenary session, introduced the *fraude à la loi* concept in case no. 19079 (10 June 1981).
58. FR: CE, 27 Sept. 2006, no. 260050, *Janfin*. This case law has since been codified in the LPF.
59. FR: Cass, 19 Apr. 1988, no. 86-19079, *Donizel*.
60. UK: ECJ, 21 Feb. 2006, Case C-255/02, *Halifax plc, Leeds Permanent Development Services Ltd and County Wide Property Investments Ltd v. Commissioners of Customs & Excise*, ECJ Case Law IBFD.
61. *See Janfin* (2006). This has since been codified in the French tax code.

commentators,[62] this solution was clearly the result of the influence of EU abuse-of-law theory, built up by the ECJ in *Halifax* (but also in *Emsland-Stärke*[63] and *Cadbury Schweppes*[64]).

Finally, in *Persicot*,[65] the CE aligned its interpretation in situations covered by article L64 of the LPF with the wording of the *Janfin* case.

Interestingly, and in order to improve legal certainty, those developments were codified in article L64 of the LPF, which now provides as follows:

> In order to restore the true character, the tax administration is entitled to discard, as acts not being able to be opposed, acts constituting an abuse of rights, whether those acts have a fictitious character or whether, seeking the benefit of a literal application of texts or decisions against the objectives sought by their authors, they could not have been inspired by any other purpose than that of avoiding or reducing the tax liability which, if these instruments had not been concluded, the taxpayer would normally have borne in respect of his actual situation and real activities.[66]

As a result, the abuse of law has two aspects:
(1) prohibition of simulation – acts that are fictitious; and
(2) prohibition of *fraus legis* – acts that pursue a tax purpose.

In the latter case, two elements have then to be characterized:
(a) the exclusive tax aim of the act/transaction; and
(b) the benefit of a literal application of the law against the intent of its authors.

It follows from the above that there has probably been a reciprocal influence between French and EU law that has lead to the definition of abuse of law.

62. O. Fouquet, *Interprétation française et interprétation européenne de l'abus de droit*, RJF 5/06, p. 383 and seq.; and J.-M. Sauvé, *Allocation d'ouverture des Entretiens du Palais-Royal*, Dr. fisc. 2007, no. 47, 976.
63. DE: ECJ, 14 Dec. 2000, Case C-110/99, *Emsland-Stärke GmbH v. Hauptzollamt Hamburg-Jonas*, ECJ Case Law IBFD.
64. UK: ECJ, 12 Sept. 2006, Case C-196/04, *Cadbury Schweppes plc and Cadbury Schweppes Overseas Ltd v. Commissioners of Inland Revenue*, ECJ Case Law IBFD.
65. FR: CE, 28 Feb. 2007, no. 284565, *Marius Persicot*.
66. Free translation of article L64 of the LPF. In French: "*Afin d'en restituer le véritable caractère, l'administration est en droit d'écarter, comme ne lui étant pas opposables, les actes constitutifs d'un abus de droit, soit que ces actes ont un caractère fictif, soit que, textes ou de décisions à l'encontre des objectifs poursuivis par leurs auteurs, ils n'ont pu être inspirés par aucun autre motif que celui d'éluder ou d'atténuer les charges fiscales que l'intéressé, si ces actes n'avaient pas été passés ou réalisés, aurait normalement supportées eu égard à sa situation ou à ses activités réelles*."

ECJ case law probably has influenced and will now continue to influence the interpretation and application of this notion.

14.2.1.2. Compatibility of the French abuse-of-law provision with EU law

The French theory of abuse of law has evolved under the influence of EU abuse-of-law theory. This is not the sole impact that EU law has had. One might note that, in many circumstances, when judges developed or applied the abuse-of-law doctrine, they had implicitly or explicitly to take into account EU law in order to avoid conflicts.

In the *Sagal* decision,[67] the CE had the opportunity to clearly link article L64 of the LPF with the ECJ's jurisprudence and to rule that it was compatible with EU law.

In this case, a company, together with five others, had bought one sixth of the share capital of a Luxembourg company, which was a holding company enjoying an exemption regime for dividends and capital gains. The French company could enjoy the participation exemption regime on dividends paid by the Luxembourg company. The FTA considered that the scheme was abusive within the meaning of article L64 of the LPF in its fraud-of-law branch.

The CE considered that the company had no substance, since:
(a) it was dependent on the bank that created it for its management and for its investment;
(b) its assets were composed of shares;
(c) it had no technical competence for realizing the investment; and
(d) its shareholder did not participate in the shareholders' meeting.

The CE underlined the fact that the Luxembourg company did not pay any corporate income tax and the shareholder's participation allowed it to benefit from the parent-subsidiary regime but also to avoid the application of the French controlled foreign company (CFC) rules.

The taxpayer mentioned that the scheme could allow realizing economies of scale together with allowing an optimization of the return on investment.

67. FR: CE, 18 May 2005, no. 267087, *Société Sagal*. *See also* FR: CE, 18 Feb. 2004, no. 247729, *SA Pléiade*, a case which, however, appears less relevant for the purposes of this chapter.

However, he could not establish that this was linked to the establishment of the subsidiary abroad (instead of in France).

The CE concluded that the arrangement to acquire a stake in a Luxembourg company with no substance for the sole purpose of avoiding tax was an abuse of law. This interpretation of article L64 of the LPF, according to the taxpayer, infringed the freedom establishment. The CE noted that the objectives of article L64 of the LPF consist specifically in excluding from the benefit of tax advantage "purely artificial arrangements whose sole objective is to circumvent French tax law",[68] and it cannot, therefore, infringe EU law.

It is clear from the Advocate General's opinion[69] that the characterization as abuse of law was not only due to the location of the subsidiary in Luxembourg, which led to the benefitting from tax advantages, but also – indeed mainly – to the setting-up of an artificial, ad hoc structure without any substance or autonomous justification with the sole aim of benefiting from the French participation exemption regime (aimed at avoiding double taxation) and from the Luxembourg exemption regime, leading to the result that the profits were not taxed anywhere. He found that article L64 of the LPF is compatible with EU law, which allows the application of legislation aimed at fighting abuse, as was the case in *Lasteyrie du Sailant*.[70]

An authorized commentator – the president of the financial section of the CE at the time – noted the clear convergence of the French and EU abuse-of-law concepts, stating that the "key to distinguish between an abusive scheme and a tax optimization scheme which cannot be criticized lies in the artificial character of the scheme, a character which itself depends on the substance of the scheme".[71] It should be added that the artificial character of the arrangement lies not in the use of a "subsidiary lacking legal substance but [one] lacking *economic substance*".[72] [emphasis added]

68. *Société Sagal* (2005).
69. P. Collin, *La prise de participation sans justification économique ou financière dans une société holding luxembourgeoise exonérée d'impôt et dépourvue de toute substance caractérise-t-elle un abus de droit (suite)?*, BDCF 2005, no. 110.
70. FR: ECJ, 11 Mar. 2004, Case C-9/02, *Hughes de Lasteyrie du Saillant v. Ministère de l'Économie, des Finances et de l'Industrie*, ECJ Case Law IBFD.
71. Fouquet, *supra* n. 62, at p. 384.
72. E. Bokdam-Tognetti, *Régime des sociétés mères et abus de droit: de l'arrêt Sté Pléiade à l'arrêt Groupement charbonnier Montdiderien, retour sur dix ans de jurisprudence du Conseil d'État*, Dr. fisc. 2014, no. 41, 566, para. 2.

Some years later, the CE followed the same line of reasoning in the *Alcatel CIT* decision.[73]

The FTA considered that a French company, part of a French group, committed an abuse of law by subscribing to the capital increase of a Belgian related company which benefited from the preferential regime of coordination centres,[74] the funds being on-lent intra-group.

The administrative court of appeal found that the Belgian company realized an important turnover, had effectively exercised its function as a financing centre and management seat of foreign exchange risk for the group and had 48 employees. Thus, it decided that the capital increase could not be considered as realized for the "sole purpose of avoiding taxation".[75]

According to the court, the fact that the activity could have been performed in France with the same results (regarding the return on investment) did not change the conclusion. In other words, the circumstances that the interests were not taxed in Belgium and that the returns benefitted in France from the parent-subsidiary regime were not relevant.

The CE then confirmed that the court did correctly apply the law (bearing in mind that its control of the appreciation of the facts by the court is limited). The Advocate General explicitly stated that the "choice of the most advantageous location within the EU … corresponds to a legitimate tax optimization aim, without the red line of abuse of law being crossed".[76] Interestingly, looking at the question of whether or not the decision to locate in Belgium could be considered an objective contrary to the intent of the legislator, the Advocate General considered that, from an EU law standpoint, this approach would not be acceptable. She pointed out that the ECJ recognized that abuse could be fought, but only provided one faces a purely artificial arrangement aiming at avoiding national tax, which, based on the substance identified in this instance, would not be the case. According to an authorized commentator, this case demonstrates that locating the subsidiary

73. FR: CE, 15 Apr. 2011, no. 322610, *Société Alcatel CIT*.
74. For a description of the regime, *see* the ECJ case *Forum 187 ABSL* (Joined cases C-182/03 and C-217/03).
75. *Société Alcatel CIT* (2011).
76. P. Collin, *Une société mère, en souscrivant à l'augmentation du capital d'une société belge bénéficiant du régime fiscal privilégié de « centre de coordination » et en recevant de sa filiale des dividendes bénéficiant du régime des sociétés mères, a-t-elle commis un abus de droit ?*, BDCF 2011, no. 91.

in another country is not “an autonomous and sufficient sequence to characterize the exclusive tax motive”.[77]

More recently, the CE had to rule in a case[78] that fell, according to this same author, between the *Pléiade* and *Alcatel CIT* cases.[79] In a nutshell, a French company borrowed some funds from a related company (that had issued bonds) and used those funds to subscribe 99.9% of the shares in a Dutch company. The latter bought US bonds from an unrelated party. In order to decide that the Dutch company had been created exclusively for tax reasons – that is to say, to benefit from the parent-subsidiary regime on income that would have been fully taxable had this subsidiary not been interposed – the administrative court of appeal considered that the tax authorities demonstrated proof of “absence of economic substance” of the company by showing that:

(a) the subsidiary’s sole activity was to manage the funds bought by its parent, and the only profits were interest and capital gains;
(b) the investment policy had been defined “once for all” when the subsidiary was created;
(c) the parent did not control the “management” of the subsidiary; and
(d) the risk to the investment through the subsidiary was not distinguished from the one the parent would have borne if it had invested directly.

The CE considered that the appreciation of the court was correct. As the Advocate General underlined, “by evoking the absence of real control of the management of the company, the court seems to refer not to the absence of participation in the general assembly or the supervision body of the company, which was contested by the plaintiff, but to the fact that the automatic pilot of the structure whose investment policy … was decided *ab initio* had for consequences the absence of real implication by the parent”.[80] This seems to be endorsed by the CE. It must be stressed that the company did not adduce any non-tax reason for setting up the company.

Interestingly, in the same case, the CE considered that there was no abuse in the company requesting the benefit of the tax credit (*avoir fiscal*) allowing the elimination of double taxation – in an EU context, thanks to the *Accor*

77. Bokdam-Tognetti, *supra* n. 72, at para. 3.
78. FR: CE, 11 May 2015, no. 365564, *Société Natixis*.
79. Bokdam-Tognetti, *supra* n. 72, at para. 3.
80. E. Bokdam-Tognetti, *Abus de droit et fraude à la loi: comment apprécier la présence ou l’absence de substance économique d’une société interposée pour les besoin d’un montage ?*, BDCF 2015, no. 109.

case[81] – to the extent that the company did not seek a literal application of the law against the intent of the legislators.

In the author's view, the fate of the French abuse-of-law doctrine is now clearly linked to the EU abuse-of-law doctrine. However, whether or not the French concept is completely in line with the EU definition is, in the author's view, highly debatable.[82] One might stress that there seems to be a difference between the French and EU abuse-of-law doctrines to the extent that the former applies an *exclusive tax purpose test* and the latter – arguably – applies a *principal tax purposes test*.

14.2.1.3. Sole purpose versus principal purpose

What should be the ground for triggering the GAAR? Should it be that the taxpayer's sole aim was obtaining a tax advantage or should it be sufficient that obtaining such an advantage was a principal purpose?

In 2014, a reform of article L64 of the LPF was launched in order to substitute the exclusive purpose test for a principal purposes test. Some reports pointed out that the exclusive purpose test would be too easy to circumvent by finding an economic or financial advantage – however small[83] – to justify the operation.

The proposed finance bill for 2014 did contain such a modification. However, the Cons. const. considered that this test would be unconstitutional, because it would grant an "important margin of appreciation to the tax authorities" and, taking into account the important sanction attached to the abuse of law, this triggers the constitutional control applicable to the constitutional principle of legality of offences, obliging the legislator to precisely define the criteria to be applied.[84]

Interestingly, the commentary on this decision by the Cons. const. notes that the CE had already considered that, if the tax advantage is predominant compared to the economic advantage, it could be concluded that the

81. FR: ECJ, 15 Sept. 2011, Case C-310/09, *Ministre du Budget, des Comptes publics et de la Fonction publique v. Accor SA*, ECJ Case Law IBFD.
82. Especially if one compares the *WebMindLicenses* (HU: ECJ, 17 Dec. 2015, Case C-419/14**,** *WebMindLicences Kft. v. Nemzeti Adó és Vámhivatal Kiemelt Adó és Vám Főigazgatóság*, ECJ Case Law IBFD) case and the French *Andros* (FR: CE, 10 Dec. 2008, no. 295977, *Société Andros*), *Alcatel CIT* (2011) and *Natixis* (2015) cases.
83. Assemblée Nationale, *supra* n. 28, at pp. 82-83.
84. 2013-685 DC (29 Dec. 2013), paras. 112-119.

taxpayer's behaviour had been exclusively inspired by a tax motive.[85] It is indeed true that, in the famous *Garnier-Choiseul* case,[86] in which a taxpayer had set up a scheme qualified as abusive by the tax authorities, the CE disregarded the taxpayer's argument that the company obtained a financial advantage together with the tax one.

Indeed the financial advantage was – in absolute and relative terms – negligible, which leads to the conclusion that the scheme was exclusively inspired by a tax motive.[87] Interestingly, an authorized commentator has considered that the CE could be seen as having distinguished the aim of the scheme from its effect.[88]

The commentary also refers to the case law of the ECJ and states that the Luxembourg court also applies an exclusive motive test (referring, *inter alia*, to *Halifax*). However, the ECJ case law on this point is not clear.[89] Recently, the ECJ looked into the question of whether the "essential aim of the transactions concerned is solely to obtain that tax advantage".[90]

In this context, the implementation of the Parent-Subsidiary Directive GAAR[91] within French tax law was awaited.

Said GAAR provides that "Member States shall not grant the benefits of this directive to an arrangement or a series of arrangements which, having been

85. *See supra* n. 40.
86. FR: CE, 17 July 2013, no. 356523, *SARL Garnier Choiseul Holding*. In this case, the scheme at stake consisted in buying shares of a company that was no longer active and had sold all its assets. Only cash remained in the company, and this was distributed to the parent, which enjoyed the participation exemption regime. This led to recognition of a depreciation of the shares, which at that time was deductible from the taxable result of the company, leading to the recognition of a loss. After 2 years, the shares were sold again to the shareholder, crystallizing the tax loss.
87. The Advocate General had the same opinion, based on FR: CE, 10 Nov. 1993, no. 62445, *Gianoli*. In the *Groupement Charbonier* case (FR: CE, 23 June 2014, no. 360708, *Société Groupement Charbonnier Montdiderien*), the financial gain was more important, but the CE considered that the financial gain was only due to the sharing of the tax gain between the seller and the acquirer of shares.
88. Bokdam-Tognetti, *supra* n. 72, at para 4.
89. *See*, for example, IT: ECJ, 22 May 2008, Case C-162/07, *Ampliscientifica Srl and Amplifin SpA v. Ministero dell'Economia e delle Finanze and Agenzia delle Entrate*, ECJ Case Law IBFD, paras. 27 and 28; and UK: ECJ, 20 June 2013, Case C-653/11, *Her Majesty's Commissioners of Revenue and Customs v. Paul Newey*, ECJ Case Law IBFD, paras. 46 and 52.
90. *WebMindLicenses* (C-419/14), para. 42.
91. Council Directive (EU) 2015/121 of 27 January 2015 amending Directive 2011/96/EU on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States, OJ L21 (2015), EU Law IBFD.

put into place *for the main purpose or one of the main purposes* of obtaining a tax advantage that defeats the object or purpose of this directive, are not genuine having regard to all relevant facts and circumstances". [emphasis added]

It has been implemented as such and covers all situations to which the Parent-Subsidiary regime applies, i.e. domestic, EU and third-country situations. The Cons. const., in a decision dated 29 December 2015, considered that the rule defines the tax base for corporate income tax and does not trigger a sanction that could be characterized as a punishment. As a result, it could not be seen as unconstitutional.[92] Several concepts now coexist in French tax law, and it would be interesting to trace the evolution of the practices of the FTA. Our question, which could be considered as a leitmotiv, is even more relevant in the context of the participation exemption regime: what is the dividing line between tax evasion and tax optimization?

14.2.2. The French implementation of the EC Recommendation on aggressive tax planning's subject-to-tax rule

The EC Recommendation on aggressive tax planning (2012/772) proposes to EU Member States to adopt and introduce into their tax treaties a subject-to-tax rule aimed at dealing with double non-taxation.

The OECD has proposed a number of measures as part of its anti-BEPS package. Action 6 proposes, as a minimum standard, the following:

(a) introduce an express statement that the treaty aims at the "elimination of double taxation with respect to taxes on income and on capital without creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance (including through treaty-shopping arrangements aimed at obtaining reliefs provided in this Convention for the indirect benefit of residents of third States)";[93] and

(b) introduce: (i) a limitation-on-benefits (LoB) rule and a principal purposes test (PPT) rule; (ii) a PPT rule alone; or (iii) an LoB rule and an anti-conduit rule.[94]

92. FR: Cons. const., 29 Dec. 2015, no. 2015-726 DC, *Loi de finances rectificative pour 2015*, paras. 2-14.

93. OECD, *Preventing the Granting of Treaty Benefits in Inappropriate Circumstances, Action 6 – 2015 Final Report*, para. 72 (OECD Publishing 2015), International Organizations' Documentation IBFD.

94. Id.

France has not introduced such a subject-to-tax rule in all its tax treaties. At this stage, to the best of the author's knowledge, the FTA have not publicly announced that they would adopt such a treaty policy. However, the CE has recently interpreted the treaty residence provision and the meaning of being "liable to tax" (*assujetti à l'impôt*) for companies.

In two decisions,[95] the CE, interpreting the provision in light of "the principal object of tax treaties, which is to avoid double taxation", decided that persons who are not subject to tax due to their "status or activity" are not liable to tax under this provision. As a result, a German and a Spanish pension fund could not benefit from the withholding tax rate of the convention.

It is not the purpose of this chapter to discuss the merits of this decision, which has been heavily criticized.[96] The author would like to stress, however, that this solution is probably less general than it might appear. For instance – and this is supported by the Advocate General's opinion[97] – companies enjoying tax holidays or loss-making companies might not automatically fall within such a rule. The same might be true of a company that would not pay taxes in its residence state due to the territoriality principle or the application of the participation exemption regime.

The author believes that France will not adopt the principle set forth in this recommendation. However, it has necessarily agreed to apply the OECD minimum standards, and the BEPS Directive is certainly relevant.

14.3. Transfer pricing rules, GAARs, SAARs and linking rules

14.3.1. Transfer pricing rules and the fight against avoidance

Article 57 of the CGI can be considered as a SAAR used by the FTA in order to fight some specific forms of strategic minimization of the tax burden in France. For instance, it is used to try to counter business reorganizations when companies relocate functions and assets to another country.

95. FR: CE, 9 Nov. 2015, no. 370054, *Landesärztekammer Hessen Versorgungswerk (LHV)*; and FR: CE, 9 Nov. 2015, no. 371132, *Société Santander Pensiones SA EGFP*.
96. M. Pelletier, *La notion de résident dans les conventions fiscales: le Conseil d'État à contre-sens*, Dr. fisc. 2015, no. 49, act. 664.
97. The Advocate General's opinion has not yet been published.

Absent any provision specifically addressing the transfer or relocation of activity, the FTA have tried to reassess those restructurings by considering that there has been a free transfer of intangibles (e.g. clients).[98]

There is an ever-increasing amount of litigation surrounding transfer pricing (TP), but this can still be considered as residual compared to the number of reassessments made on these grounds.

14.3.2. LoB in French tax treaty practice

The term "LoB" often refers to the provision in US treaties which contains a number of tests to define qualified persons that can enjoy a treaty benefit. Taking a broader view, we also include provisions implementing a PPT rule.

The LoB proposed by the OECD in Action 6 takes into account three elements to determine whether or not there is a "sufficient link between the entity and its State of residence":[99]
(1) legal nature (i.e. under paragraph 2, some persons that can be considered as qualified persons);
(2) ownership (especially under paragraphs 2(c), requiring shareholders to be located in the contracting state, and 2(e) and 4, with the derivative benefit clause); and
(3) general activities of the entities (under paragraph 3).

France does not have a treaty policy of including LoB provisions within its bilateral conventions. In some rare cases, however, France has introduced

98. FR: CAA Paris, 5 Feb. 2013, no. 11PA02914, *Société Nestlé Finance International Ltd*; and FR: DGFiP, *Délocalisation de profits dans un pays où ils sont soumis à une fiscalité plus favorable dans le cadre d'une restructuration* (Apr. 2015), available at http://www.economie.gouv.fr/files/files/directions_services/dgfip/controle_fiscal/montages_abusifs/Fiche_3_Delocalisation_de_profits_suite_a_restructuration.pdf (accessed 1 Feb. 2016).
99. OECD, *supra* n. 93, at p. 9.

them. This is the case in the treaties[100] with Cyprus,[101] Japan,[102] Switzerland[103] and the United States.[104]

The treaties between France and Japan[105] and between France and the United States[106] take into account the elements identified by the OECD. In these cases, it seems quite obvious that France is agreeing to comply with its partner's treaty policy. The treaty with Switzerland contains only a provision aiming at avoiding conduit arrangements.[107]

As mentioned (*see* section 14.2.2.), the OECD also proposes an anti-avoidance rule that is general in nature but specific to treaties, the so-called principal purposes test or PPT. It provides as follows:

> 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.[108]

100. *See* Gouthière, *supra* n. 49, at para. 7485; and E. Raingeard de la Blétière & H. Perdriel-Vaissière, *French Report*, in *The Impact of the OECD and UN Model Conventions on Bilateral Tax Treaties*, (M. Lang et al. eds., Cambridge University Press 2012).
101. *Convention between the Government of the French Republic and the Government of the Republic of Cyprus for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income and on Capital* art. 13 (18 Dec. 1981), Treaties IBFD [hereinafter *Cyprus-Fr. Income and Capital Tax Treaty*]. This treaty contains a provision excluding from the benefit of some advantages companies enjoying a preferential regime and held by a non-resident/non-national.
102. *Convention between the French Republic and the Government of Japan for the Avoidance of Double Taxation and the Prevention of Tax Evasion and Fraud with Respect to Taxes On Income (together with an Exchange of Letters)* [unofficial translation] (3 Mar. 1995), Treaties IBFD [hereinafter *Fr.-Jap. Income Tax Treaty*].
103. *Convention between the French Republic and the Swiss Confederation for the Avoidance of Double Taxation with respect to Taxes on Income and Capital* [unofficial translation] (9 Sept. 1966), Treaties IBFD [hereinafter *Fr.-Switz. Income and Capital Tax Treaty*].
104. *Convention between the Government of the United States of America and the Government of the French Republic for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income and Capital* (31 Aug. 1994), Treaties IBFD [hereinafter *Fr.-US Income and Capital Tax Treaty*].
105. Art. 22A *Fr.-Jap. Income Tax Treaty*.
106. Art. 30 *Fr.-US Income and Capital Tax Treaty*.
107. Art. 14 *Fr.-Switz. Income and Capital Tax Treaty*.
108. OECD, *supra* n. 93, at p. 59.

One might recognize elements of the French (and EU) *fraus legis* doctrine, which has already been applied in the context of double tax treaties.

In its treaties, France sometime includes those provisions.

The treaties with Colombia[109] and Panama[110] are good examples. They both provide that "a resident of a Contracting State may not benefit from any tax reduction or exemption granted by the other Contracting State by virtue of the Convention if the main purpose or one of the main purposes of the conduct of operations by such resident or a person connected to such resident was to obtain the benefits of the Convention".[111]

The treaty with China also contains general anti-abuse provisions setting a principal purposes test.[112]

14.3.3. French CFC rules

France has CFC rules set out in article 209 B of the CGI. We are following the outline of the OECD report to provide its key elements.[113]

109. *Convention between the Government of the French Republic and the Government of the Republic of Colombia for the Avoidance of Double Taxation and for the Prevention of Fiscal Evasion and Fraud with Respect to Taxes on Income and on Capital* [unofficial translation] (25 June 2015.), Treaties IBFD [hereinafter *Colom.-Fr. Income and Capital Tax Treaty*].

110. *Convention between the Government of the French Republic and the Government of the Republic of Panama for the Avoidance of Double Taxation and for the Prevention of Fiscal Evasion and Fraud with Respect to Taxes on Income (together with a Protocol)* [unofficial translation] (30 June 2011), Treaties IBFD [hereinafter *Fr.-Pan. Income Tax Treaty*].

111. Art. 25(1) *Fr.-Pan. Income Tax Treaty* and art. 26(1) *Fr.-Colom. Income and Capital Tax Treaty*. They both also contain several provisions stating that, in case a company is not the beneficial owner of an item of income and this results in a tax advantage, a state may deny the application of the treaty.

112. *Agreement between the Government of the People's Republic of China and the Government of the French Republic for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income* [unofficial translation] arts. 10(7), 11(8), 12(7), 22(4) and 24 (26 Nov. 2013), Treaties IBFD [hereinafter *Fr.-PRC Income Tax Treaty*].

113. FR: DGFiP, BOI-IS-BASE-60-10-20120912 ET seq.; *see also* Gouthière, *supra* n. 49, at para. 73100; Gutmann, *supra* n. 31, at para. 812 et seq.; and J. Benamran, *France - Corporate Taxation* sec. 10.4., Country Analyses IBFD (accessed 1 Feb. 2016).

14.3.3.1. Entity definition

Article 209 B of the CGI applies to entities subject to corporate income tax owning a foreign legal entity (in the broad sense: legal person, partnership, trust etc.) or having a PE.

14.3.3.2. Control

Article 209 B of the CGI focus on the legal and economic control as it applies when the legal entity holds, directly or indirectly, more than 50% of the shares, financial rights or voting rights of the foreign entity.

An anti-abuse rule is provided for, setting the rate at 5% when 50% of the stake is owned by French companies or by companies directly or indirectly under the control of the French entity (the control being a legal or de facto one). If the foreign entity is listed, it would apply if and only if the companies are acting in concert.

14.3.3.3. CFC exemptions and threshold requirements

In order to fall within the scope of article 209 B of the CGI, the foreign entity must be subject to a so-called privileged tax regime, that is to say, an effective tax rate lower than 50% of what it would have been if the companies had been taxable in France. French CFC rules do not provide for a *de minimis* threshold but, due to the safe harbour, focus on abusive transactions.[114]

14.3.3.4. CFC income definition

All income of the CFC is attributed to its parent, in due proportion to its stake in the foreign legal entity. The results of the foreign entity that are taxable in France in the hands of the French company are computed under the French tax rules. Losses of the French company are not offset against the French taxable result but can be carried forward against its own profits.

114. *See* sec. 14.3.3.7.

14.3.3.5. Attribution of income

The income is attributed in proportion to the stake of the French parent in the company.

The result of the foreign entity is deemed distributed and taxed as a deemed dividend.[115] If the French company owns a PE, it would be taxable on its result as business income.

14.3.3.6. Rules to prevent double taxation

Double taxation would be eliminated whether it is linked to the corporate income tax paid in the residence country of the CFC or any tax levied in a source state for income earned by the CFC and taxed in France (a pro rata applies should there be several shareholders). Conditions apply, however, such as the existence of a tax treaty between France and the source state and adherence to the conditions and the rate set in that treaty.

14.3.3.7. Safe harbours

Within the European Union, article 209 B of the CGI only applies to artificial arrangements aimed at circumventing French tax law. More generally, it does not apply if the French entity demonstrates that the operations have principally an object and an effect other than localizing profits in a country where it is subject to a privileged tax regime. This is, for example, the case when the company conducts an effective industrial or commercial activity in the foreign territory.

14.3.4. Linking rules

France has introduced some linking rules, although they differ from the OECD recommendations.

The first was introduced before the issuance of the OECD's BEPS Action 2 final report. It is supposed to be an anti-hybrid instrument rule but does not

115. Prior to 2005, profits of affiliates were taxed in the hands of the French resident shareholders. In 2005, following the Schneider case (FR: CE, 28 June 2002, no.°232276, *Société Schneider Electric*), in which the CE held that the former rules were incompatible with double tax treaties, new French CFC rules were introduced. Profits of the foreign entity are now deemed to be distributed.

target conflict of qualification, as it applies generally to interest paid by a French company (subject to tax) to a French[116] or a foreign company[117] that is, for the current tax year, subject to corporate tax on the interest income at a rate which is less than 25% of the corporate tax that would be due under French tax rules (i.e. around 8.6%). When the lender is domiciled or established outside France, one should determine the tax liability that the lender would have had on the interest if it had been in France. According to the FTA, one should only look at the statutory rate,[118] i.e. the rate applicable to the gross product. If the guidelines refer to the calculation of the effective tax rate, it seems that it is only to take into account a rebate or provision limiting the inclusion of interest in the tax base.[119]

The second is the implementation of the Parent-Subsidiary Directive special anti-abuse rule.[120] Article 145 6 b) of the CGI provides that the exemption does not apply to income received when the distributed income is deductible from the taxable result of the company.

14.3.5. Interest limitation rules

France has a large number of interest limitations rules:
(a) the abnormal-act-of-management rule could be used to challenge deductibility;
(b) article 57 of the CGI sets the TP rule;
(c) article 212 *bis* of the CGI sets a general limitation to the deduction of interest expenses: companies are able to deduct 75% of the total amount of net interest expenses, unless this amount is less than EUR 3 million;

116. It would be hard to find cases where such rule would apply in a domestic situation. This has certainly been provided for to avoid EU criticisms; however, such an “abuse of law” would probably not succeed. Indeed, the qualification of restriction would be due to the fact that they apply in the “vast majority of cases” to cross-border situations (*see* DE: ECJ, 26 Oct. 1999, Case C-294/97, *Eurowings Luftverkehrs AG v. Finanzamt Dortmund-Unna*, ECJ Case Law IBFD; and HU: ECJ, 5 Feb. 2014, Case C-385/12, *Hervis Sport- és Divatkereskedelmi Kft. v. Nemzeti Adó- és Vámhivatal Közép-dunántúli Regionális Adó Főigazgatósága*, ECJ Case Law IBFD).
117. Special rules apply to transparent companies.
118. FR: DGFiP, BOI-IS-BASE-35-50-20140805, para. 40.
119. A. Lagarrigue & B. Hardeck, *Dispositif anti-hybrides: retour sur les difficultés d’application à la lumière des premiers commentaires de l’Administration*, Dr. fis. 2014, no. 22, 352, para.5.
120. Council Directive 2014/86/EU of 8 July 2014 amending Directive 2011/96/EU on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States, OJ L219 (2014), EU Law IBFD.

(d) article 212 I a) of the CGI allows the deductibility of the interest paid to related parties, provided they meet a specific kind of arm's length test (or a fixed rate provided for by article 39 of the CGI);[121]
(e) article 212 I b) of the CGI also provides for the so-called anti-hybrid rules mentioned above (*see* section 14.3.4.);
(f) article 212 II and III of the CGI provides for thin capitalization rules (*see* below);
(g) article 209 IX of the CGI (the so-called *Carrez* amendment) provides for a specific limit when a French company borrows money to purchase shares giving a right to the participation exemption regime, (very) broadly stating that the company must prove that it exercises an influence on the target (or its French parent or its French sister does – giving rise to a possible incompatibility with EU law); and
(h) article 223 B of the CGI (the so-called *Charasse* amendment) provides for a specific anti-abuse rule targeting interest payments linked to the financing of an intra-group acquisition of a company becoming part of the group tax consolidation.

Rules exist with respect to their combinations and their consequences, especially with respect to the order in which they apply and to the fact that non-deductible interest as a result of those rules gives rise to deemed dividend distribution (which is a general rule set by article 109 et seq. of the CGI).

We elaborate below on thin capitalization rules, due to the fact that they are closed to the OECD's BEPS earnings before interest, taxation, depreciation and amortization (EBITDA) limitation.[122] Article 212 II and III of the CGI provides for some ratio tests. Interest paid to related parties may be disallowed as a deductible expense if the company's interest exceeds each of the three following limits:
(1) the result of the interest multiplied by 1.5 times net equity divided by the related-party debts;
(2) 25% of adjusted net income before tax, which is the operating and financial result plus related-party interest, amortizations and certain specific lease payments; and
(3) the interest income received from related parties.

121. Article 212 of the CGI allows the tax deduction of interest paid to related parties up to the higher of (i) the average annual interest rate charged by lending institutions to companies for medium-term (2 years or more) variable-rate loans; or (ii) the interest that the indebted company could have obtained from independent banks under similar circumstances.
122. OECD, *Limiting Base Erosion Involving Interest Deductions and Other Financial Payments, Action 4 – 2015 Final Report*, (OECD Publishing 2015), International Organizations' Documentation IBFD.

These three tests are cumulative. Interest that exceeds the higher limit is not deductible, provided it exceeds EUR 150,000. The portion of non-deductible interest may be carried forward and offset when there is excess capacity in the subsequent years based on limitation (2) above. However, the interest carried forward is reduced by 5% each year, from the second accounting period following that in which the interest expense was incurred.

There are exceptions applicable.[123] Notably, the non-deductibility would not apply if the French indebted company can demonstrate that the debt-to-equity ratio of the worldwide group to which it belongs exceeds its own debt-to-equity ratio.

14.3.6. Others

French tax law provides for several other SAARs, such as:
(a) article 155 A of the CGI, which is a provision aimed at fighting against "rent a star" schemes and, more generally, against the interposition of a foreign company invoicing services in France that are realized by an individual who generally is the sole shareholder or manager or service provider of the company;
(b) article 223 *quinquies* C of the CGI, implementing country-by-country reporting rules that were introduced into French tax law in 2015: companies will have to communicate some tax-related information to the tax authorities for the financial year 2016 in 2017;
(c) article 123 *bis* of the CGI, providing for CFC rules applicable to individuals;
(d) article 221 of the CGI, containing the exit tax rule, which was introduced along the lines of the ECJ's *National Grid Indus* (2011) line of case law, i.e. upon a transfer of a seat or of a PE in an EU Member State, the company can either pay the taxes due on unrealized capital gains immediately or pay in five instalments;
(e) article 238 *bis*-0 I of the CGI, which provides specific rules applicable to the transfer of assets to a trust or a comparable institution;
(f) several provisions[124] against the use of companies located in non-cooperative states and territories, i.e. countries that have not concluded ex-

123. E.g. those rules do not apply to financial institutions, specific rules apply to tax consolidation etc.
124. FR: CGI, art. 39 *duodecies*, art. 57, art. 123 *bis*, art. 125-0 A, art 125 A, art. 145, art. 163 *quinquies* C, art. 163 *quinquies* C *bis*, art. 182 A *bis*, art. 182 A *ter*, art. 182 B, art. 187, art. 212, art. 219, art. 238-0 A, art. 244 *bis*, art. 244 *bis* A, and art. 244 *bis* B; and FR: LPF, art. L13.

change of information agreements with France or with 12 OECD member countries. This status leads to: (i) applying higher withholding tax rates on French source income; (ii) disapplying the participation exemption regime for both capital gains and dividends;[125] (iii) requiring justification of expenses paid to a company resident in a country in which it benefits from a special tax regime; and (iv) denying deduction of some listed expenses if paid to a non-cooperative state or territory, unless the French company demonstrates that the payments do not have for object and effect the location of those expenses in those countries; and

(g) article 990 D of the CGI, providing a 3% tax on the value of French real estate (or legal rights) owned, directly or indirectly, by legal persons, trusts or comparable institutions, unless some conditions are fulfilled (the provision is aimed at avoiding situations in which an individual interposes a foreign entity to try to escape the application of net wealth tax on French real estate).

There are also highly targeted rules aimed at fighting a number of "optimization" schemes once they have been characterized as abuse of law in some specific circumstances, including a scheme in which a company holding an ailing company makes a capital increase before selling the shares or liquidating the company in order to be able to record a deductible capital loss in the tax return[126] and a scheme in which a French company purchases a company that is no longer active and has sold all its assets, meaning that its only asset is cash (or the like), and the newly acquired subsidiary distributes dividends which benefit from the participation exemption regime but trigger a tax-deductible depreciation of the shares in the books of the shareholder.[127]

Finally, even if not binding for anyone, the FTA now publish on a website a number of schemes that are, in their opinion, abusive, require taxpayers not to implement them and, in case of implementation in the past, require taxpayers to rectify their tax returns so as not to take the tax benefit.[128]

125. The Cons. const. considered that it should not be applied in non-abusive situations (no. 2014-437 QPC).
126. FR: *Loi de finances rectificative pour 2012*, 16 Aug. 2012, no. 2012-958, art. 18.
127. Id., art. 16.
128. Available at http://www.economie.gouv.fr/dgfip/carte-des-pratiques-et-montages-abusifs (accessed 1 Feb. 2016).

14.3.7. Application of GAARs, TP rules and SAARs

As is clear from the above, there are many GAARs and SAARs applicable in France. The interactions between them are often (but not always) provided for by a regulation or by FTA in their guidelines.

We can give some example of cases where the interaction between SAARs is provided for:
(1) the FTA, in their guidelines on the so-called anti-hybrid instrument rule, provide that, if the lender is subject to tax in France through the application of the CFC rules, the interest is tax-deductible in the hand of the borrower;[129] and
(2) if CFC rules apply to a foreign entity, dividends paid by this entity should be exempt from French tax, provided the profits have already been taxed (and up to the profit taxed) as a result of the CFC rules.[130]

With respect to the combination of a GAAR and a SAAR, in some cases, the abnormal act of management and TP rules could be applied. The latter could also be applied in combination with abuse of law, although the author is not aware of any case law in this field.

However, it is hard to see any possible combination of abuse of law and many of the SAARs (such as articles 209 B or 212 of the CGI), since, once the latter are within the law, they become tax base rules and, in most cases, the *fraus legis* branch of abuse of law would not be applicable, simulation cases aside. If the taxpayer does not apply such a rule, he may well be fined for having deliberately misapplied the law (*manquement delibéré*). The next step is perhaps to apply *fraus legis* to schemes aimed at circumventing the application of a SAAR.

129. FR: DGFiP, BOI-IS-BASE-35-50-20140805, paras. 210 and 220.
130. FR: CGI, art. 102 Y annex II; and FR: DGFiP, BOI-IS-BASE-60-10-30-30-20120912, para. 180 et seq.

Chapter 15

Germany

Ekkehart Reimer

15.1. The meaning of avoidance and aggressive tax planning and the BEPS initiative

15.1.1. The meaning of tax avoidance in national legal systems

15.1.1.1. The development of the German GAAR until the last (2008) reform

Drawing convincing and practical demarcation lines between different phenomena and species of tax avoidance schemes has been an evergreen topic since the rise of modern tax law theory in Germany during the early 1920s. Originally, the exceptional interest in concept(s) of tax avoidance was triggered by three elements: a sharp increase in the tax burden after World War I,[1] an unprecedented centralization of tax legislation, tax administration and a specialized judiciary[2] and, above all, the codification of general rules of tax law, including a general anti-avoidance rule (GAAR) in the 1919 *Reichsabgabenordnung* (RAO). In its original version of 1919, the GAAR (sec. 5 of the RAO) read [author's translation]:

(1) Durch Missbrauch von Formen und Gestaltungsmöglichkeiten des bürgerlichen Rechts kann die Steuerpflicht nicht umgangen oder gemindert werden.	(1) The tax duty cannot be circumvened or reduced through an abuse of forms or freedoms of civil law.

1. H.-P. Ullmann, *Der Deutsche Steuerstaat. Geschichte der öffentlichen Finanzen vom 18. Jahrhundert bis heute* pp. 97 et seq. (Beck 2005).
2. Foundation of the *Reichsfinanzhof* by the *Errichtungsgesetz* of 26 July 1918, RGBl 1918, 959. On its history, *see* J.H. Kumpf, *Kaiserreich, Weimarer Republik und ‚Drittes Reich'. Der Reichsfinanzhof 1918-1938 aus der Sicht seines ersten Präsidenten*, in *Festschrift 75 Jahre Reichsfinanzhof/Bundesfinanzhof* pp. 23 et seq. (Stollfuss 1993).

(2) Ein Missbrauch im Sinne des Abs. 1 liegt vor, wenn:

1. *in Fällen, wo das Gesetz wirtschaftliche Vorgänge, Tatsachen und Verhältnisse in der ihnen entsprechenden rechtlichen Gestaltung einer Steuer unterwirft, zur Umgehung der Steuer ihnen nicht entsprechende, ungewöhnliche Rechtsformen gewählt oder Rechtsgeschäfte vorgenommen werden, und*
2. *nach Lage der Verhältnisse und nach der Art, wie verfahren wird oder verfahren werden soll, wirtschaftlich für die Beteiligten im wesentlichen derselbe Erfolg erzielt wird, der erzielt wäre, wenn eine den wirtschaftlichen Vorgängen, Tatsachen und Verhältnissen entsprechende rechtliche Gestaltung gewählt wäre, und ferner*
3. *etwaige Rechtsnachteile, die der gewählte Weg mit sich bringt, tatsächlich keine oder nur geringe Bedeutung haben.*

(2) In the sense of paragraph 1, an abuse exists:

1. Where the law imposes a tax on economic transactions, facts or circumstances in their appropriate arrangement, if inappropriate or unusual legal forms have been chosen or legal transactions performed for the purpose of tax avoidance, and
2. Where, according to circumstances, modalities and steps of the transaction, the economic outcome for the participants is substantially identical to the outcome which would have occurred if an arrangement appropriate to the economic transactions, facts or circumstances had been chosen; and moreover,
3. Where potential legal disadvantages of the way chosen have no or little relevance.

(3) Liegt ein Missbrauch vor, so sind die getroffenen Maßnahmen für die Besteuerung ohne Bedeutung. Die Steuern sind so zu erheben, wie sie bei einer den wirtschaftlichen Vorgängen, Tatsachen und Verhältnissen angemessenen rechtlichen Gestaltung zu erheben wären. Steuern, die auf Grund der für unwirksam zu erachtenden Maßnahmen etwa entrichtet sind, werden auf Antrag erstattet, wenn die Entscheidung, die diese Maßnahmen als unwirksam behandelt, rechtskräftig geworden ist.

(3) Where an abuse exists, the measures taken shall be irrelevant for taxation. Taxes shall be levied like for an arrangement appropriate to the economic transactions, facts or circumstances. Where taxes have been paid on the basis of the measures that shall now be regarded as irrelevant, those taxes shall be reimbursed upon application as soon as the decision that treats these measures as void has become final and conclusive.

Albert Hensel's 1923 essay "Zur Dogmatik des Begriffs 'Steuerumgehung'" [Conceptualizing Tax Avoidance] has established the common core of doctrinal reflection on this old German GAAR. Based on Roman law and modern private law concepts on the abuse of law concepts on the one hand and a genuine substance-over-form approach on the other, Hensel tries to develop sharp contours for the term "abuse". Above all, however, he is very clear on the legal consequences of the GAAR: the GAAR does not prohibit any behaviour (not even any form of tax avoidance or tax fraud), but spoils the desired effect of the scheme, i.e. reverses (neutralizes) the tax advantage.

The post-1920s developments of the GAAR are heterogeneous. Like other indefinite norms, the GAAR soon appeared as a perforation, if not an open door for the intrusion of Nazi ideology into the application of tax law by the administration and the *Reichsfinanzhof*. Increasingly, tax case law of the second half of the 20th century aimed at restricting the impact of the GAAR. This restrictive development had at least three different, but overlapping reasons.

(a) First, it can be regarded as a direct counter-reaction to the abuse of the GAAR during the 1930s and early 1940s, based on a negative experience with, and a strong commitment not to continue, any judicial activism driven by ideology and/or obedience to real or anticipated expectations of the government.

(b) A second explanation is the increasing impact of the Federal Constitution, the *Grundgesetz,* on the application of general and vague rules. On the basis of strict standards of legal certainty and the rise of *verfassungskonforme Auslegung* (interpretation of vague rules in conformity with the constitution), tax avoidance was contained by way of a purposive (teleological) interpretation of the single (ordinary) tax laws rather than by recourse to the GAAR.[3]

(c) Third, the more reluctant tax judges became, the more urgent was the need for the tax legislator to introduce special anti-avoidance rules (SAARs).[4] The existence and the concrete design of these SAARs had repercussions on the interpretation of the GAAR: courts argued that

3. This move of the judges from the "external" GAAR "into" the single (ordinary) tax rules was labelled as the shift from the *Außentheorie* to the *Innentheorie*.
4. Examples include CFC and exit tax legislation in the early 1970s, limitations on corporate carry-forward of losses as well as thin cap rules in the 1990s (on limitations of loss carry-forward, *see* R. Neumann, in Rödder, Herlinghaus & Neumann (eds.), *Körperschaftsteuergesetz. Kommentar* (Otto Schmidt 2015), § 8c m.nos. 34 et seq.; on

> wherever the parliament banned or restricted frequently used tax avoidance schemes, SAARs should be regarded as definite and conclusive, i.e. leave no space for a second-tier recourse to the GAAR. Moreover, the fact that the legislator was able to introduce (but refrained from introducing) SAARs made the *Bundesfinanzhof* practise considerable self-restraint in the application of the GAAR even where a tax avoidance scheme did not show any proximity to the topic of any SAAR.

Consequently and subsequently, the parliament reacted by making ongoing refinements (*rectius*, aggravations) of both the SAARs and the GAAR. The 1977 re-codification in sec. 42 of the new *Abgabenordnung* (AO) reduced the 1919 text to only two sentences, viz.

Durch Missbrauch von Gestaltungsmöglichkeiten des Rechts kann das Steuergesetz nicht umgangen werden. Liegt ein Missbrauch vor, so entsteht der Steueranspruch so, wie er bei einer den wirtschaftlichen Vorgängen angemessenen rechtlichen Gestaltung entsteht.	Tax law cannot be circumvened through an abuse of legal freedoms. In the case of an abuse, the tax claim is established as if it would have been established for an arrangement appropriate to the economic transactions.

In 2001, these two sentences were numbered as paragraph 1 and a second paragraph was added:

(2) Absatz 1 ist anwendbar, wenn seine Anwendbarkeit gesetzlich nicht ausdrücklich ausgeschlossen ist.	(2) Paragraph 1 applies unless its application has been excluded explicitly.

The preliminary end of the evolution of the GAAR had been reached in 2008. In accordance with the broad picture sketched above, a *legal definition of tax avoidance* was re-introduced. This might be seen as a shift from a broad judicial margin of appreciation back to a statute-based, thus somewhat anti-judicial approach. At the same time, however, legislators withdrew the 2001 rule in sec. 42(2) of the AO, viz. that only an explicit ban on sec. 42 of the AO was able to overcome the applicability of sec. 42(1) of the AO.

thin cap under the old sec. 8a of the *Körperschaftsteuergesetz*, *see* I. Stangl, in Rödder, Herlinghaus & Neumann, id., § 8a m.nos. 28 et seq.; on the current state of thin cap rules as part of the interest limitation rules, *see* section 15.4.2.).

In the course of the 2008 reform, the GAAR was phrased as follows:

(1) Durch Missbrauch von Gestaltungsmöglichkeiten des Rechts kann das Steuergesetz nicht umgangen werden. Ist der Tatbestand einer Regelung in einem Einzelsteuergesetz erfüllt, die der Verhinderung von Steuerumgehungen dient, so bestimmen sich die Rechtsfolgen nach jener Vorschrift. Anderenfalls entsteht der Steueranspruch beim Vorliegen eines Missbrauchs im Sinne des Absatzes 2 so, wie er bei einer den wirtschaftlichen Vorgängen angemessenen rechtlichen Gestaltung entsteht.

(1) Tax law cannot be circumvened through an abuse of legal freedoms. If the preconditions of an anti-avoidance rule in a single tax Act are fulfilled, the legal consequences shall be based on the latter rule. If not, the tax claim in the case of an abuse under paragraph 2 is established as if it would have been established for an arrangement appropriate to the economic transactions.

(2) Ein Missbrauch liegt vor, wenn eine unangemessene rechtliche Gestaltung gewählt wird, die beim Steuerpflichtigen oder einem Dritten im Vergleich zu einer angemessenen Gestaltung zu einem gesetzlich nicht vorgesehenen Steuervorteil führt. Dies gilt nicht, wenn der Steuerpflichtige für die gewählte Gestaltung außersteuerliche Gründe nachweist, die nach dem Gesamtbild der Verhältnisse beachtlich sind.

(2) An abuse exists where an inappropriate legal arrangement has been chosen that, compared to an appropriate legal arrangement, results in a tax benefit on the side of the taxpayer or a third person, if such benefit is not provided by law. This does not apply where the taxpayer can prove non-tax reasons for the arrangement chosen if, with a view to the overall circumstances, these reasons are significant.

In conceptualizing and interpreting these rules, there seems to be a factual dualism. One could even speak of two faces of the GAAR.

(a) The first face (at least in the chronological order of a tax case) is the way how most German tax officers including, above all, tax auditors interpret and apply sec. 42 of the AO. In their hands, the GAAR is usually not applied with great sensitivity to its complex textual structure, the literal meaning of its single textual elements and the constitutional framework in which it is embedded. Rather, auditors tend to use the

GAAR in a somewhat deterring manner. They indicate they might apply the GAAR unless the taxpayer gives in on disputable factual matters, e.g. in a valuation (e.g. TP) context. In this perspective, the GAAR appears as a powerful instrument from a psychological or game theory viewpoint, with a practical bias to the detriment of taxpayers.[5]

(b) Quite disconnected is the second, i.e. the juridical and judicial face of the GAAR. When judges (especially of the second and highest instance, the Munich-based *Bundesfinanzhof*) are confronted with what the tax administration considers to be a case for sec. 42 of the AO, they tend to fall back into their long-standing reluctance to replace the exact wording of the single tax rules with the GAAR. Even after the 2008 reform with the new definition in sec. 42(2) of the AO, they are remarkably shy to affirm an "abuse".

Empirically, the number of cases where the courts have accepted the application of sec. 42 of the AO by the tax administration is significantly lower than the number of cases where the courts decided against the application of sec. 42 of the AO.

15.1.1.2. Functions, constitutionality and dynamics of the GAAR

These two faces of the GAAR reflect its dual function. On the one hand, it is a powerful tool to maintain a safe distance between taxpayers (and their advisors) and an "aggressive", i.e. less desired tax planning. This function cannot be fulfilled without a considerable degree of uncertainty. On the assumption that substantive tax law will always remain imperfect, i.e. leave undesired loopholes, the uncertainty of one or more terms used in the GAAR is indispensable.

On the other hand, the GAAR functions as part of an overall rule-of-law framework and thus aims at contributing to a clear-cut demarcation between taxable and non-taxable arrangements. This juridical function emphasizes that the GAAR and its application are subject to constitutional limits. It is true that the GAAR is phrased widely, indefinitely and vaguely. Considering, however, that this lack of legal certainty is necessary (and even the *raison d'être*) if the GAAR wants to fulfil the first-mentioned object and purpose, the GAAR itself will not be regarded as unconstitutional. Rather,

5. *See* W. Schön, *Gestaltungsfreiheit und Belastungsgleichheit als Grundlagen des Steuerrechts*, in R. Hüttemann ed., *Gestaltungsfreiheit und Gestaltungsmissbrauch im Steuerrecht*, DStJG vol. 33 (Otto Schmidt 2010), pp. 29 et seq. (62 et seq.).

the way out of this constitutional dilemma is a restrictive interpretation of the GAAR: wherever possible, and as soon as possible, the parliament itself must declare which typical arrangements are abusive and which are tolerable. This needs to be done by legislative concretization of anti-abuse rules (most notably, by the introduction or refinement of SAARs) for typical arrangements.

A *future perspective* (not yet adopted by the courts on a large-scale basis) is the following: courts and scholars should further develop this approach of a restrictive interpretation of the GAAR in a *dynamic manner*. Guided by the Constitution, Courts could stress the importance of the timeline – the indefiniteness of the GAAR can be maintained if, on the level of application of the GAAR, it is kept free from the need to cover standard arrangements. As soon as Parliament *can* be more precise in identifying abusive arrangements, it *must* be more precise. Consequently, an abusive arrangement that was initially covered by the GAAR grows out of the GAAR as time goes by. Where the legislator does not react, a certain behaviour or a certain tax planning scheme will then change from the status as "taxable" (while covered by the GAAR) to "non-taxable" (when silently tolerated by an informed legislator). In other words, the GAAR remains sustainably effective for all cases where it simply *prevents* taxpayers from realizing an arrangement. Where, however, the taxpayer does realize the arrangement and tax inspectors *apply* the GAAR, the GAAR itself wears down and erodes. It is then *up to the parliament to decide* if arrangements of this kind should continue to be treated as taxable also in the future. This dynamic approach could best reconcile the factual needs to combat unknown or unforeseen abusive arrangements with the constitutional need for legal certainty.

15.1.1.3. Judicial and scholarly interpretation of the GAAR today

Looking at the GAAR from a technical viewpoint, and considering the overarching need that it should catch (or prevent) new and unknown arrangements, it is a little surprising that guidance on how to apply the GAAR cannot be found in any statutory or quasi-statutory codification. There are, however, *administrative concretizations* for the application of sec. 42 of the AO.[6] Moreover, many special ordinances and ministerial letters on specific rules, transactions or situations mention sec. 42 in the context of special tax provisions that are not themselves accompanied by a SAAR.

6. Bundesministerium der Finanzen, *Anwendungserlass zur Abgabenordnung 1977* (*AEAO*), last update on 26 Jan. 2016, zu § 42 AO. *See* Annex for the full text of the AEAO text pertaining to sec. 42 AO.

For these reasons, the conceptualization of sec. 42 and what a practicable test of a case against the GAAR should look like, recourse should be made to *judicial case law* and (as always in Germany) to the accompanying literature. Based on these two sources, the following test reflects the current application of the GAAR by German courts:[7]

15.1.1.3.1. *Delimitation to SAARs*

The first step is the delimitation of the material scope of the GAAR against anti-abuse rules in separate, i.e. special tax rules (*see* section 15.4. for details).

15.1.1.3.2. *Choice of an inappropriate legal arrangement*

Where the *lex specialis* rule does not inhibit recourse to the GAAR, the arrangement at issue needs to be tested against the positive and negative preconditions of the concept of abuse under sec. 42(2) of the AO. Above all, an abuse requires that the taxpayer has chosen an "inappropriate legal arrangement". In its General Decree on the application of the *Abgabenordnung*, the Federal Ministry of Finance convincingly states that the yardstick for this test is the values (*Wertungen*) contained in the principles and sub-principles of the respective type of tax at issue.[8]

Neither the motive to save taxes is inappropriate in itself, nor is an unusual arrangement necessarily abusive. Arrangements can be regarded as inappropriate only if, in a world without taxes, they should be regarded as:
(a) detrimental from an economic viewpoint;
(b) circuitous,[9] complicated or cumbersome;
(c) artificial;
(d) redundant or useless;
(e) ineffective, counterproductive; or even
(f) absurd.

7. Following the detailed analysis by Klaus-Dieter Drüen, in Tipke & Kruse (eds.), *Abgabenordnung/Finanzgerichtsordnung. Kommentar*, loose-leafed. (Otto Schmidt 2010), Vor § 42 AO, m.nos. 8 et seq.; and the recent comparative analysis by Markus Seiler, *GAARs and Judicial Anti-Avoidance in Germany, the UK and the EU* (Linde 2016).
8. Bundesministerium der Finanzen (*supra* n. 6), at m.no. 2.2.
9. The typical character of artificial arrangements as "U-turn arrangements" has convincingly been stressed by W. Schön (*supra* n. 5), p. 60.

Moreover, the Ministry has exemplified indications for the characterization of an arrangement as abusive, viz.:

(a) that a sound unrelated party had not set up the arrangement solely for the tax advantage, taking into account the economic circumstances and the object and purpose of the transaction;
(b) the interposition of family members or other related persons/entities was merely motivated by tax considerations;
(c) the shift or transfer of earnings or assets to a third person were merely motivated by tax considerations.

15.1.1.3.3. *Tax benefit*

Third, this inappropriate legal arrangement must result in a tax benefit on the side of the taxpayer or a third person. This sub-test requires a comparison between the (actual) arrangement in casu and the (fictitious) sound arrangement that has been conceptualized for the "appropriate" test in section 15.1.1.3.2. Moreover, the arrangement must be causal for the tax benefit.

15.1.1.3.4. *Deviation from a notional legal model*

Fourth, the benefit must be "not provided by law". In the grammatical structure, this requirement reverses the ordinary rule-exception relation, as guaranteed by the constitution: as a rule, it is the *burden* of tax that needs to be "provided by law", and no tax is due in the absence of such explicit legal provision. By contrast, the first sentence of sec. 42(2) of the AO takes the burden of tax for granted where an arrangement is both "inappropriate" (*see* section 15.1.1.3.2.) and beneficial (*see* section 15.1.1.3.3.), thus requiring a positive justification for the *benefit*.

This inversion of the substantive-law relation between rule and exception corresponds to an inversion of the burden of proof in administrative and court procedures: while normally, the State must justify a burden, the verdict of an inappropriate benefit brings the taxpayer in a position where (s) he must justify the absence of such a burden.

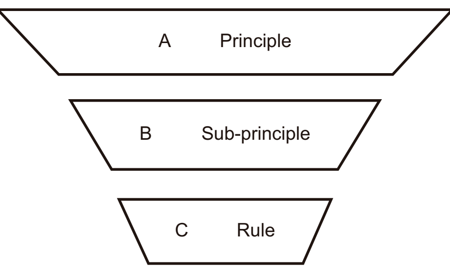
In substance, the "provided by law" requirement in the first sentence of sec. 42(1) of the AO compares:

(a) the tax avoidance arrangement and its beneficial outcome on the basis of a literal interpretation of the specific tax rules

(b) to the object and purpose of these specific tax rules, based on a more principle-oriented approach.

While this relative approach can be clearly derived from sec. 42(1) of the AO, its concretization is challenging, if not impossible. In his groundbreaking 2009 report for the *Deutsche Steuerjuristische Gesellschaft*, Wolfgang Schön convincingly exemplified the contradictions that can be found in case law when it comes to the identification of the right frame of reference.[10] The difficulties stem from the multi-tier structure of most, if not all tax laws. Tax legislation is based on external requirements (constitution, EU law, international law) and in itself contains rules of different abstraction. To keep it simple, the normative model in figure 15.1. shows the difficulties:

Figure 15.1.



While the predicate that an arrangement that circumvents a single rule (C) is "beneficial" (*see* section 15.1.1.3.3.) can always be drawn from its direct test against the next higher level (B), the "not provided by law" test is much more flexible on this point. Sec. 42(2) of the AO does not give any hint whether the arrangement should be tested against the object and purpose of B or of A. It is true that the question remains irrelevant where A and B point to the same direction so that B can be seen as a declaratory concretion of A. However, if the concretion is a true refinement (and does not only re-phrase B in a semantically redundant manner), B does not only affirm the inclusion of certain cases in A. At the same time, B also excludes cases that otherwise might have been included on the mere basis of A. To the extent that B carves out certain cases, the GAAR that might make up for deficits of C receives divergent messages. The object and purpose of C can be derived from either B or A. This ambiguity is the true core of all difficulties in the application of the "not provided by law" test in sec. 42(2) of the AO.

10. W. Schön (*supra* n. 5), pp. 61 et seq.

15.1.1.3.5. *Absence of significant non-tax reasons for the arrangement chosen*

Fifth, the abuse test requires includes a negative element, viz. that there are no significant non-tax reasons for the actual arrangement chosen (second sentence of sec. 42(2) of the AO). Both for the existence and the relevance (impact, volume) of these non-tax reasons, the burden of proof is with the taxpayer.

15.1.1.3.6. *Irrelevance of subjective elements*

Traditionally, German case law has shown strong tendencies to underweight subjective elements in testing (potentially) abusive arrangements against the GAAR. At a superficial and practical level, courts have frequently justified their reluctance by the fact that intentions and wills can be proven only by recourse to objective elements in any case. Thus, tax law design and interpretation can tie to these objective elements directly, thus skip the uncertainties in the statement of thoughts and intentions. The underweighting of subjective elements is supported by the observation that the sheer mass of tax cases sets limits to highly diligent investigations into personal intention of taxpayers and their advisors.

Underneath the surface, a second line of reasoning might be connected to the character of the *Bundesfinanzhof* as an appellate court that is not entitled to inquire into the facts of a case and to hear evidence. By downgrading the range of relevant facts (here, fading out the subjective intention of a taxpayer/tax advisor) and focusing on the objective facts as stated in the files of a case, the *Bundesfinanzhof* is able to shift the necessary distinctions and delimitations to the level of the legal standards and, in so doing, retains full authority on issues of sec. 42 of the AO.

It follows that elements like the object and purpose of an arrangement are regarded as objective concepts that follow certain prototypes, and that these generalized objective standards make it difficult to accept counter-evidence only because the taxpayer claims that (s)he was unaware of certain facts, the context or even the (potential) tax benefit as such.

It should be noted that the low weight that German courts assign to subjective elements when conceptualizing the GAAR (or when interpreting the ordinary tax rules as such) has not found unanimous support in the literature. Academics who advocate for a restricted use of the GAAR, and its

application in clear cases of *fraus legis* only, usually stress that the GAAR is supplemented by (unwritten) subjective elements, i.e. an intention of abuse (*Missbrauchsabsicht*).[11] Likewise, many consultants conceive the application of the GAAR as a negative sanction. This perception suggests that the GAAR, like a rule in criminal law, cannot exist without mirroring the objective elements of the case on the subjective side, i.e. in the intention of the taxpayer.

15.1.1.4. The German GAAR in the light of the five criteria listed in the questionnaire

Considering the main criteria that the EATLP questionnaire provides to National Reporters, the elements and technical structure of sec. 42 of the AO show a high degree of overlap with regard to the first, second and third criterion:

a) The reference to the values and principles underlying the specific tax laws at issue[12] triggers a *main objective test* (the accrual of a tax advantage the grant of which is contrary to the purpose of the legal provision).

b) The negative element laid down in the second sentence of sec. 42(2) of the AO goes along the lines of the *essential aim test* (obtaining a tax advantage as the essential aim of the transactions concerned).

c) Germany is reluctant to assign substantial relevance to *subjective elements* (i.e., the intention of taxpayers).[13] For this reason, the German GAAR does not match the international "complementary business purpose test", nor does it link to any *other subjective elements* (intention of the taxpayer to obtain a tax advantage). In its objective approach, the German GAAR comes closer to the EU "genuine economic activity test".

d) The principle of proportionality does not play any substantial role in German conceptual thinking of the GAAR and single SAARs. This reluctance sounds astonishing at first glance. However, it matches the overarching understanding that ordinary tax rules (i.e. rules that are not employed in a tax expenditure context or otherwise aim at incentivizing a certain behaviour) have the financing of public budgets as their only

11. For example, W. Schön (*supra* n. 5), p. 61.
12. *See* section 15.1.1.3.2.; and Bundesministerium der Finanzen (*supra* n. 6), at m.no. 2.2.
13. *See* section 15.1.1.3.6.

purpose and that this purpose (due to its immeasurability) is not accessible to ordinary proportionality tests.

15.1.2. Tax rulings as an instrument to restore legal certainty

In spite of the conceptual structures outlined in section 15.1.1.3., the GAAR still brings about (and wants to bring about) a high degree of uncertainty and deterrence. While other GAAR jurisdictions compensate for this by procedural means, i.e. tax rulings, Germany is traditionally relatively reluctant and restrictive in this respect. Still, three different instruments are available.

15.1.2.1. Ordinary advance rulings (*verbindliche Auskunft*)

According to sec. 89(2) of the AO, both the *Länder* and the federal tax authorities are authorized, but not obliged, to issue advance rulings on the relevance of specific (clearly designated) facts on the application of tax law. Taxpayers have a right to apply for such binding rulings if they can establish a particular interest in the ruling on the basis of significant tax law consequences. However, even if all of these preconditions are met, the tax authorities can deny this request under due consideration.[14]

In practice, the costs and duration of advance ruling procedures make them not very attractive in daily life. Moreover, based on nationwide instructions issued by the Federal Ministry of Finance,[15] no advance rulings should be granted on TP issues. This instruction is not in line with the duty of tax authorities to decide anew in every single case, and to exercise its statutory discretion on a case-by-case basis.[16]

14. *See* sec. 5 AO.
15. Bundesministerium der Finanzen, *Verordnung zur Durchführung von § 89 Abs. 2 der Abgabenordnung* (Steuer-Auskunftsverordnung – StAuskV) of 30 Nov. 2007, BGBl. I 2007, pp. 2783 et seq.
16. *See* J. Becker, G. Kimpel, A. Oestreicher & E. Reimer, *Internationale Verrechnungspreise – Herausforderungen und Lösungsansätze für Familienunternehmen* (Stiftung Familienunternehmen 2015), available at http://www.familienunternehmen.de/media/public/pdf/publikationen-studien/studien/Studie_Stiftung_Familienunternehmen_Internationale-Verrechnungspreise.pdf, pp. 2, 67 et seq.; and id., *Das Verfahrensrecht der Verrechnungspreise. Grundlagen, Erfahrungen und Perspektiven* (Springer Gabler 2017), pp. 17-19 and p. 23.

15.1.2.2. Binding affirmation after tax audits (verbindliche Zusage)

A second type of ruling is an affirmation in writing (*verbindliche Zusagen*) issued subsequent to a tax audit. Its legal basis is sec. 204 et seq. of the AO. Content-wise, the ruling states that *rebus sic stantibus*, the tax authorities will stick to the legal treatment of the same or similar facts in future audits and for future years. This affirmation, also, is subject to application by the taxpayer. Unlike the *verbindliche Auskunft*, however, the post-audit affirmation:

a) "should" be granted (no free discretion of the tax administration). This quasi-claim can only be denied in exceptional cases and where the tax administration sees special reasons;
b) does not trigger any fees.

In practice, there seem to be no significant problems with the application of sec. 204 et seq. of the AO. It rather reflects a joint (and sound) desire of both sides not to argue more often than necessary on economically identical issues.

15.1.2.3. Agreements on facts (*tatsächliche Verständigung*)

Finally, administrative practice has developed a *praeter legem* instrument by which the taxpayer and the tax administration can settle difficulties in the scrutiny of the facts of a case.[17] The courts regard such agreements on facts as admissible,[18] though not binding on the courts themselves. Unlike advance rulings (*see* section 15.1.2.1.), agreements on facts are always retrospective and do not anticipate the assumption of future facts.[19]

In no case shall the agreement include legal analyses or determine the interpretation and application of the law. Given that there is no statutory basis

17. *See* A. Eich, *Die tatsächliche Verständigung im Steuerverfahren und Steuerstrafverfahren* (Otto Schmidt 1992); J. Englisch, *Bindende "tatsächliche" und "rechtliche" Verständigungen zwischen Finanzamt und Steuerpflichtigen* (Institut Finanzen und Steuern 2004); U. Pflaum, *Kooperative Gesamtbereinigung von Besteuerungs- und Steuerstrafverfahren: Die Verbindung von steuerrechtlicher und strafprozessualer Verständigung* (Duncker & Humblot 2010); and J. Melchior, *Verständigung, tatsächliche*, in *Beck'sches Steuer- und Bilanzrechtslexikon* (Beck 2016).
18. Bundesfinanzhof (BFH), 11 Dec.1984 – VIII R 131/76 –, BStBl. II 1985, 354.
19. BFH, 6 March 1997 – IV R 21/96 –, DStRE 1997, 757.

for such agreements anyway, and considering the constitutional guarantees of equality, there is no leeway for agreements on the law.[20]

15.2. Constitutionalization of anti-avoidance – A new phenomenon

Before issues of supranational (EU) and international (OECD and G20) influence on anti-avoidance are analysed (*see* sections 15.3. and 15.4.), this national report needs to show a very recent development that is connected to a 2014 judgment of the Federal Constitutional Court (*Bundesverfassungsgericht*) in a famous case on inheritance tax.[21] The main question was the compatibility of a far-reaching exemption for business assets from inheritance taxation[22] with the principle of equality.[23] One of the preliminary questions was, however, how far specific private law arrangements enable the taxpayer to convert private assets into business assets, thus obtaining the exemption in a (potentially) abusive manner.

15.2.1. Possibility of tax avoidance can make a tax act unconstitutional

The *Bundesverfassungsgericht* took this danger very seriously. When elaborating on the standards of unconstitutionality based on inequality, it ruled that a tax act or single elements thereof (here, the exclusion of business assets from the inheritance tax base) are unconstitutional if they do not prevent the taxpayer from entering into arrangements that reduce the burden of tax in a way that:

(a) was obviously not intended by legislators and
(b) is not justifiable under the right to equality.[24]

This harsh standard goes far beyond the traditional approach to combat tax avoidance by means of ordinary statutory law (GAAR, SAARs and purposive interpretation). The *Bundesverfassungsgericht* does not leave the decision on whether there should be anti-avoidance legislation up to the

20. For example, BFH, 15 March 2000 – IV B 44/99 –, BeckRS 2000, 25004598.
21. Bundesverfassungsgericht (BverfG, First Senate) of 17 Dec 2014 – 1 BvL 21/12 –, available at http://www.bundesverfassungsgericht.de/SharedDocs/Entscheidungen/DE/2014/12/ls20141217_1bvl002112.html.
22. Laid down in secs. 13a, 13b of the Inheritance Tax Act (*Erbschaftsteuergesetz*).
23. Art. 3(1) of the Federal Constitution (*Grundgesetz*).
24. BVerfG (*supra* n. 21) at no. 254.

parliament. The Senate makes it clear that anti-avoidance legislation is an obligation of the parliament under the Constitution and does not prescribe how tax avoidance is to be prevented.

15.2.2. Relation to statutory anti-avoidance

However, when judging the unconstitutionality of a single rule in a tax act on the basis of the new possibility-of-avoidance test (*see* section 15.2.1.), the *Bundesverfassungsgericht* takes all ways to counter tax avoidance arrangements on the basis of statutory (ordinary) tax laws and/or their interpretation into account. Considering the actual existence of a GAAR in sec. 42 of the AO, the Senate explains that:

> When interpreting and applying sec. 42 AO, the tax courts should, wherever possible, to use this anti-abuse rule in order to counteract tax planning schemes that would otherwise [i.e., under the new possibility-of-avoidance test] lead to the unconstitutionality of a norm.[25]

This indicates a clear *priority of statutory and interpretative anti-avoidance* over the far-reaching verdict of the unconstitutionality of a tax privilege or even an entire tax act. Thus, the new possibility-of-avoidance test is a last resort. It might have been developed with a special view on the tremendous influence of lobbyism on the design of inheritance tax law.

If this assumption is correct, the *Bundesverfassungsgericht* might regard the abstract menace of unconstitutionality of a statutory provision as a *help for legislators* to be restrictive when granting tax privileges and to keep exemptions clear-cut, to prevent the rule (taxation) being inverted into an exception. Therefore, it is a veritable punishment of those who died without, or before they have sought, professional tax planning advice.

15.2.3. Conclusion

The new possibility-of-avoidance test is an instrument of last resort that guarantees (and requires) a minimum of statutory (parliamentary) and interpretative (judicial) effort to prevent tax avoidance. It is in line with earlier scholarly writing on the impact of the constitution in favour of effective

25. BVerfG (*supra* n. 21), at no. 255.

anti-abuse legislation.[26] This new test is similar, but not identical to the requirement that a tax act must not be "structurally unenforceable".[27] At the same time, it fits perfectly into the general principle that, wherever possible, the *interpretation of ordinary tax acts in conformity with the constitution* (*verfassungskonforme Auslegung*) should take precedence over the verdict of unconstitutionality of the act.

15.3. European influence on German anti-abuse measures

The impact of EU law on anti-abuse rules has at least two dimensions. First, the ECJ has developed criteria that aim to protect EU law against abusive rent-seeking strategies by taxpayers.[28] Second, EU law influences the design and/or effect of national anti-abuse rules, including national GAARs of the Member States. The following analysis confines itself to this second aspect which, again, needs to be split up into two sub-sections. On the one hand, the fundamental freedoms interact with national GAARs and other anti-abuse techniques of the Member States negatively, i.e. that they restrict the application of GAARs (*see* section 15.3.1.). On the other hand, secondary EU law might obtain positive influence on national GAARs (*see* sections 15.3.2. and 15.3.3.).

15.3.1. ECJ case law

Independent and separately from anti-abuse rules of the Member States, the ECJ has implemented an abuse proviso in its conceptualization of the fundamental freedoms and, more precisely, the design of reasons that could

26. For example, K.-D. Drüen, *Unternehmerfreiheit und Steuerumgehung*, *Steuer und Wirtschaft* (2008), pp. 154 et seq.
27. Where a tax act shows *strukturelle Vollzugsdefizite* (structural enforcement deficits), this act as such (not only the deficits of the level of its application) misses the character of a law as a *general* rule and violates the constitutional principle of equality, thus can be declared void: BVerfG of 27 June 1991 – 2 BvR 1493/89 –, BVerfGE 84, 239, available at http://www.servat.unibe.ch/dfr/bv084239.html.
28. On this aspect, A. Niemann, *Der allgemeine Missbrauchsvorbehalt nach der Rechtsprechung des EuGH und seine Auswirkungen auf die Anwendung des § 42 AO* (Peter Lang 2012) and more recently, Lord Robert Reed, *Anti-Avoidance Principles Under Domestic and EU Law, British Tax Review* 2016, pp. 288 et seq., as well as L. M. Baudenbacher, *Vom gemeineuropäischen zum europäischen Rechtsmissbrauchsverbot* (Nomos 2016). For a global conceptualization of GAAR as a general principle of law, *see* J. D. Rolim, *The General Anti-Avoidance Rule: Its Expanding Role in International Taxation*, 44 *Intertax* (2016), pp. 815 et seq.

(where proportionate) justify discriminatory or restrictive measures taken by the Member States.

The landmark decision in the *Cadbury Schweppes* case[29] has been explicitly mentioned by the German Federal Ministry of Finance in its General Decree on sec. 42 of the AO in a way that a cross-border arrangement is always "inappropriate" (thus, abusive) under the first sentence of sec. 42(1) of the AO if it is "wholly artificial" and "aims only at circumventing domestic taxes". Although this language is based on the ECJ decision, it shows minor deviations and needs to be contextualized.

15.3.1.1. Deviation from *Cadbury Schweppes*

By explicitly referring to the ECJ judgment in *Cadbury Schweppes*,[30] the Federal Ministry of Finance creates the impression that its General Decree on sec. 42 of the AO is literally in line with *Cadbury Schweppes*. However, the Ministry actually has re-phrased the circumvention test:

ECJ, *Cadbury Schweppes*, no. 51	**Federal Ministry of Finance**
A national measure restricting freedom of establishment may be justified where it *specifically relates to* wholly artificial arrangements aimed at circumventing the *application of the legislation* of the Member State concerned. (emphasis added)	A cross-border arrangement is to be regarded […] as inappropriate especially if the arrangement chosen is wholly artificial and *only* aims at circumventing the *establishment* of a domestic tax claim. (emphasis added)

In more than one respect, this (alleged) reference to *Cadbury Schweppes* is misleading. Most noticeably, the Ministry added the word "only", thus excluding the application of the *Cadbury Schweppes* formula in cases where the taxpayer adopted a certain arrangement mainly because of the tax benefit, but still co-motivated by non-tax aspects. One may wonder, however, whether the ECJ, also, has not integrated such a requirement of exclusivity when using the word "wholly" (when referring to artificial).

Second, the Ministry reduces the *Cadbury Schweppes* formula to cases where the existence of the tax claim as such (i.e. from a qualitative viewpoint) is at stake ("the establishment of a domestic tax claim"). By contrast,

29. ECJ, 12 Sept. 2006, Case C-196/04, *Cadbury Schweppes*, [2006] ECR I-7995, ECJ Case Law IBFD.
30. Id., at no. 51.

the ECJ has phrased the anti-abuse proviso more gently by only using the verb “circumventing”. This leaves significant leeway for the application of the *Cadbury Schweppes* proviso also in cases where the parties do not argue about the coming-into-being of a tax claim to the detriment of the taxpayer. The ECJ wording can easily be extended to, for example, inappropriate refund claims and/or claims for unjustified refundable credits (e.g. in the context of the cum-ex scandal), while the ministerial Decree creates the (misleading) impression that abuse can only occur (and thus needs to be combated only) on the side of a alleged tax burden, not on the side of refunds, tax credits or the like.

15.3.1.2. Systematic context

Moreover, it should be noted that the Federal Ministry of Finance does not replace the traditional GAAR test by the (modified; *see* section 15.3.1.1.) *Cadbury Schweppes* formula, not even for intra-EU cases with cross-border impact. Rather, the existing German GAAR doctrine, as laid down in sec. 42 of the AO itself and the pertaining ministerial Decree,[31] remain fully applicable. The (modified) *Cadbury Schweppes* criteria are only added as an alternative track to the verdict of “abuse”. The Ministry avoids any hints that might be read as a way out of the GAAR for intra-EU cases.

15.3.2. EC Recommendation C(2012) 8806 of 6 December 2012

The 2012 Recommendation by the EU Commission proposes that EU Member States adopt a GAAR in their domestic law. This harmonized national GAAR was intended to read as follows:[32]

> 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.

31. Bundesministerium der Finanzen (*supra* n. 6).
32. European Commission, *Recommendation of 6 Dec. 2012 on aggressive tax planning*, C(2012) 8806, no. 4.2.

15.3.2.1. No textual changes of German law

Germany has not replied to this Recommendation by a change in its domestic law. Considering the 2001 and 2008 reforms, neither the Federal Ministry of Finance nor fractions or members of the Federal Parliament recognized any need for more change. In the case of Germany, a literal adoption of the COM Recommendation would have reduced the textual complexity of the 2008 GAAR without reflecting the helpful achievements enshrined therein. This goes particularly for the provisions on the relationship between the GAAR and SAARs. Moreover, unlike the COM Recommendation, the 2008 German GAAR refers to persons other than the taxpayer when designating the relevant focal points and persons. Vice versa, the COM Recommendation does not contain any preconditions or legal consequences that are not, literally or implicitly, part of the German GAAR.

For these reasons, the national GAAR can be regarded as compatible with the concept of abuse underlying the COM Recommendation. Consequently, any textual change of sec. 42 of the AO after the 2012 COM Recommendation would have reduced the sophisticated, but well-designed structure of the 2008 GAAR. The Federal Ministry of Finance has not seen any reason to amend its General Decree on sec. 42 of the AO[33] either.

15.3.2.2. Interpretative relevance

This does not exclude that the 2012 COM Recommendation has obtained, or might obtain, an indirect effect on the application of sec. 42 of the AO. It is true that this does not go for the text of the GAAR, as proposed by the COM Recommendation – it will remain irrelevant on the interpretative side. However, the additional refinements contained in nos. 4.3.-4.7. of the COM Recommendation do reach further than the existing German case law and doctrine in some points. The following contains a more detailed discussion:

15.3.2.2.1. *Definition of "arrangement"*

The description of the term "arrangement" in no. 4.3. of the COM Recommendation makes it clear that this term means "any transaction, scheme, action, operation, agreement, grant, understanding, promise, undertaking or event. An arrangement may comprise more than one step or part". Although this descriptive list gives a good illustration of an "arrangement",

33. *See supra* n. 6.

it is less than a definition. Its value for the application of the German GAAR is diminished by the fact that the German version of the Recommendation does not employ any of the customary terms contained in Germany's anti-abuse legislation (e.g. *Gestaltung* or *wirtschaftlicher Vorgang*) but uses the term *Vorkehrung* that re-translates also as "physical provision", "preventive/precautionary measure", "prevention/precaution" and thus sounds odd in this connection.

In all, while the list provided in the first sentence of no. 4.3. of the COM Recommendation is of little relevance, the explicit inclusion of multi-step or multi-part arrangements in the second sentence of no. 4.3. makes it clear that arrangements should not be pinpointed on the micro-level but that a comprehensive or broader look should be taken on various elements of a case, even if these elements do not happen at the same time, the same place or with the same persons.

At first glance, this clarification is helpful. It seems to coincide with the *Gesamtplan* notion[34] and supports the broad perspective taken under this traditional approach under sec. 42(1) and (2) of the AO. A second look, however, faces the challenge of reconciling this second sentence of no. 4.3. with the notion of "series of arrangements" used in nos. 4.4.-4.7. of the COM Recommendation. This dualism of concepts seems to be redundant. Theoretically (and at best), it could be seen as the logical basis to conclude that the term "arrangements" is located on a meso level and has rather sharp contours, i.e. that an arrangement can both:

(a) have immanent complexity (more than one micro-elements) and
(b) contribute to external complexity on the macro level of a "series" of arrangements, with this "series" being not itself an arrangement.

However, these theoretical conclusions do not provide further guidance on the interpretation of the domestic GAAR.

15.3.2.2.2. *Clarification of "artificial"*

No. 4.4. of the COM Recommendation gives a negative definition of the term "artificial", as used in no. 4.2., viz. that the arrangement "lacks commercial substance". This phrase confirms the overall substance-over-form requirement that is the essential core of GAARs in any case. It convincingly stipulates a more economic approach.

34. *See supra* n. 1.

More concrete contours are given by the list of variable (flexible) indicators ("situations") that follow, viz.:

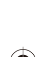
(a) the legal characterization of the individual steps that an arrangement consists of is inconsistent with the legal substance of the arrangement as a whole;
(b) the arrangement or series of arrangements is carried out in a manner that would not ordinarily be employed in what is expected to be a reasonable business conduct;
(c) the arrangement or series of arrangements includes elements that have the effect of offsetting or cancelling each other;
(d) transactions concluded are circular in nature;
(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; and
(f) the expected pre-tax profit is insignificant in comparison to the amount of the expected tax benefit.

For the most part, the list corresponds to structures and constellations that are also reflected in case law and doctrinal literature on the German GAAR. This goes particularly for the (closely related) cases of U-turn arrangements mentioned in letter (c) and circular arrangements mentioned in letter (d).

A new and helpful element is the situation described in letter (f), viz. the quantitative comparison of pre-tax benefit and after-tax benefit of the arrangement. Although the adjective "insignificant" does not provide the highest degree of legal certainty, this rule indicates the contours of a formula that might refine notions like "*wholly* artificial" in the future. It is highly conceivable that the qualitative term "wholly" could then – in a quantitative test – translate as "pre-tax benefit lower than x per cent of after-tax benefit", while it would be up to national legislators and/or the courts to quantify "x". However, at least from the German viewpoint, such a higher degree of precision has not been achieved yet, and there are no quantitative ceilings in sight.

15.3.2.2.3. *Clarification of "avoiding taxation"*

No. 4.5. of the COM Recommendation explains the term "avoid taxation" by ruling out any relevance of subjective elements ("subjective intentions"). Rather, the decisive criterion should be whether the arrangement (or series of arrangements) "defeats the object, spirit and purpose of the tax provisions that would otherwise apply".



Again, this is in line with traditional German case law and doctrine that have also shown strong tendencies to underweight subjective elements into their tests (*see* section 15.1.1.3.6.).

15.3.2.2.4. *Clarification of "essential"*

Both linguistically and from a methodological viewpoint, the term "essential" is immune against any clear-cut definition. Still, the guidance provided in no. 4.6. of the 2012 COM Recommendation is helpful in that it adopts a relative view. According to this provision, "a given purpose is to be considered essential where any other purpose that is or could be attributed to the arrangement or series of arrangements appears at most negligible, in view of all the circumstances of the case".

15.3.2.2.5. *Clarification of "tax benefit"*

Finally, no. 4.7. of the COM Recommendation states that the notion "tax benefit", too, requires a comparison of "the amount of tax due by a taxpayer, having regard to those arrangement(s), with the amount that the same taxpayer would owe under the same circumstances in the absence of the arrangement(s)".

The second sentence of no. 4.7. elaborates on five potential reasons or criteria for the tax benefit, i.e.[35] (i) a priori non-inclusion in the tax base; (ii) deduction from the tax base; (iii) creation of losses for tax purposes; (iv) forbearance of withholding tax; and (v) offset of foreign against domestic taxes. It is true that these five elements show potential doors for tax benefits. However, the list is neither exhaustive nor coercive:

(a) On the one hand, further points for unjustified tax benefits might be added that are not listed here, e.g. privileges on the side of the tax rate, excessive thresholds/tax-free amounts, or even the intentional employment of hybrid mismatches.

(b) On the other hand, none of the five elements contained in the second sentence of no. 4.7. is *intrinsice malum*. On the contrary, all of these elements are neutral parts of all modern tax regimes. The fact that a

35. Unlike other language versions, the English version of no. 4.7. of the Recommendation erroneously uses letters (g)-(k) for this list (obviously in continuation of the numbering of no. 4.4.). The two lists are unrelated, however.

taxpayer obtains one or more of the five elements cannot, and should not, be used as an indicator of a "benefit".

This suggests that the list in the second sentence of no. 4.7. of the COM Recommendation might have (and should have) no substantial impact on the interpretation of national GAARs. With a view to the German GAAR and its application, no traces can be found of any kind of influence of no. 4.7. of the Recommendation.

15.3.2.2.6. *Conclusion*

In all, the COM Recommendation has little interpretative impact on the German GAAR.

15.3.3. The 2016 EU Proposal for National GAARs

Following up to its 2012 Recommendation (*see* section 15.3.2.), the European Commission has presented a new and amended proposal for a harmonized GAAR in its 28 January 2016 Anti-BEPS package. Article 7 of the Proposal for an Anti-BEPS Directive[36] reads:

> 1. Non-genuine arrangements or a series thereof carried out for the essential purpose of obtaining a tax advantage that defeats the object or purpose of the otherwise applicable tax provisions shall be ignored for the purposes of calculating the corporate tax liability. An arrangement may comprise more than one step or part.
>
> 2. For the purposes of paragraph 1, an arrangement or a series thereof shall be regarded as non-genuine to the extent that they are not put into place for valid commercial reasons which reflect economic reality.
>
> 3. Where arrangements or a series thereof are ignored in accordance with paragraph 1, the tax liability shall be calculated by reference to economic substance in accordance with national law.

Besides many identical or similar features, the proposed Directive shows some textual and substantial deviations from the 2012 Recommendation.

36. European Commission, Proposal for a Council Directive laying down rules against tax avoidance practices that directly affect the functioning of the internal market (COM(2016) 26 final).

Most notably, its scope is restricted to corporate taxation[37] and thus lags behind the German GAAR, which is not restricted to certain types of taxes but applies throughout the whole range of different taxes.

Moreover, the proposed Directive uses “non-genuine arrangements” instead of “arrangements” alone. This additional criterion is another (though somewhat redundant) indicator for the more economic approach, i.e. a reference to a frame of reference outside the direct wording of the specific legal rules concerned.

15.4. Anti-abuse provisions in German international tax law

The above-mentioned analyses have not put any particular focus on cross-border cases. However, before and after the BEPS Project, Germany has aimed at preventing taxpayers from, or cutting off any advantages of, the use of tax avoidance arrangement in cross-border cases. The relevant rules are laid down partly in domestic law. Above all, this goes for some linking rules, restrictions on the deduction of interest payments and for Germany’s CFC legislation (*see* sections 15.4.1.-15.4.4.). At the same time, a number of tax treaty features aim at preventing taxpayers from taking unjustified advantages (*see* sections 15.4.5.-15.4.8.).

15.4.1. Linking rules

15.4.1.1. No comprehensive linking rule

Germany has not – or not yet – adopted a general linking rule. It is true that the *Länder* proposed a far-reaching bill in connection with BEPS Action Item no. 2 in 2014. This proposal denied the deduction of payments on the side of the payor in the two well-known constellations of:

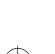
(a) non-taxation on the side of the payee (case of hybrid financial instruments), or
(b) double deduction on the side of the payor, i.e. also in another State. This second alternative makes an explicit exclusion where the double deduction occurs in the realm of the credit method, or where it is provided only for purposes of a proviso safeguarding progression.

37. First sentence of Art. 7(1) of the proposed Directive.

The proposal was phrased as follows:

[1] Aufwendungen sind nicht als Betriebsausgaben abziehbar, soweit sie beim unmittelbaren oder mittelbaren Empfänger nicht als Einnahmen in der Steuerbemessungsgrundlage berücksichtigt werden oder einer Steuerbefreiung unterliegen, weil das zugrundeliegende Rechtsverhältnis bei der Besteuerung des Leistenden und des Empfängers nicht einheitlich als Fremdkapitalüberlassung behandelt wird.	[1] To the extent that expenses are not considered as earnings forming part of the tax base on the side of the direct or indirect recipient, or that they are subject to a tax exemption because the underlying legal circumstances are not consistently treated as debt financing both on the side the payor and the recipient, these expenses are not deductible as business expenses.
[2] Die einer Betriebsausgabe zugrundeliegenden Aufwendungen sind nur abziehbar, soweit die nämlichen Aufwendungen nicht in einem anderen Staat die Steuerbemessungsgrundlage mindern.	[2] Business expenses are deductible only to the extent that they have not reduced the tax base in another State.
[3] Satz 2 gilt nicht, wenn die Berücksichtigung der Aufwendungen ausschließlich dazu dient, einen Progressionsvorbehalt im Sinne des § 32b Absatz 1 Satz 1 Nummer 3 oder eine Steueranrechnung im Sinne des § 34c oder im Sinne des § 26 Absatz 1 des Körperschaftsteuergesetzes zu berücksichtigen.	[3] Clause 2 does not apply if expenses are considered only for the purpose of a proviso safeguarding progression (sec. 32b(1) cl. 1 no. 3) or of a tax credit (sec. 34c, or sec. 26(1) of the *Körperschaftsteuergesetz*).

However, the Federal Parliament (the *Bundestag*) did not adopt this proposal. This does not exclude federal legislation of this kind in the future. For the time being, German domestic law contains an increasing number of linking rules in its domestic law on cross-border situations anyhow, as follows:



15.4.1.2. Dividend-interest mismatch

Earnings derived from hybrid financial instruments are excluded from the dividend exemption if the payment has been deductible on the side of the payor (sec. 8b(1), second sentence of the *Körperschaftsteuergesetz*), in line with the recent amendment of the Parent-Subsidiary Directive.

15.4.1.3. Losses of a subsidiary within the *Organschaft*

Losses of a subsidiary are not attributed to the controlling (German) parent company under the German *Organschaft* rules if these losses have been considered by a foreign jurisdiction (sec. 14(1), no. 5 of the *Körperschaftsteuergesetz*).

15.4.1.4. Subject-to-declaration rule for employment income

Where a DTC provides for exemption of employment income from the German tax base, this applies only if the taxpayer proves that such employment income has been taxed by the source state, or that the source state has forfeited its right to tax (sec. 50d(8) of the *Einkommensteuergesetz*). The latter alternative shows that the rule is not, and does not aim at being, a subject-to-tax rule.[38] Double non-taxation remains available if the other contracting state (usually the source state) is aware of the employment income at issue but deliberately refrains from taxing it.

Thus, sec. 50d(8) of the *Einkommensteuergesetz* can be seen as a subject-to-declaration rule – it applies only where the taxpayer has not declared the employment income in the other contracting state.[39] Where, however, a tax treaty establishes stricter conditions for a tax exemption in Germany (most notably, a true subject-to-tax clause), these stricter requirements remain applicable.[40]

38. On these rules, *see* section 15.4.7.
39. *See also* W. Neyer, *Neue Nachweisanforderungen bei steuerbefreiten Einkünften. Anmerkungen zu § 50 d Abs. 8 EStG*, *Betriebs-Berater* (2004), pp. 519 et seq.; and F. Loschelder, in Schmidt (ed.), *Einkommensteuergesetz. Kommentar*, 34th ed. (Beck 2015), sec. 50d m.nos. 52 et seq.
40. For an example, *see* BFH of 13 Oct. 2015 – I B 68/14 –, www.bundesfinanzhof.de at no. 15.

15.4.1.5. Hybrid mismatch on the level of treaty interpretation

More broadly, any treaty-based exemption by Germany is revoked under sec. 50d(9), no. 1 of the *Einkommensteuergesetz*, if the other contracting state:

(a) applies the DTC in a way that the items of income concerned are (also) exempt on the side of this State, or
(b) applies the DTC in a way that this State has to reduce the tax rate under the DTC.

15.4.1.6. No unlimited personal tax liability of the recipient in the other state

Moreover, Germany switches from the exemption to the credit method if the other contracting state does not tax the respective "income" either and if this is due to the fact that the person to which this state attributes such income is not a resident of this state (sec. 50d(9), no. 2 of the *Einkommensteuergesetz*).[41] It should be noted that the Bundesfinanzhof favours a remarkably restrictive interpretation of this rule, based on the statutory wording ("nur deshalb […], weil" instead of "weil und soweit"), viz. that the "income" should not be itemized. Therefore, sec. 50d(9), no. 2 of the *Einkommensteuergesetz* does not apply where at least a certain (even small) fraction of the income is taxed in the other country, based on a limited tax liability in that country.[42]

15.4.1.7. Mismatch in personal attribution of dividends

A DTC exemption for dividends received is revoked if these dividends are attributed to different persons under the DTC on the one hand, and under German domestic law on the other (sec. 50d(11) of the *Einkommensteuergesetz*).

41. For details, *see* BFH of 19 Dec. 2013 – I B 109/13, http://juris.bundesfinanzhof.de/cgi-bin/rechtsprechung/druckvorschau.py?Gericht=bfh&Art=en&nr=29307; and F. Loschelder (*supra* n. 39) at m.no. 57.
42. BFH (*supra* n. 41) no. 9.

15.4.1.8. Mismatch in the application of the Interest-Royalty Directive

Relief under the Interest-Royalty Directive is available only if the attribution of the interest/royalties is coherent in both States involved (sec. 50g(3) and (6) of the *Einkommensteuergesetz*).

15.4.2. Deduction of interest payments

Among the most disputed and at the same time most challenging regal innovations of the last years is a restriction on the deduction of interest payments. Unlike former German thin cap rules that were abolished after the ECJ *Lankhorst Hohorst* decision,[43] the new interest limitation rule (*Zinsschranke*) applies uniformly in cross-border and in purely domestic cases. As a rule, deduction is disallowed for the fraction of interest payments exceeding 30 per cent of the taxpayer's earnings before interest, taxation, depreciation and amortization (EBITDA) (sec. 4h(1) of the *Einkommensteuergesetz*).

However, far-reaching exceptions limit this restriction (sec. 4h(2) of the *Einkommensteuergesetz* and sec. 8a of the *Körperschaftsteuergesetz*). Many of these exceptions are (partly literally) reflected in Art. 4 of the 28 January 2016 COM proposal for an EU Directive laying down rules against tax avoidance practices that directly affect the functioning of the internal market.[44] Moreover, Germany allows:
(a) a carry-forward of non-deductible interest payments, i.e. later deduction as soon as new EBITDA is available in a subsequent year,
(b) a carry-forward of unused EBITDA into subsequent years in which the taxpayer has not generated sufficient EBITDA (when looked at in isolation) for set-off against all interest payments made in that year under the 30-per cent rule.

15.4.3. Transfer pricing rules

Although Germany had TP rules since sec. 1 of the *Außensteuergesetz* was enacted in 1972, these rules had little relevance for German-owned companies or groups for more than two decades (1977-1999) when Germany

43. ECJ of 12 Dec. 2002, C-324/00, 2002 ECR I-11779 = ECLI:EU:C:2002:749.
44. Proposal COM(2016) 26 final.

offered an indirect corporate tax credit against income taxes on dividends, i.e. when corporate taxes were only a pre-payment of personal income tax.

Since 2000, however, both the normative density and the factual relevance of Germany's TP rules increased rapidly. Today, both:
(a) substantive provisions on the methodology, checks and adjustments of transfer prices and
(b) procedural/compliance rules

are highly sophisticated, and constitute a closed system within Germany's anti-abuse legislation. While substantive law is closely connected to OECD standards (especially the Transfer Pricing Guidelines, as accompanied by the authorised OECD approach (AOA) rules on the attribution of profits to PEs), formal duties of documentation, notification, advance rulings,[45] tax audits and administrative and judicial remedies show a number of national particularities and inefficiencies.[46]

As far as the factual side is concerned, audits of cross-border cases focus on issues of TP more than on any other topic. Given the high complexity of TP methods, however, *judicial disputes* are relatively rare. In the decade between the beginning of 2006 and the end of 2015, the *Bundesfinanzhof* decided on only 37 TP cases (including cases on the attribution of profits to PEs), as compared to 621 cases on, or in connection with, tax treaty issues.

15.4.4. CFC legislation

In 1972, CFC legislation was introduced in Germany. The main features of this system are:
(a) a substantial participation (> 50 per cent of shares or of voting rights, directly or indirectly) of a German resident individual or corporation in a foreign controlled company;
(b) intermediary partnerships remain irrelevant (look-through approach);
(c) exclusion of active income derived by the CFC, based on a while list of activities;[47]
(d) tax level for the remaining (i.e. passive) items of income in the CFC state < 25 per cent.[48]

45. *See* section 15.1.2.
46. For a critical analysis, *see* the publications by J. Becker, G. Kimpel, A. Oestreicher & E. Reimer (*supra* n. 16), passim.
47. Sec. 8(1) *Außensteuergesetz*.
48. Sec. 8(3) *Außensteuergesetz*.

The CFC legislation also applies where the CFC is based in a country with which Germany has concluded a DTC. This is based on a long-standing tradition of German negotiators to include a proviso safeguarding CFC in German bilateral DTCs. Typically, such clauses read:

> This Agreement shall not be interpreted as to prevent the Federal Republic of Germany from imposing its taxes on amounts to be included in the income of a resident of the Federal Republic of Germany under parts 4, 5, and 7 of the German External Tax Relations Act (*Außensteuergesetz*).[49]

However, for CFCs residing in other EU or EEA Member States,[50] Germany suspends its CFC legislation if the taxpayer (i.e. the German parent company/shareholder of the CFC) can prove that the CFC pursues economic activity in its State of residence and if the CFC state exchanges information with Germany on the basis of the EU Directive on Mutual Administrative Assistance.[51]

15.4.5. Saving clause and limitation of benefits (LOB)

As far as provisions and features of German DTCs are concerned, the most fundamental question is how far tax treaties restrict their personal scope, as compared to Arts. 1 and 4 of the OECD Model Convention (OECD MC), and do not grant treaty protection to all German residents (Art. 4 of the OECD MC).

15.4.5.1. Saving clause

A saving clause cannot be found in German DTCs to the detriment of resident aliens. The saving clause in the German-United States treaty applies only to US residents and US citizens (including former US citizens within a 10-year period of loss of citizenship). These persons can invoke treaty protection in the United States only with regard to the treaty rules listed in no. 1(b) of the Final Protocol.

49. Art. 28(1) no. 2 of the German *Basis for negotiation for agreements for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income and on capital* (hereinafter referred to as the German Model), Bundeministerium der Finanzen of 22 Aug 2013 – IV B 2 – S 1301/13/10009 – (available at http://www.bundesfinanzministerium.de/Content/DE/Standardartikel/Themen/Steuern/Internationales_Steuerrecht/Allgemeine_Informationen/2013-08-22-Verhandlungsgrundlage-DBA-englisch.pdf).
50. *See* ECJ of 12 Sept. 2006, Case C-196/04 – *Cadbury Schweppes*, ECR 2006 I-07995, ECLI:EU:C:2006:544.
51. Sec. 8(2) *Außensteuergesetz*.

Although there was no indication whether or not Germany would adopt the new OECD proposal on the application of tax treaties to restrict a contracting state's right to tax its own residents (sometimes labelled an OECD saving clause)[52] in the 5 October 2015 Final OECD/G20 Report on BEPS Action Item 6[53] and although none of the present German DTCs contains a corresponding rule, the rule became part of the Multilateral Instrument[54] and will also be included in the 2017 update of the OECD MC. On this basis, it is more probable than not that Germany will also adopt it in future bilateral treaties.

15.4.5.2. Limitation of benefits (LOB)

More customary, though still rare, are LOB clauses in the German treaty network. Even though LOB clauses have been outlined as an option in no. 20 Commentary on Article 1 of the OECD MC since 2003,[55] Germany has not supported or requested such clauses from its treaty partners. However, in a few cases where the other contracting states requested an LOB clause, Germany has accepted it. Today, LOB clauses can be found in Germany's DTCs with Ireland (2011), Kuwait (1999), the United Arab Emirates (2010), the United Kingdom (2010) and the United States (1989). These clauses vary in their wording. Some are limited to certain distributive rules or sectors of industry, always depending on the request of the other contracting state.[56]

52. For example, J. Schuch & N. Neubauer, *The Saving Clause: Article 1(3) of the OECD Model*, in: *Base Erosion and Profit Shifting (BEPS). The Proposals to Revise the OECD Model Convention* (Lang, Pistone, Rust, Schuch & Staringer, eds., Linde 2016), pp. 27 et seq. (36 et seq.).
53. OECD proposes a new Art. 1(3) OECD MC ("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 9 and Articles 19, 20, 23 A [23 B], 24 and 25 and 28") as well as new Commentary on this rule: OECD, *Preventing the Granting of Treaty Benefits in Inappropriate Circumstances*. BEPS Action 6: 2015 Final Report of 5 Oct. 2015, available at http://www.oecd-ilibrary.org/deliver/2315331e.pdf, pp. 86 et seq.
54. OECD*, Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Eruosion and Profit Shifting,* Draft of 24 November 2016, available at http://www.oecd.org/tax/treaties/ multilateral-convention-to-implement-tax-treaty-related-measures-to-prevent-BEPS.pdf, Article 11.

55. *See also* Art. 22 US MC (November 2006). For a detailed analysis, *see* R. Prokisch, in Vogel & Lehner (eds.), *Doppelbesteuerungsabkommen*, 6th edition (Beck 2015), Art. 1 at m.nos. 121 et seq.
56. For a detailed analysis, *see* Prokisch (*supra* n. 55) at m.no. 144g-144i.

15.4.6. A treaty GAAR – Treaty reference to domestic GAAR

Traditionally, German DTCs have not brought their own GAAR in the treaty on the treaty. However, many German DTCs include specific provisos safeguarding the application of German domestic anti-abuse rules including the domestic GAAR. A typical example reads: "This Agreement shall not be interpreted to mean that a Contracting State is prevented from applying its domestic legal provisions on the prevention of tax evasion or tax avoidance".[57]

A more recent development, however, seems to indicate a new direction, namely that Germany inserts a treaty GAAR (general anti-abuse rule in the treaty on the treaty). The first example is Art. 29(1) of the 2014 Chinese-German DTC: "The benefits of this Agreement shall not be available where the main purpose for entering into certain transactions or arrangements was to secure these benefits and obtaining those benefits would be contrary to the object and purpose of the relevant provisions of this Agreement".

15.4.7. Subject-to-tax rules

In the method article of its DTCs, Germany has always adopted certain deviations from Art. 23 of the OECD MC. As a rule, Germany follows the exemption method (Art. 23A(1) of the OECD MC): it exempts items of income of a German resident (in the sense of Art. 4(1)-(3) of the OECD MC) which, in accordance with the provisions of the DTC, may be taxed in the other contracting states.[58] This assigns highest relevance to the question of whether (and how) anti-abuse provisions in general, and subject-to-tax (STT) provisions in particular, are to be adopted in the German DTC network.

15.4.7.1. Traditional German treaty practice

For many years, Germany stuck very closely to the OECD MC and did not add substantial anti-abuse provisions in its treaties. However, the binary choice between the exemption and credit method has often been replaced by a more sophisticated regime. As far as Germany is concerned in its capacity

57. For example, Art. 29(2) of the DTC between China and Germany of 28 Mar 2014, BT-Drs. 18/6449. For an exhaustive list, *see* R. Prokisch (*supra* n. 55) at m.no. 135.
58. Art. 22(1) no. 1, first sentence of the German MC (*supra* n. 49).

as State of residence, it has always taken the exemption method as a starting point but negotiated that the credit method, or a flexible switching over to the credit method, is admissible with regard to certain untaxed items of income, especially in a tax avoidance context (*see* section 15.4.8. for details).

15.4.7.2. EU COM Recommendation C(2012) 8806 of 6 December 2012

In its 2012 Recommendation C(2012) 8806 on Aggressive Tax Planning, the Commission proposed two STT rules. The first concerns DTC law, i.e. all DTCs of Member States (also the ones with third states).[59] It encourages Member States to include "an appropriate clause" in their DTCs.[60] The Recommendation submits the following proposal (but makes clear that equivalent alternatives can equally fulfil the soft law obligation under the Recommendation):[61] "Where this Convention provides that an item of income shall be taxable only 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".

Moreover, the Recommendation requires a similar rule to be employed by domestic law of Member States on cross-border cases:[62] "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".

For both rules, the term "subject to tax" is determined consistently, namely that:[63] "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".

On the timeline, one can hardly see any direct impact of the COM Recommendation on German DTC practice. In substance, however, German DTCs have considered effective taxation by the other Contracting State in a large number of cases and constellations already before 2012.

59. Recommendation of 6 Dec 2012 (*supra* n. 32), no. 3.1.
60. Id., no. 3.2.
61. Id., no. 3.2.
62. Id., no. 3.3.
63. Id., no. 3.4.

15.4.7.3. Flexible modifications of the method article

Germany has introduced restrictions on the full range of treaty benefits in cases where the other contracting state, in its capacity as source state (that enjoys taxing rights under the DTC), offers non-taxation or low taxation. In addition to numerous activity provisos and switch-over clauses (*see* section 15.4.8.), a couple of "hard" STT rules exist in Germany's bilateral method articles (corresponding to Art. 23 OECD MC), though not in the German Model.

In most cases, the bilateral STT clauses apply to all types of income.[64] By contrast, bilateral STT clauses in Germany's DTCs with Austria and Switzerland refer to employment income or certain types of employment income only.[65]

Even more popular are amendments to the method article that are designed like source rules.[66] Typically, they read:

Für die Zwecke dieses Artikels stammen Gewinne oder Einkünfte einer in einem Vertragsstaat ansässigen Person aus Quellen innerhalb des anderen Vertragsstaats, wenn sie in diesem anderen Staat gemäß diesem Abkommen besteuert worden sind.	For the purposes of this Article profits, income or gains of a resident of one Contracting State shall be regarded as arising from sources in the other Contracting State if they have been subjected to taxation in that other State in accordance with this Agreement.

In substance, these rules function as ordinary STT rules.[67]

Although not a genuine STT provision either, Germany uses a structurally similar rule to combat "deduction – non-inclusion" schemes for hybrid

64. This is true for Germany's bilateral DTCs with Bulgaria (Art. 22(1)(a)), Hungary (Art. 22(1)(a)), Spain (Art. 22(2)(a)), the 2010 DTC with the United Kingdom (Art. 23(1)(a)) and the United States (Art. 23(4)(b), second alternative).
65. Art. 15(4) of the DTC with Austria (employment income in general) as well as Art. 15(3), second sentence and Art. 15(4), second sentence of the DTC with Switzerland (salaries of wages of staff of ships and aircraft; directors' fees).
66. Rules of this kind can be found in Germany's DTCs with Canada (as of 1981, expired in 2000: Art. 23(3)), Denmark (Art. 24(3)), Italy (no. 16(d) of the Protocol on Art. 24), New Zealand (Art. 23(3)), Norway (Art. 23(3)), Sweden (Art. 23(1)) and the former DTC with the United States (Art. 23(2), expired in 2007).
67. BFH of 17 Oct 2007 – I R 96/06 – *Bundessteuerblatt* 2008 II p. 953, available at http://juris.bundesfinanzhof.de/cgi-bin/rechtsprechung/druckvorschau.py?Gericht=bfh&Art=en&nr=14613.

financial instruments in many of its method articles by way of a carve-out from the general exemption of inter-company dividends under Germany's participation exemption in the clause corresponding to Art. 23A(1) of the OECD MC:[68] where the other Contracting State accepted a deduction on the side of the distributing company (the payor), Germany revokes the dividend exemption. Typically, this rule reads:

> The exemption [by the Federal Republic of Germany] […] shall not apply to dividends paid by a tax exempt company or to dividends that the distributing company may deduct for [name of the other Contracting State] tax purposes or for dividends that are attributed under the law of the Federal Republic of Germany to a person that is not a company resident in the Federal Republic of Germany.

15.4.7.4. Subject-to-tax clauses in the distributive articles

It should be noted in this connection that Germany has not only modified its method article (cf. Art. 23 of the OECD MC), but has also inserted STT rules in some (though few) distributive rules. In other words: it is the source state that recaptures the right to taxation where the State of residence (as determined under Art. 4(1)-(3) of the DTC) does not tax items of income that (in the eyes of the source state) have originally been assigned to this State of residence under the DTC.

A typical example is the pension article. Where this distributive rule (corresponding to Art. 18(1) of the OECD MC) assigns exclusive taxation to the State of residence, the source state is precluded from taxation by virtue of the words "taxable only". If, however, the State of residence does not tax such pensions, Germany (in its position as source state) recaptures its right to tax the pensions.[69] A typical treaty clause reads as follows:[70]

> Notwithstanding the provisions of paragraph 1, pensions, similar remuneration or annuities may also be taxed in the other State if they are attributable in whole or in part to contributions which, in that State and for more than 15 years in total,
> 1. did not form part of the taxable income, or
> 2. were tax-deductible, or
> 3. were afforded some other form of beneficial treatment by that State.

68. Art. 22(1) no. 1 cl. 2 German Model (*supra* n. 49).
69. For an example, *see* Art. 16(1) of Germany's DTC with South Africa; and BFH of 13 Oct 2015 – I B 68/14 –, www.bundesfinanzhof.de at nos. 11 et seq.
70. Art. 16(3) German Model (*supra* n. 49).

> Sentence 1 shall not apply if the beneficial treatment under subparagraphs 1) through 3) was clawed back because the person ceased to be a resident of that State.

Similar clauses can be found in no. 1 of the Protocol on Arts. 6-21 of Germany's DTC with Namibia (1993) and in Art. 15(2)(d) of Germany's DTC with Singapore (2004).[71]

15.4.8. Activity provisos and switch-over clauses

As indicated in section 15.4.7.1.), Germany has weakened the impact of the exemption method by extensive catalogues of items of income for which Germany, in its capacity as the State of residence, replaces the exemption by the credit method.[72] These items of income are:[73]

(a) dividends within the meaning of Art. 10 to which the dividend exemption for inter-company dividends in case of substantial participations does not apply;
(b) capital gains under Art. 13(4);
(c) directors' fees (Art. 15 of the German Model);
(d) income of artistes and sportspersons (Art. 16 of the German Model);
(e) pensions derived under social security legislation (Art. 17(2) of the German Model);
(f) pensions taxable in the source state (Art. 17(3) of the German Model);[74]
(g) moreover, exemption of business income that is attributable to a PE in the other contracting state under Art. 7(2) as well as capital gains in connection with such foreign PE are to be exempt only if, and to the extent that, the PE performs a substantial activity. As such, Art. 22(1) no. 4 of the German Model acknowledges the following activities:
    (i) the production, processing, working or assembling of goods and merchandise;
    (ii) the exploration and extraction of natural resources;
    (iii) banking and insurance;
    (iv) trade or the rendering of services.

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71. *See also* Bundesministerium der Finanzen, *Anwendung von Subject-to-tax-, Remittance-base- und Switch-over-Klauseln nach den Doppelbesteuerungsabkommen.* Circular of 20 June 2013, available at http://www.bundesfinanzministerium.de/Content/DE/Downloads/BMF_Schreiben/Internationales_Steuerrecht/Allgemeine_Informationen/2013-07-20-rueckfallklauseln.pdf.
72. For a general overview and further interpretative guidance, *see* id., pp. 10 et seq. (sub 4.).
73. Art. 22(1) no. 3 German Model (*supra* n. 49).
74. *See* section 15.4.7.4.

Moreover, in all of these four cases, Art. 22(1) no. 4 of the German Model also requires that a business undertaking (*Geschäftsbetrieb*) exists, and that this undertaking is adequately equipped (*dem Geschäftszweck angemessen*). Where any of these preconditions has not been met, Germany uses the credit method.

15.5. Application of GAARs, TP rules and SAAR

Looking at the relation between the German GAAR, the TP rules and SAARs, what seems to be a triangle is usually conceived as quite a simple structure as soon as TP rules are regarded as one species of SAAR (which is the usual perception in German case law and doctrine). This conception suggests a two-tier approach.

The first step is the delimitation of the material scope of the GAAR against each SAAR at issue, i.e. against all anti-abuse rules contained in separate (special) tax law contexts. In line with the *lex specialis* principle, the second sentence of sec. 42(1) of the AO declares that those special anti-abuse rules in the single tax statutes take precedence over the GAAR. Where the preconditions of the SAAR are met in a concrete case, the legal consequences follow this SAAR. The GAAR remains inapplicable.[75]

If a SAAR exists in the subject area of the arrangement at issue but the preconditions of this SAAR have not been met, recourse to the GAAR remains possible.[76] However, the tax administration then needs to establish that the SAAR is not open to an *e contrario* reasoning, i.e. that the SAAR does not aim at designating certain arrangements as non-abusive. This cannot be established where the SAAR employs, for example, clear-cut time limits. Thus, if the SAAR states that two formally separated transactions should be seen as an economic unity if they occur within a five-year period,[77] one may still test a case in which the actual time distance was five years plus one day against the GAAR. However, the preconditions of an "abuse" in the sense of the GAAR (sec. 42(2) of the AO) are not met, given that the time threshold fixed in the SAAR has been exceeded. In other words, a *ceteris paribus* analysis is required.

75. Bundesministerium der Finanzen (*supra* n. 6) at m.no. 1; and Drüen (*supra* n. 7) at m.nos. 10-12.
76. Bundesministerium der Finanzen (*supra* n. 6) at m.no. 1.
77. Example: sec. 18(3) *Umwandlungsteuergesetz*.

However, if additional circumstances of the case deliver additional indicators for the assumption that the arrangement was abusive for these other reasons, the elapsing of the time period does not create a general immunity for the arrangement. On the contrary, recourse to the GAAR remains admissible and the result can be positive (i.e. the GAAR applies) in two constellations:[78]

(a) first, where the additional circumstances that bear the assumption that the arrangement is “abusive” are not part of, and not reflected by, the SAAR – in other words, where the SAAR targets qualitatively different arrangements than the one in casu (SAAR as pseudo *lex specialis*); and
(b) second, where the SAAR itself is circumvented in an abusive manner (abuse of the SAAR).

In all, the courts are dedicated to reconciling SAARs and the GAAR in a precise and methodologically convincing way. These attempts ought to be seen in the light of:

(a) the necessity to keep the GAAR free from constellations that could have been sourced out in a SAAR (*see* section 15.1.1.2.); and
(b) the constitutional call for effective anti-abuse legislation as a whole (*see* section 15.2.).

Annex

Bundesministerium der Finanzen, *Anwendungserlass zur Abgabenordnung 1977* (AEAO), as updated on 26 Jan 2016 (extract).

AEAO zu § 42 – Missbrauch von rechtlichen Gestaltungsmöglichkeiten:

1. Bei Anwendung des § 42 Abs. 1 Satz 2 AO ist zunächst zu prüfen, ob das im Einzelfall anzuwendende Einzelsteuergesetz für den vorliegenden Sachverhalt eine Regelung enthält, die der Verhinderung von Steuerumgehungen dient. Ob eine Regelung in einem Einzelsteuergesetz der Verhinderung der Steuerumgehung dient, ist nach dem Wortlaut der Regelung und dem Sinnzusammenhang, nach der systematischen Stellung im Gesetz sowie nach der Entstehungsgeschichte der Regelung zu beurteilen.

Liegt danach eine Regelung vor, die der Verhinderung von Steuerumgehungen dient, gilt Folgendes:

78. Drüen (*supra* n. 7) at m.no. 14, with further references.

a) Ist der Tatbestand der Regelung erfüllt, bestimmen sich die Rechtsfolgen allein nach dieser Vorschrift, nicht nach § 42 Abs. 1 Satz 3 i.V.m. Abs. 2 AO. In diesem Fall ist unerheblich, ob auch die Voraussetzungen des § 42 Abs. 2 AO vorliegen.

b) Ist der Tatbestand der Regelung dagegen nicht erfüllt, ist in einem weiteren Schritt zu prüfen, ob ein Missbrauch i.S.d. § 42 Abs. 2 AO vorliegt. Allein das Vorliegen einer einzelgesetzlichen Regelung, die der Verhinderung von Steuerumgehungen dient, schließt die Anwendbarkeit des § 42 Abs. 1 Satz 3 i.V.m. Abs. 2 AO damit nicht aus.

2. Sofern ein Missbrauch i.S.d. § 42 Abs. 2 AO vorliegt, entsteht der Steueranspruch bei allen vom Sachverhalt Betroffenen so, wie er bei einer den wirtschaftlichen Vorgängen angemessenen rechtlichen Gestaltung entsteht (§ 42 Abs. 1 Satz 3 AO).

2.1 Ein Missbrauch i.S.d. § 42 Abs. 2 AO liegt vor, wenn
a) eine rechtliche Gestaltung gewählt wird, die den wirtschaftlichen Vorgängen nicht angemessen ist,
b) die gewählte Gestaltung beim Steuerpflichtigen oder einem Dritten im Vergleich zu einer angemessenen Gestaltung zu einem Steuervorteil führt,
c) dieser Steuervorteil gesetzlich nicht vorgesehen ist und
d) der Steuerpflichtige für die von ihm gewählte Gestaltung keine außersteuerlichen Gründe nachweist, die nach dem Gesamtbild der Verhältnisse beachtlich sind.

2.2 Ob eine rechtliche Gestaltung unangemessen ist, ist für jede Steuerart gesondert nach den Wertungen des Gesetzgebers, die den jeweiligen maßgeblichen steuerrechtlichen Vorschriften zugrunde liegen, zu beurteilen. Das Bestreben, Steuern zu sparen, macht für sich allein eine Gestaltung noch nicht unangemessen. Eine Gestaltung ist aber insbesondere dann auf ihre Angemessenheit zu prüfen, wenn sie ohne Berücksichtigung der beabsichtigten steuerlichen Effekte unwirtschaftlich, umständlich, kompliziert, schwerfällig, gekünstelt, überflüssig, ineffektiv oder widersinnig erscheint. Die Ungewöhnlichkeit einer Gestaltung begründet allein noch keine Unangemessenheit.

Indizien für die Unangemessenheit einer Gestaltung sind zum Beispiel:
a) die Gestaltung wäre von einem verständigen Dritten in Anbetracht des wirtschaftlichen Sachverhalts und der wirtschaftlichen Zielsetzung ohne den Steuervorteil nicht gewählt worden;

b) die Vor- oder Zwischenschaltung von Angehörigen oder anderen nahe stehenden Personen oder Gesellschaften war rein steuerlich motiviert;
c) die Verlagerung oder Übertragung von Einkünften oder Wirtschaftsgütern auf andere Rechtsträger war rein steuerlich motiviert.

Bei einer grenzüberschreitenden Gestaltung ist nach der Rechtsprechung des EuGH (vgl. z.B. Urteil vom 12.9.2006, Rs. C-196/04, EuGHE I S. 7995) Unangemessenheit insbesondere dann anzunehmen, wenn die gewählte Gestaltung rein künstlich ist und nur dazu dient, die Steuerentstehung im Inland zu umgehen.

2.3 Bei der Prüfung, ob die gewählte Gestaltung zu Steuervorteilen führt, sind die steuerlichen Auswirkungen der gewählten Gestaltung mit der hypothetischen steuerlichen Auswirkung einer angemessenen Gestaltung zu vergleichen. Dabei sind auch solche Steuervorteile zu berücksichtigen, die nicht beim handelnden Steuerpflichtigen selbst, sondern bei Dritten eintreten.

Dritte i.S.d. § 42 Abs. 2 Satz 1 AO sind nur solche Personen, die in einer gewissen Nähe zum Steuerpflichtigen stehen. Dies ist insbesondere dann anzunehmen, wenn die Beteiligten Angehörige des Steuerpflichtigen i.S.d. § 15 AO oder persönlich oder wirtschaftlich mit ihm verbunden sind (z.B. nahe stehende Personen i.S.v. H 36 KStH 2006 oder § 1 Abs. 2 AStG).

2.4 Der in § 42 Abs. 2 AO verwendete Begriff des „gesetzlich nicht vorgesehenen Steuervorteils“ ist nicht deckungsgleich mit dem „nicht gerechtfertigten Steuervorteil“ i.S.d. § 370 Abs. 1 AO. Steuervorteile i.S.d. § 42 Abs. 2 AO sind daher nicht nur Steuervergütungen oder Steuererstattungen, sondern auch geringere Steueransprüche.

2.5 Der durch die gewählte Gestaltung begründete Steuervorteil ist insbesondere dann gesetzlich vorgesehen, wenn der Tatbestand einer Norm erfüllt ist, mit der der Gesetzgeber ein bestimmtes Verhalten durch steuerliche Anreize fördern wollte.

2.6 § 42 Abs. 2 Satz 2 AO eröffnet dem Steuerpflichtigen die Möglichkeit, die bei Vorliegen des Tatbestands des § 42 Abs. 2 Satz 1 AO begründete Annahme eines Missbrauchs durch Nachweis außersteuerlicher Gründe zu entkräften. Die vom Steuerpflichtigen nachgewiesenen außersteuerlichen Gründe müssen allerdings nach dem Gesamtbild der Verhältnisse beachtlich sein. Sind die nachgewiesenen außersteuerlichen Gründe nach dem Gesamtbild der Verhältnisse im Vergleich zum Ausmaß der

Unangemessenheit der Gestaltung und den vom Gesetzgeber nicht vorgesehenen Steuervorteilen nicht wesentlich oder sogar nur von untergeordneter Bedeutung, sind sie nicht beachtlich. In diesem Fall bleibt es bei der Annahme eines Missbrauchs nach § 42 Abs. 2 Satz 1 AO.

3. Ein Missbrauch von rechtlichen Gestaltungsmöglichkeiten nach § 42 AO ist als solcher nicht strafbar. Eine leichtfertige Steuerverkürzung oder eine Steuerhinterziehung kann aber vorliegen, wenn der Steuerpflichtige pflichtwidrig unrichtige oder unvollständige Angaben macht, um das Vorliegen einer Steuerumgehung zu verschleiern.

4. § 42 AO in der Fassung des Jahressteuergesetzes 2008 ist ab dem 1.1.2008 für Kalenderjahre, die nach dem 31.12.2007 beginnen, anzuwenden. Für Kalenderjahre, die vor dem 1.1.2008 liegen, ist § 42 AO in der am 28.12.2007 geltenden Fassung weiterhin anzuwenden.

Chapter 16

Greece

Eleni Theocharopoulou

16.1. The meaning of avoidance and aggressive tax planning and the BEPS Project

16.1.1. The meaning of tax avoidance in the Greek legal system

In the Greek legal system, there is no legal definition of tax avoidance. However, it could be argued from a legal point of view that, a definition indirectly stems from the recently adopted general anti-avoidance rule (GAAR) through (article 38 of) the Greek code on tax procedures (CTP) 4174/2013, entitled "general anti-tax avoidance provision", in force since 1 January 2014. This is indeed the first GAAR adopted by the Greek tax legislator. It can be said that in (article 38 of the) Greek CTP 2013, the will of the Greek legislator was to adopt a GAAR similar to the one proposed by the EC Recommendation C-(2012) 8806 of 6 Dec. 2012.

In the Greek literature, under the influence of foreign literature, tax avoidance is defined as follows: "Tax avoidance has as an objective the lower tax burden, through legal means (through the use of either a legislative vacuum or more favorable solutions from the taxpayer's point of view)".[1]

It is worth noting that in our legal system, there are no administrative regulations clarifying the meaning of tax avoidance, even though a relevant administrative "directive" has been expected from the Greek General Secretariat for Public Revenue since the beginning of the adoption of the GAAR of (article 38 of the) Greek CTP 2013.

Furthermore, it has to be noted that, according to Greek tax law, not only are (cross-border) tax rulings in advance not provided for, but tax rulings are forbidden. The rationale behind this is the fact that according to article 78

1. Th. Fortsakis/K. Savvaidou, *Tax Law*, p. 408 (Nomiki Vivliothiki 2013) (in Greek); and K. Finokaliotis, *The Treatment of Tax Avoidance at a National and at an EU level*, in *"Symmeikta" Liber Amicorum John C. Dryllerakis*, p. 364 (Nomiki Vivliothiki 2015) (in Greek).

paragraphs 1 and 4 of the Greek Constitution, the tax obligation (tax subject, tax object, tax rate and tax exemption) stems from the formal statute (statute enacted by the parliament and promulgated and published by the President of Democracy), hence, it cannot be subject to an agreement with the Administration (constitutional principle of the (formal) legality of the tax).[2] In Greece, (article 22 of the) CTP 2013 provides the possibility of advance pricing arrangements (APAs). However, they have different functions from the traditional tax rulings. In Greece, they are about the methodology concerning the pricing of certain future cross-border transactions[3] and they have a 4-year maximum duration without the possibility of a rollback. Therefore, there is no question of their having an impact on the tax rulings on avoidance.

Generally, tax avoidance is a new area for the Greek legislative order and Greek legislation and theory began to concern themselves after the outburst of the acute financial crisis in Greece, i.e. after 2009. Consequently, no case law exists on the issue. The acute financial crisis provided a good incentive to establish anti-tax avoidance measures in Greece in order to detect additional income and raise the public revenue to cover the public debt.

16.1.2. The meaning of tax planning, abusive tax planning and aggressive tax planning

In the Greek legal system, there is no legal definition for tax planning. There is, however, a definition for international tax planning in Greek literature. According to this definition, international tax planning has as an objective "the lower tax burden, with the ultimate goal of reinvesting the resources saved by the reduction of the tax burden".[4]

As far as aggressive tax planning is concerned, it could be argued that the definition, from a legislative point of view, derives indirectly from the recently adopted GAAR of (article 38 of the) CTP 2013. The rationale behind this is that the will of the Greek legislator, as mentioned above, was to adopt a

2. *See* El. Theocharopoulou, *Greece,* in *Separation of Powers in Tax Law*, 2009 EATLP Congress, p. 110 (Dourado A.P. ed., EATLP International Tax Series vol. 7, Series editor K. Van Raad).
3. APAs focus on an appropriate set of criteria that are used, such as the method, comparables and appropriate adjustments thereto, critical assumptions as to future events for the determination of the TP for those transactions over a fixed period of time.
4. Th. Fortsakis/K. Savvaidou, *supra* n. 1, p. 408; and K. Finokaliotis, *supra* n. 1, p. 364.

provision similar to the GAAR proposed by EC Recommendation C-(2012) 8806 of 6 Dec. 2012, which equally concerned aggressive tax planning. Nevertheless, in (article 38 of the) CTP 2013, there is no reference to either abusive tax planning or to aggressive tax planning. Similarly, neither relevant administrative regulations exist, nor case law.

16.2. The reaction to avoidance and aggressive tax planning in the BEPS context

16.2.1. Domestic GAARs

As already noted, in the Greek legal system, a GAAR was adopted for the first time and it is similar to the GAAR proposed by EC Recommendation C-(2012) 8806 of 6 Dec. 2012. It is article 38 of the CTP 2013, entitled "general anti-tax avoidance provision".

As regards the level of compatibility of the Greek GAAR with the EU's concept of abuse, it is argued that a problem is caused by the fact that the ECJ jurisprudence about the "wholly artificial arrangement"[5] was not adopted.

In addition, one aspect of incompatibility with the EU's concept of abuse is worth mentioning. The Greek GAAR includes not only direct taxes, but also indirect ones despite the fact that EC Recommendation of 6 Dec. 2012 whose transposition led to the Greek GAAR, refers only to direct taxes. The lack of distinction between direct and indirect taxes is not in conformity with the EU's concept of abuse, according to which it is established, for instance, that for direct taxes, the ECJ jurisprudence uses the criterion of the "wholly artificial arrangement",[6] while for indirect ones it suffices that the

5. *See The Scientific Service of the Hellenic Parliament*, in K. Finokaliotis, *supra* n. 1, pp. 374-375.

6. UK: ECJ, 16 July 1998, Case C-264/1996, *ICI v. Kenneth Hall Colmer* [1998] ECR I-04695, ECJ Case Law IBFD, DE: ECJ, 12 Dec 2002, Case C-324/2000, *Lankhorst-Hohorst v. Finanzamt Steinfurt* [2002], ECR I-11779, ECJ Case Law IBFD, SE: ECJ, 21 Nov. 2002), Case C-436/2000, *X en Y v. Riksskatterverket* [2002], ECR I-10829, ECJ Case Law IBFD, FR: ECJ, 11 Mar. 2004, Case C-9/2002, *De Lasteyrie du Saillant v. Ministere de l'Economie, des Finances et de l'Industrie* [2004] ECR I-2409, ECJ Case Law IBFD, UK: ECJ, 12 Sept. 2006, Case C-196/2004, *Cadbury Schweppes v. Commissioners of Inland Revenue* [2006] ECR I-07995, ECJ Case Law IBFD (D. Weber, *Abuse of Law in European Tax Law: An Overview and Some Recent Trends in the Direct and Indirect Tax Case Law of the Court of Justice of the European Law,* in *Vergiden Kacinmanin Onlenmesi, Preventing Tax Avoidance, International Tax Law Conference Series -2, November 2011*, p. 331 (B. Yalti ed., Beta 2014).

arrangement is "mainly artificial".[7] In particular, as far as VAT is concerned, according to the ECJ's jurisprudence, when it is apparent from a number of objective factors that the essential aim[8] of the transactions concerned (of the company) is to obtain a tax benefit (the granting of which is contrary to one or more purposes of the VAT Directive),[9] this constitutes abusive practice regardless of whether there are also other, non-fiscal economic objects present, such as, in *Part Service* (Case C-425/2006), the marketing, organization and guarantees. In *Part Service,* it was found that it is not necessary for the tax benefit to be exclusively envisioned with a certain transaction, but other economic objects can also exist.[10]

This broadening of the scope of the Greek GAAR in order to include also the indirect taxes, as well as the lack of distinction between direct and indirect taxes, leads, in the author's opinion, to the following conclusions, concerning tax authorities:

In the case of VAT imposition, it could easily be argued that the said article limits the powers of the tax authorities to conclude that there is abusive practice, since it includes more requirements related to the essential aim of obtaining a tax benefit, in the sense that potential other, non-fiscal purposes, should be considered negligible at most. Nonetheless, the ECJ jurisprudence on VAT, as it has been formed, provides for wider limits for the tax authorities.

In contrast, in the case of imposition of direct taxes, even though in the ECJ jurisprudence the criterion of a "wholly artificial arrangement" has prevailed, (article 38 of the) CTP 2013, by not adopting this criterion, broadens the discretion of the tax authorities, as to the determination of the existence of abusive behaviour, because such behaviour is limited only to the criterion of a "simple artificial arrangement". However, this criterion

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7. G. Kofler/M. Tumpel, *"Abuse" in Direct and Indirect Community Tax Law: A Convergence of Standards,* in *Value Added Tax and Direct Taxation*, *Similarities and Differences,* p. 480 (M. Lang/P. Melz/E. Kristoffersson eds., IBFD 2009).

8. The text which traveled around the world and offered the definitions was the English translation where reference is made to the "principal aim", although the decision's original languages were French (*but essentiel*) and Italian, *see* F. Vanistendael, *Dispositions Anti-Abus et Droit Communautaire en Matière Fiscale*, in *Liber Amicorum, Jacques Autenne, Promenades sous les Portiques de la Fiscalité*, pp. 79-80 (Bruylant, Bruxelles 2010), according to whom in the aforementioned decision the same wording is used as in *Halifax* (Case C-225/02). Moreover, according to Prof. Weber, there is not a great distance between the notions of principal and essential goal (D. Weber, *supra* n. 6, p. 331).

9. IT: ECJ, 21 Feb. 2008, Case C-425/2006, *Ministero dell' Economia e delle Finanze v. Part Service* [2008] ECR I-897, ECJ Case Law IBFD.

10. *Part Service* (Case C-425/2006).

applies, according to (article 38 of the) CTP 2013, as well as to the EC Recommendation, in combination with other criteria.[11]

Finally, some scholars in Greece raise objections as to the compatibility of the GAAR with the EU's concept of abuse for additional reasons. Hence, there is a climate of disapproval in the wording of the Greek GAAR that is vague and imprecise, hence, difficult to comply with the principle of certainty of tax and which, it is considered, will cause many issues on its interpretation.[12] It is also argued that indirectly, the said GAAR, transfers the burden of proof to the taxpayer unacceptably, something that is contrary to the European Commission's Communication on the implementation of national anti-abusive measures in the field of direct taxation within the European Union and in relation to third countries.[13,14] It should also be mentioned that there are also those who criticize the – in their opinion – wrong translation or interpretation of the GAAR proposed by EC Recommendation C(2012) 8806 of 6 Dec. 2012 into Greek.[15]

Concerning the elements that are part of the Greek GAAR, they are the following:

(a) the main objective test. As it is provided in the GAAR, "the purpose of an arrangement consists in avoiding taxation where, … it defeats the object, spirit and purpose of the tax provisions that would otherwise apply". It is therefore concluded that any transaction should be examined based on the criterion of whether the tax advantage that is granted is contrary to the purpose of the legal provision (article 38 paragraph 4 of the CTP);

(b) the obtaining of a tax advantage is the essential aim of the transactions concerned. If there are other parallel goals that are not at most negligible (in view of all the circumstances of the case), there is no abusive practice (article 38 paragraph 5 of the CTP);

(c) the genuine economic activity test. A substantial economic activity should be present and not an artificial arrangement lacking commercial substance (article 38 paragraph 3 of the CTP); and

11. For all these issues, *see* in detail E. Theocharopoulou, *Tax Transparency and Exchange of Information in Times of Financial and International Economic Crisis*, pp. 188-217 (Kiriakidis Brothers, Publishers A.E. 2016) (in Greek).

12. K. Finokaliotis, *supra* n. 1, pp. 374-375.

13. European Commission, Communication. COM(2007) 785 final, p. 6, 10 Dec. 2007.

14. K. Finokaliotis, *supra* n. 1, p. 374.

15. Ch. Poulakos, *Aggressive Tax Planning (Article 38 CTP) and Inappropriate Tax Legislation: Linguistic Exaggerations at an EU Level and the Pointless Declaration of War Against Tax Avoidance,* Journal of Administr. Law 5 (2014), pp. 695-696 (in Greek).

(d) the principle of proportionality. The national authorities are invited to compare the amount of tax due by a taxpayer, with regard to the arrangements, with the amount that the same taxpayer would owe under the same circumstances in the absence of the arrangement (article 38 paragraph 6 of the CTP).

In contrast, the subjective element, consisting of the intention to obtain a tax advantage (article 38 paragraph 4 of the CTP) is not taken into account. The reason for this is because the objective circumstances are more important than the taxpayer's intention to avoid taxation and they are also easier to prove.[16]

Unfortunately, there is no Greek case law on these issues but neither has the tax administration appeared to have faced these issues yet. This is why an explanatory directive has not yet been by the General Secretariat for Public Revenue.

16.2.2. EC Recommendation C(2012) 8806 of 6 Dec. 2012 and subject-to-tax rule

Greece has not yet introduced a subject-to-tax rule as proposed by the EC in its DTCs. Perhaps this will take place in the future.

As to whether the domestic GAAR corresponds to the proposed GAAR in the ATAD proposal of 28 January 2016 or not, the answer in the author's opinion is affirmative, as the elements that are part of the Greek GAAR are – as was already mentioned above –[17] the main objective test, the obtaining of a tax advantage as the essential purpose of the transactions concerned and the genuine economic activity test. The author believes that these same elements also result from the proposed GAAR in the ATAD proposal. In addition, the author believes that the proposed GAAR, in comparison to the domestic GAAR, has the following advantage: It is much more concise and, for that reason, more intelligible. The only element of the domestic GAAR that is not seen in the proposed GAAR is that the national authorities are invited to compare the amount of tax due by the taxpayer, with regard to the arrangements, with the amount that the same taxpayer would owe under the same circumstances in the absence of the arrangement. However, this can take place without being expressly provided for in a GAAR. Nevertheless,

16. *Supra* n. 11.
17. Id.

it should be highlighted once more that the Greek GAAR does not cover only corporate taxation, but all taxes, which raises, as it was mentioned[18], issues of non-compatibility of the domestic GAAR with ECJ jurisprudence.

As to whether the Greek SAARs, which are further analysed in section 16.3., have to be redrafted or amended according to the rules in the ATAD Proposal, the answer is as follows:

Regarding the interest limitation rule, the Greek SAAR (article 49 of the new Greek Income Tax Code (ITC) 4172/2013) should be amended according to article 4 of the ATAD proposal. Regarding the exit taxation and the switch-over clause, the Greek legislation should be enriched, according to articles 5 and 6 of the ATAD proposal.

Regarding the CFC legislation, there are a lot of similarities between the Greek SAAR (article 66 of the new Greek ITC) and the ATAD proposal. However, paragraph 2 of the Greek SAAR should be redrafted according to paragraph 2 article 8 of the ATAD proposal, because the wording of the Greek SAAR is too general, thus creating legal uncertainty (as there is only a mere reference to "artificial arrangement created for the essential purpose of avoiding the tax"). Besides that, the differences between the Greek SAAR and article 8 of the ATAD proposal are such that an amendment of the Greek SAAR is not required, since the latter is much more demanding than the former. For instance, the Greek SAAR requires – among other things – a percentage exceeding 30% (and not 50%) of the income accruing to the entity to fall within one of the categories of the CFC of the ATAD proposal. In addition, the Greek SAAR is applicable if the CFC is subject to taxation with a tax rate lower than 50% (and not lower than 40%) or even if the CFC is situated in a non-cooperative state (a condition which is not provided for in the case of the CFC of the ATAD proposal).

Regarding the computation of CFC income, the author believes that the Greek SAAR should be enriched according to article 9 of the ATAD proposal, given that the Greek SAAR (article 66 paragraph 4 of the ITC) mentions only that "the categories of income are calculated on an annual basis and based on the applicable tax rate for the profits from business activities". Finally, regarding the hybrid mismatches, the Greek legislation should be enriched, according to article 10 of the ATAD proposal.

18. Id.

16.3. Transfer pricing rules, GAARs, SAARs and linking rules

The TP rules had been used for decades in Greece in order to combat tax evasion not tax avoidance and the relevant Greek law provided for, besides the accounting reform of the results of the company, a relevant fine.[19] During the past few years, however, in ITC 2013, the TP rules have become special provisions against tax avoidance and the fine has been abolished. The provision includes only an accounting reform of the results of the company, while the current legal framework does not allow adjustments. The "evaded sum" is therefore included in the profits of the associated entity, but exclusively to the extent of non-reduction of the payable tax.

Several litigations took place in the past, when the provisions were set to combat tax evasion. However, recently, there have not been many litigations.

This older jurisprudence on TP rules concerned interpretation issues of the older Greek legal framework, where the law did not refer to associated persons or legal entities, but to transactions between enterprises that were either "under the control" of the one of the other "due to participation of the foreign company, in the capital or the administration of the local one" or, in the case of local enterprises, there was between them "a relation of direct or indirect substantial administrative or financial dependence or control". Therefore, the Greek Council of State (CoS) judged in which cases there was "control" or "a relation of direct or indirect substantial administrative or financial dependence or control". Hence, the jurisprudence held that, for instance, there is an indirect substantial financial dependence between local companies when they co-locate, the one exclusively distributes its products to the other and has as a single goal the trade of these products.[20] So, the de facto connection between the companies was sometimes enough. Also, cases where one local company was trading with its sole partners[21] or with a sole proprietorship whose proprietor was the major shareholder of the company, president of the administrative board and managing director[22] were also determined to be entities under dependence.

In addition, it has been adjudicated that there is a substantial administrative dependence and control if the local company is trading with another, also

19. El. Theocharopoulou, *Taxation On Income Derived From E-Commerce*, p. 325 (Ant. N. Sakkoulas, 2007) (in Greek).
20. GR: CoS 4258/1988.
21. GR: CoS 786/1988.
22. GR: CoS 1976/1993.

local company, and the main members of the former are also on the administrative board of the latter.[23] Similarly, it has been adjudicated that there is an indirect administrative dependence between companies when the legal representative of one of the related companies is the vice-president of the administrative board of the other.[24] As far as foreign companies that control local ones are concerned, the Greek law requested in the past a de jure connection, as for example in the typical case of parent-subsidiary companies.[25]

Furthermore, the older CoS jurisprudence on the TP rules dealt with the determination of the arm's length price. From this, it is concluded, in the author's opinion, that only the comparable uncontrolled price method[26] was acceptable in the past. Hence, while today (article 50 of the) ITC 2013 expressly refers to the OECD TP and guidelines, in the past this was not so. Indeed, as comparable evidence to determine the arm's length price, what was accepted was only the prices of the transactions taking place either with other customers,[27] or under the same conditions by other similar companies,[28] and which concerned the same products.[29] The CoS jurisprudence has rejected other methods of determination of the price used by the tax authorities as being not compliant with the law that was applicable at the time, such as the invocation of the large gap between the gross income deriving from the sale of goods between associated enterprises and the gross income resulting from the application of single gross profit rates.[30]

Finally, it was judged by the CoS that there was a rebuttable presumption of TP,[31] if the tax authorities proved that the requirements for having "control" or "dependence" between enterprises and not having an arm's length price were met.[32] The absence of one of the above requirements excluded the

23. GR: CoS 4413/1996.
24. GR: CoS 1644-1646/2005.
25. GR: Athens Admin. Court of Appeal 3460/1989, CoS 826/1995, Athens Admin. Court of Appeal 80/1990 and Athens Admin. Court of Appeal 5153/2001.
26. Theocharopoulou, *supra* n. 16, p. 329.
27. GR: CoS 3803/1988, Athens Admin. Court of Appeal 80/1990, CoS 3498/1991, CoS 660/1995 and CoS 2444/2005. For example, the 1644-1646/2005 CoS decisions deemed that the agency fees that were collected by the company when the other parties were companies under indirect administrative dependence were by far lower than the ones collected by the former company for ship brokerage from independent companies.
28. GR: CoS 3803/1988, Athens Admin. Court of Appeal 80/1990.
29. GR: CoS 1031/2002.
30. GR: CoS 786/1988. Theocharopoulou, *supra* n. 16, p. 321. *See also* M. Tsirikos/P. Zafiropoulos, *Regulation of TP Issues in Greek and in International Tax Law*, Law of Enterprises and Companies (Greek Journal) issue 101, 2 (2004) p. 184 (in Greek).
31. GR: CoS (Plenum) 402/1987, CoS (Plenum) 1405/1987 and Athens Admin. Court of Appeal 3460/1989.
32. *See* GR: CoS 4413/1996, CoS 3803/1988.

application of the above presumption.[33] The law offered the possibility or rebuttal of the presumption when it was proved that price undercutting and overpricing did not have tax evasion as an objective.[34] The burden of proof for the absence of an intention to evade tax was carried by the companies and not by the tax authorities. Based on the current legal framework, the absence of intention to evade tax by the enterprises is not being checked anymore.

Concerning the LOB rules, these are not included in the Greek DTCs. On the other hand however, a CFC rule has been recently introduced rule in Greece. It was introduced after the beginning of the financial crisis by (article 66 of the) new ITC (law) 4172/2013 (ITC), and is in force since 2014.[35] According to this provision, a Greek parent company, alone or together with associated persons, owning, directly or indirectly, a percentage higher than 50% of the capital of the CFC, or having the right to collect more than 50% of the capital of the CFC, or having the right to collect more than 50% of the profits of the subsidiary company must include in its own taxable income (in Greece), the non-distributed income of this subsidiary, if the subsidiary constitutes a CFC. A subsidiary constitutes a CFC if:

> a) the Greek parent company owns directly or indirectly a percentage higher than 50% of the capital, or has the right to collect more than 50% of the profits of the subsidiary, b) the subsidiary is subject to taxation at a non-cooperative state or a state with a privileged tax regime, c) more than 30% of the net income (calculated before taxes) of the subsidiary falls into one or more of certain categories of income (namely interests, royalties, dividends and gain from stock transfers, revenue from movable and immovable property, income from insurance, bank and other financial activities) and exclusively if more than a half of this income (50% of the relevant category of income) comes from transactions between the subsidiary (CFC) and the Greek parent company or the associated with the Greek parent company persons, d) the subsidiary is not a company whose main category of stocks is negotiated in an organized market (stock exchange).

The aim of this innovation for the Greek legislation provision is to locate the real beneficiary in Greece. This provision does not apply in the case of a subsidiary resident of a Member State of the European Union, except for the case in which the establishment or the economic activity of the subsidiary is an artificial situation created for the exclusive purpose of tax avoidance.

33. GR: CoS 4464/1997, CoS 2444/2005.
34. *See* GR: CoS 4464/1997, CoS 2444/2005.
35. This new provision contains some similarities to the previous one (of article 51 B) of the previous ITC, which was also taken into account as a measure to combat the financial crisis in Greece from 2010 onwards.

According to (article 65 paragraph 6 of the) ITC 2013, a presumption for the residence in a state with a privileged tax regime is established in the following three cases: the company is not subject to taxation, or the company is not indeed taxed, or it is subject to income tax or capital tax inferior or equal to 50% of the corporate tax rate which would be owed, according to the Greek tax legislation, if this company had its residence or PE in Greece.

Furthermore, linking rules as recommended in OECD/BEPS have not been introduced yet in Greece. Concerning the limits on the deduction of interest, the tax deduction of interest cost on inter-group debt is subject to thin capitalization rules according to (article 49 of the) ITC 2013 concerning thin capitalization in general, i.e regardless of whether a company is in a group or not. Article 50 of the ITC 2013 includes TP provisions that are very general and does not offer special provisions related to interest deduction. According to article 49 of the ITC 2013, in combination with article 72 paragraph 9 of the same code concerning thin capitalization, interest costs are not recognized as deductible business expenses to the extent that the excess interest costs exceed the 50% of the taxable income before interests, taxes and depreciation (EBITDA). This rate will decrease every year (40% from 1 January 2016), to reach 30% from 1 January 2017. Excess interest costs are the interest costs that exceed the interest income (article 49 paragraphs 1 and 2 of the ITC 2013). Interest costs are fully recognized as deductible business expenses if the total net interest costs in the books do not exceed the amount of EUR 5,000,000 per year (article 49 paragraph 3 of the ITC 2013). From 1 January 2016, the limit will be EUR 3,000,000. Every interest cost that is not deductible is transferred to the next accounting year without a time limit (article 49 paragraph 4 of the ITC 2013). The rules of article 49 of the ITC 2013 apply to all interest costs (not only to inter-group debt). The rules do not take into account the worldwide debt ratio of the group of companies.

As for the rest of the SAARs that are applicable in Greece, the author would also include the provisions for non-cooperative Member States in tax matters or Member States with a privileged tax regime. With regard to non-cooperative Member States in tax matters, the following apply: in Greece, due to the acute financial crisis, domestic law has incorporated provisions that identify non-cooperative Member States in tax matters and subsequently the subjects related to them territorially. The first legal provision was included in a law of 2010.[36]

36. GR: Law 3842/2010, art. 78 para 1.

Today, according to the applicable (article 65 paragraph 3 of the) ITC 2013, non-cooperative states are non-EU Member States that, firstly, have not signed and are not implementing an administrative cooperation agreement in tax matters and in parallel, secondly, have not signed such an agreement with at least twelve more states. What is considered as an administrative cooperation agreement for the implementation of the ITC is an international agreement that allows the exchange of that information that is necessary for the implementation of the tax legislation of the contracting parties.[37]

After a study by the Ministry of Finance, these states are determined on an annual basis and the relevant list with non-cooperative states is published in the Official Gazette in January each year (article 65 paragraph 4 of the ITC).

Moreover, as is provided for in the same tax law, every year, those states that have signed and implemented an administrative assistance agreement with Greece by the date of publishing are removed from the list. In parallel, what is added to said list are: (a) states that, although they have signed an administrative assistance agreement with Greece, the provisions of this agreement or its implementation, have not allowed the Greek tax administration to receive the information that is necessary for the implementation of the tax legislation; and (b) states that have not signed an administrative assistance agreement with Greece, even though the latter has proposed before 1 January of the previous year the signature of such an agreement. Finally, as is provided for in (article 65, paragraph 4, case c of the) ITC 2013, what is either added to or removed from the list are those states that have not signed an administrative assistance agreement with Greece, those to which Greece had not proposed such an agreement before 1 January of the previous year and those for which the Global Forum on Transparency and Exchange of Information for Tax Purposes, which was established by the OECD decision of 17 September 2009, considers that they are exchanging or not exchanging all the necessary information for the implementation of the tax law of the contracting parties.

The list with non-cooperative states is in force for the states added on 1 January of the year following the publication, while for the states that are removed, the characterization as non-cooperative and its consequences stop at the moment of the publication of the list.[38]

37. GR: ITC 2013, art. 65 para. 2.
38. Art. 65 para. 5 ITC 2013.

Concerning the states with a privileged tax regime, the requirements for the characterization of a state as such have already been presented above. There is a relevant study of the Ministry of Finance and a list is drafted that is also published in the Official Gazette in January each year.

16.4. Application of GAARs, TP rules and SAARs

At the moment, in the Greek tax system, only TP rules and SAARs have been applied, while there are no cases of GAAR application yet perhaps because it is a new provision and it has created numerous interpretational difficulties due to its imprecise notions that have not yet been interpreted by the Greek tax administration. In parallel, no procedural rules underlying the application of national GAAR, TP rules and/or SAARs have been established.

The author believes that, as far as the hierarchy or coordination between the different rules is concerned, the easy solution is to apply the SAARs and TP rules and to apply the GAAR only when there is not an applicable SAAR. Until now, this issue has not concerned either the jurisprudence or the scholars in Greece. However, it could be held that in a state such as Greece, where the public's financial interest is synonymous with general interest, the question of coordination of the said measures could be also resolved through the principle of proportionality. Depending on the case, the measure chosen should be one that would bring a higher amount of tax to the treasury. However, it could be argued that such a solution is against the principle of tax certainty.

Chapter 17

Italy

Giuseppe Zizzo

17.1. The meaning of avoidance and aggressive tax planning and the BEPS initiative

17.1.1. The meaning of tax avoidance in national legal systems

The first definition of tax avoidance appeared in Italian legislation in 1990.[1] Article 10 of Law 408 of 29 December 1990 stated:

> The tax authorities may refuse to recognize the tax benefits received through business combinations, transformations, demergers, capital reductions, liquidations, valuations of shareholdings, transfers of credit and transfers or valuations of securities performed without sound economic reasons, for the sole purpose of fraudulently obtaining tax savings.

This provision provided a rather ambiguous definition, since the term "fraudulently" could be interpreted as having the meaning of "contrary to the purpose of the relevant legal provisions", but also as having the meaning of "through false statements and documents". While the first meaning was

1. On tax avoidance and abuse of law, in general: P. Tabellini, *L'elusione fiscale* (Giuffrè 1988); S. Cipollina, *La legge civile e la legge fiscale* (CEDAM 1992); S. Fiorentino, *L'elusione tributaria. Scelte di metodo e questioni terminologiche* (ESI 1996); A. Contrino, *Elusione fiscale, evasione e strumenti di contrasto* (Cisalpino 1996); A. Garcea, *Il legittimo risparmio d'imposta* (CEDAM 2000); S. Cipollina, *Elusione fiscale*, in *Dig. disc. priv., sez. comm.*, agg. (UTET 2007); G. Zizzo, *Elusione ed evasione tributaria*, in *Dizionario di diritto pubblico* p. 2173 (S. Cassese, Giuffrè 2006); G. Zizzo, *Abuso del diritto, scopi di risparmio d'imposta e collegamento negoziale*, Rass. Trib., p. 869 (2008); G. Zizzo, *L'elusione tra ordinamento nazionale ed ordinamento comunitario: definizioni a confronto e prospettive di coordinamento*, in *Elusione ed abuso del diritto tributario* (G. Maisto ed., Giuffré 2009); A Marcheselli, *Equivoci e prospettive della elusione tributaria, tra principi comunitari e principi nazionali*, I Dir. Prat. Trib., p. 801 (2010); V. Mastroiacovo, *L'economicità delle valide ragioni (note minime a margine della recente evoluzione del principio dell'abuso del diritto)*, I Riv. dir. trib., p. 449 (2010); G. Fransoni, *Appunti su abuso del diritto e "valide ragioni economiche"*, Rass. Trib., p. 932 (2010); F. Tesauro, *Elusione e abuso nel diritto tributario italiano*, I Dir. Prat. Trib., p. 683 (2012); S. La Rosa, *Abuso del diritto ed elusione fiscale: differenze e interferenze*, I Dir. Prat. Trib., p. 707 (2012); and G. Fransoni, *Spunti in tema di abuso del diritto e "intenzionalità" dell'azione*, Rass. Trib., p. 403 (2014).

in line with the common understanding of the notion of tax avoidance, the second was not, recalling the notion of tax fraud.[2]

In order to dispel the doubts that it raised, the definition set out in article 10 was replaced by a new one in 1997. Article 7, Legislative Decree 358 of 8 October 1997 inserted into Presidential Decree 600 of 29 September 1973, regulating the assessment of income taxes, article 37-bis, entitled "Anti-Avoidance Provisions", which empowered the tax administration to disregard the tax advantages stemming from "acts, facts and transactions, whether or not related, lacking of sound economic reasons, aimed at avoiding obligations or prohibitions foreseen by the tax system, and obtaining tax reductions or refunds otherwise not obtainable".[3]

Tax avoidance transactions were thus defined as transactions that (1) circumvent (avoid) tax obligations or prohibitions; (2) are aimed at obtaining a tax reduction or refund that would not otherwise be obtained; and (3) cannot be justified showing the existence of sound economic reasons.

The circumvention of tax obligations or prohibitions, which was at the core of this definition, implied the availability of an alternative route to the one taken, more adequate to the economic and legal outcome actually achieved. On the basis of this availability, it could indeed be argued that, by selecting the latter, the taxpayer managed to avoid the obligation or prohibition that the law attached to the former, therefore creating a conflict between the wording of the relevant provisions, which sheltered the taxpayer from facing the obligation or prohibition, and their purpose, which notwithstanding requested the enforcement of the same obligation or prohibition.

2. R. Lupi, *Prime ipotesi in tema di norma antielusione sulle operazioni societarie*, II Riv. dir. trib., p. 439 (1992).

3. On this provision: P. Piccone Ferrarotti, *Riflessioni sulla norma antielusiva introdotta dall'Art. 7 del D. Lgs. n. 358/1997 (Art. 37-bis del D.P.R. n. 600/1973)*, Rass. Trib., p. 1147 (1997); M. Nussi, *Elusione tributaria ed equiparazioni al presupposto nelle imposte sui redditi*, I Riv. dir. trib., p. 503 (1998); G. Zizzo, *Prime considerazioni sulla nuova disciplina antielusione*, in *Commento agli interventi di riforma tributaria* p. 435 (M. Miccinesi ed., CEDAM 1999); G. Vanz, *L'elusione fiscale tra forma giuridica e sostanza economica*, Rass. Trib., p. 1606 (2002); R. Lupi, *Le operazioni societarie tra lecita pianificazione fiscale ed elusione: concetti generali e casi applicativi*, in *La fiscalità delle operazioni straordinarie d'impresa* (R. Lupi and D. Stevanato eds., Il Sole 24 Ore 2002); D. Stevanato, *La norma antielusiva nei pareri del Comitato per l'interpello*, I Dir. Prat. Trib., p. 219 (2002); G. Zizzo, *La nozione di elusione nella clausola generale*, Corr. Trib., p. 3087 (2006); and G. Falsitta, *Natura delle disposizioni contenenti "norme per l'interpretazione di norme" e l'Art. 37 bis sull'interpretazione analogica o antielusiva*, I Riv. dir. trib., p. 519 (2010).

According to the Supreme Court, it was necessary to inquire if

> there is a manipulation or alteration of traditional legal instruments, to be considered inconsistent with ordinary market practices, and if there is an actual interchangeability with the solutions indicated by the tax authority.[4]

In 2006, the Supreme Court started to apply the abuse of law doctrine in tax law cases.[5] Until 2008, the Supreme Court grounded this doctrine on ECJ's case law.[6] Although claiming it was referring to the ECJ's definition of abuse of law, the Supreme Court in most decisions focused mainly on the purpose to obtain a tax saving, setting apart the other element that characterized the ECJ's definition, namely the contrast between the accrual of the saving and the purpose of the relevant provisions. Indeed, in these decisions, the Supreme Court held that transactions were to be deemed abusive when, "even if actually desired and not subject to invalidity, they are carried out, based on a group of objective elements, essentially for the purpose of obtaining a tax benefit".[7]

Since reliance on ECJ's case law was clearly weak outside the field of harmonized taxes, as in the case of income taxes, at the end of 2008, the Joint Chambers of the Supreme Court stated that the doctrine was also grounded on the ability-to-pay principle set by article 53 of the Italian Constitution. In this decision, the Supreme Court also provided a new definition of abuse of law, according to which it entails "a distorted use of legal instruments capable of producing tax savings which, without violating specific provisions,

4. IT: Sup. Ct., sec. V, 14 Jan. 2015, 438 and 439, commented by M. Beghin, *Ancora equivoci sul concetto di vantaggio fiscale elusivo e sulla sua inopponibilità al Fisco*, Corr. Trib., p. 895 (2015) and by D. Stevanato, *Il disconoscimento del prezzo pagato per acquistare l'azienda e il paradosso dell'elusione senza "aggiramento"*, GT – Riv. giur. trib., p. 501 (2015); and IT: Sup. Ct., sec. V, 15 July 2015, 14760 and 14761; IT: Sup. Ct., sec. V, 27 Mar. 2015, 6226 commented by M. Beghin, "*Elusione", tassazione differenziale e impatto sulla motivazione degli avvisi di accertamento*, Corr. Trib., p. 1827 (2015).

5. G. Zizzo, *L'elusione tra ordinamento nazionale ed ordinamento comunitario: definizioni a confronto e prospettive di coordinamento*, in *Elusione ed abuso del diritto tributario* (G. Maisto ed., Giuffré 2009); and G. Zizzo, *La giurisprudenza in materia di abuso ed elusione nelle imposte sul reddito*, Corr. Trib., p. 1019 (2012).

6. On the European roots of the "abuse of law" concept, *see* P. Pistone, *L'abuso del diritto nella giurisprudenza tributaria della Corte di giustizia dell'Unione Europea*, Dir. Prat. Trib. Int., p. 431 (2012); P. Piantavigna, *Abuso del diritto fiscale nell'ordinamento europeo* (Giappichelli 2011); and P. Piantavigna, *Tax Abuse in European Union Law: A Theory*, 3 EC Tax Review (2011).

7. IT: Sup. Ct., sec. V, 9 Mar. 2011, 5583; IT: Sup. Ct., sec. V, 22 Sept. 2010, 20030; and IT: Sup. Ct., sec. V, 9 Dec. 2009, 25710.

lack of sound economic reasons other than the mere expectation of the tax saving".[8]

This definition has since been steadily applied by the Supreme Court, which in later cases explained that the use of a legal instrument is distorted when the instrument is misused, manipulated or used inappropriately in a way not suitable with its typical purpose and not consistent with ordinary market practices[9] and that the tax savings should be undue, meaning not in line with the goal of the relevant provisions.[10]

In order to reconcile the definition of tax avoidance provided by article 37-bis, Presidential Decree 600 of 29 September 1973 with the one of abuse of law developed by the Supreme Court, article 1 Legislative Decree 128 of 5 August 2015 inserted into Law 212 of 27 July 2000 (Charter of Taxpayer's Rights) article 10-bis, entitled "Abuse of Law or Tax Avoidance", according to which "One or more transactions are deemed to be abusive when they do not have economic substance and, while formally consistent with tax law, achieve essentially undue tax advantages".[11]

Two elements characterize this definition: (1) the transaction shall lack of economic substance; and (2) the tax advantages shall be undue.

The first element is clarified by article 10-bis at paragraph 2(a), which specifies that an arrangement or series of arrangement lacks economic substance

8. IT: Sup. Ct., sec. V, 23 Dec. 2008, 30055, 30056 and 30057 commented by G. Zizzo, *Clausola antielusione e capacità contributiva*, Rass. Trib., p. 486 (2009), and by M. Cantillo, *Profili processuali del divieto di abuso del diritto: brevi note sulla rilevabilità d'ufficio*, Rass. Trib., p. 476 (2009). Similarly, IT: Sup. Ct., sec. V, 21 Jan. 2009, 1465; IT: Sup. Ct., sec. V, 20 Mar. 2009, 6800; IT: Sup. Ct., sec. V, 21 Apr. 2010, 9476; IT: Sup. Ct., sec. V, 12 Nov. 2010, 22994; IT: Sup. Ct., sec. V, 31 Mar. 2011, 7343; IT: Sup. Ct., sec. V, 12 May 2011, 10383; IT: Sup. Ct., sec. V, 13 May 2011, 10549; IT: Sup. Ct., sec. V, 20 May 2011, 11236; and IT: Sup. Ct., sec. V, 16 Feb. 2012, 2193.

9. IT: Sup. Ct., sec. V, 14 Jan. 2015, 405 commented by G. Zoppini, *Nuove prospettive giurisprudenziali in tema di abuso*, Rass. Trib., p. 1276 (2015); and IT: Sup. Ct., sec. V, 27 Mar. 2015, 6226.

10. IT: Sup. Ct., sec. V, 6 Mar. 2015, 4570; and IT: Sup. Ct., sec. V, 18 Mar. 2015, 5378, 5379 and 5380.

11. On the new GAAR: F. Gallo, *Brevi considerazioni sulla definizione di abuso del diritto e sul nuovo regime del c.d. adempimento collaborativo*, Dir. Prat. Trib., p. 10947 (2014); A. Giovannini, *L'abuso del diritto nella legge delega fiscale*, I Riv. dir. trib., p. 231 (2014); G. Zizzo, *L'abuso del diritto tra incertezze della delega e raccomandazioni europee*, Corr. Trib., p. 2997 (2014); G. Zizzo, *La nuova nozione di abuso del diritto e le raccomandazioni della Commissione europea*, Corr. Trib., p. 4577 (2015); A. Contrino and A. Marcheselli, *Luci e ombre nella struttura dell'abuso fiscale 'riformato'*, Corr. Trib., p. 3787 (2015); and D. Stevanato, *Elusione fiscale e abuso delle forme giuridiche, anatomia di un equivoco*, Dir. Prat. Trib., p. 695 (2015).

if it "is unable to produce meaningful effects apart from the tax advantages. Signs of the lack of economic substance are, in particular, the fact that the legal characterization of the individual steps is inconsistent with the legal substance of the arrangement as a whole and the fact that the legal instruments are used in a manner inconsistent with ordinary market practices". And at paragraph 3, under which transactions cannot be considered abusive when they are "justified by sound non-tax reasons".

While at first referring to the inability to produce meaningful non-tax effects, it appears that this element is aimed at striking only those transactions that are circular in nature. The examples that are subsequently provided indicate that it also encompasses situations where it is just a question of inconsistency between legal form and economic substance.

The relevance of this element is perfectly understandable in the light of the ability-to-pay principle, which, in the opinion of the Supreme Court, justifies the adoption of anti-avoidance measures. If an arrangement or a series of arrangements is unable to affect the economic and legal sphere of the taxpayer, apart from taxes, it can be argued that its enactment does not change the taxpayer's ability to pay. Similarly, if an arrangement or a series of arrangements *is* able to affect the taxpayer's economic and legal sphere, but it does not represent the most efficient one available to those ends, it can be argued that its enactment is unable to create a meaningful difference between the ability to pay connected to the arrangement or series of arrangements enacted and the one connected to the most efficient arrangement or series of arrangements.

Therefore, an arrangement or series of arrangements falls outside the scope of this element either if a certain modification in the taxpayer's economic and legal sphere is attained following the most efficient route, or if, when a certain modification in the taxpayer's economic and legal sphere may be attained following different routes, all alike for efficiency, the taxpayer chooses among them. Indeed, in both cases, there are effects apart from the tax advantages, and the legal form is consistent with them.

The second element is clarified by article 10-bis at paragraph 2(b), which states that a tax advantage is undue when its "accrual defeats the purpose of the tax provisions or of the principles of the tax system". And at paragraph 4, pursuant to which "The taxpayer is free to choose between different tax regimes or between transactions that bear a different tax burden". Since no distinction is made, the tax provisions mentioned could be either

those applied by the taxpayer (the "abused" provisions) or those that would otherwise apply (the "avoided" provisions).

This element implies that, when the tax system offers the possibility to apply different tax regimes to a certain set of facts, the fact that the taxpayer chooses the most convenient one cannot qualify the tax saving as undue. Indeed, when providing an option between different regimes, unavoidably, the system admits that the choice among them could be guided exclusively by their tax consequences. Similarly, when the tax system regulates differently transactions that have the same economic substance, the choice among them of the most convenient one from a tax standpoint cannot qualify the tax saving as undue.

Indeed, as taxes are not levied directly on the taxpayers' ability to pay, but on situations deemed to reveal it, as they are selected and shaped by lawmakers (through a judgment unquestionable if not unreasonable) taking into account various instances of a technical and political nature, there is no abuse of law when the tax savings are fully consistent with the legislative intent.

17.1.2. The meaning of tax planning, abusive tax planning and aggressive tax planning in national legal systems

The concept of "tax planning" now has a statutory basis in article 10-bis, paragraph 4, of the Charter of Taxpayer's Rights, pursuant to which "The taxpayer is free to choose between different tax regimes or between transactions that bear a different tax burden". Tax-influenced behaviour is thus expressly allowed by the tax system, as long as it does not conflict with the legislative intention. As already pointed out, when the system grants the option between different regimes or attaches different consequences to transactions that have the same economic substance, it is easy to argue that any benefit deriving from the choice among those regimes or those transactions shall be deemed coherent with the legislative intent.

Before, this concept could be grounded in the Supreme Court's case law. According to it, "the use of contractual and/or organisational forms that allow a smaller tax burden constitutes exercise of free enterprise and commercial freedom",[12] and does not therefore amount, in itself, to abuse of law. In addition, in the light of the need to safeguard the principles of free

12. IT: Sup. Ct., sec. V, 17 Oct. 2008, 25374.

enterprise and commercial freedom (article 42 of the Constitution), as well as that of full legal protection of the taxpayer (article 24 of the Constitution), the Supreme Court has held that "the Administration's supervision cannot extend to imposing a restructuring measure different from those which are legally possible… only because this measure would result in higher taxation".[13]

No statutory or case law basis may be found, on the other hand, for the concepts of "abusive tax planning" and "aggressive tax planning". It is therefore possible to argue that for the Italian tax system they overlap with the concept of abuse of law. The definition of abuse of law included in article 10-bis is indeed mainly drawn, as is discussed in section 17.2.1., from the Recommendation on aggressive tax planning issued by the European Commission on 6 December 2012.[14]

17.2. The reaction to avoidance and aggressive tax planning in the BEPS context

17.2.1. Domestic general anti-avoidance rules (GAARs)

As pointed out in section 17.1., the first Italian statutory GAAR was enacted in 1990, as article 10, Law 408 of 29 December 1990. Its scope was actually rather narrow. It concerned essentially corporate reorganizations and applied mainly in the field of income taxes.

A step further was taken in 1997, when article 10 was replaced by article 37-bis, Presidential Decree 600 of 29 September 1973. The new GAAR, while still relating to income taxes and to specific transactions, had a broader working range than the previous one. It indeed encompassed a significantly higher number of transactions than the one included in article 10.

Alongside this GAAR, since 2006, the Supreme Court has developed a general anti-abuse of law doctrine, applicable to the entire tax system, although in some recent rulings, assuming a substantial identity between the statutory notion of tax avoidance provided by article 37-bis and the judicial one of abuse of law, it clarified that in the field of income taxes abusive practices

13. IT: Sup. Ct., sec. V, 21 Jan. 2011, 1372. *See* S. La Rosa, *Ancora sugli incerti confini tra abuso del diritto, elusione ed illecito fiscale*, II Riv. dir. trib., p. 353 (2012); and M. Beghin, *Una strana idea di libertà economica e di vantaggio fiscale asistematico (su elusione fiscale e abuso del diritto*, Corr. Trib., p. 731 (2015).
14. EU Commission Recommendation, Brussels, 6.12.2012, C(2012) 8806 final.

could be disregarded only if the conditions set forth in article 37-bis were fulfilled.[15] The Supreme Court therefore recognized that article 37-bis, while providing a tool to fight abusive practices, also had the purpose to draw the line between more dangerous abusive practices, curbing them because they are unacceptable, and less dangerous ones, upholding them because they are acceptable, in order to foster certainty in this specific area of tax law.

This judicial doctrine has been applied very successfully by the tax authority. The fuzziness of its boundaries has led the Court to apply it even in cases clearly outside its scope, where the tax authority had no need to resort to it in order to justify the assessment, as in cases dealing with sham transactions or in cases merely raising statutory construction issues.[16]

In 2015, article 37-bis was superseded by article 10-bis, Law 212 of 27 July 2000, which provides a real statutory GAAR, since it applies to all abusive practices, regardless of the area of tax law and the transactions involved. Its scope therefore overlaps with the one of the judicial anti-abuse of law doctrine, the legislative intent being clearly to bring under the same regime all cases of abuse of law, going beyond the previous two-prong structure, and putting an end to the excesses brought about by the judicial doctrine. Indeed, at paragraph 10, article 10-bis provides that there can be abuse of law "only when the tax advantages cannot be disregarded claiming the violation of specific tax provisions".

The definition of abuse of law outlined in this new GAAR is explicitly drawn from the one used in the Recommendation on aggressive tax planning issued by the European Commission on 6 December 2012.

According to it, "One or more transactions are deemed to be abusive when they do not have economic substance and, while formally consistent with tax law, achieve essentially undue tax advantages". As pointed out in section 17.1.1., the definition of abusive practice provided by article 10-bis relies therefore on two elements: (1) the transaction shall lack economic substance, meaning they shall be unable to produce meaningful effects apart from the tax advantages; and (2) the tax advantages shall be undue, meaning

15. IT: Sup. Ct., sec. V, 14 Jan. 2015, 405 commented by G. Zoppini, *Nuove prospettive giurisprudenziali in tema di abuso*, Rass. Trib., p. 1276 (2015); and IT: Sup. Ct., sec. V, 27 Mar. 2015, 6226.
16. G. Falsitta, *Spunti critici e ricostruttivi sull'errata commistione di simulazione ed elusione nell'onnivoro contenitore detto "abuso del diritto"*, II Riv. dir. trib., p. 349 (2010); and G. Zizzo, *La giurisprudenza in materia di abuso ed elusione nelle imposte sul reddito*, Corr. Trib., p. 1019 (2012).

they shall conflict with the purpose of the tax provisions or of the principles of the tax system. Both tests have an objective nature. No room is thus left to the subjective intention of the taxpayer.

Since the GAAR is new, there is no case law dealing specifically with it. Nevertheless, based on their similarity, in relation to its first element it is possible to recall the position taken by the Supreme Court on the circumvention element of article 37-bis. For the Court, in order to apply this provision it was necessary to inquire if "there is a manipulation or alteration of traditional legal instruments, to be considered inconsistent with ordinary market practices, and if there is an actual interchangeability with the solutions indicated by the tax authority".[17]

As explained in section 17.1.1., the lack of economic substance to which article 10-bis refers is not limited to cases where no economic substance may be found (that is, where no modification in the taxpayer's economic and legal sphere occurs). It also expands to cases where an economic substance is achieved (that is, where a modification in the taxpayer's economic and legal sphere occurs), but the legal form chosen by the taxpayer is inconsistent with it. It is likely that the Supreme Court will identify this inconsistency when the above-mentioned conditions are met.

With article 6 of Directive 2016/1164 (the so-called anti-BEPS Directive), the European Union has established a new model for domestic GAARs. In this provision, abusive transactions are defined as "arrangements which, having been put into place for the main purpose or one of the main purposes of obtaining a tax advantage that defeats the object or the purpose of the applicable tax law, are not genuine having regard to all relevant facts and circumstances", pointing out that "an arrangement or a series thereof shall be regarded as non-genuine to the extent that are not put into place for valid commercial reasons which reflect economic reality". In the author's view, this new model will not require changes in the Italian GAAR. The elements that characterize abusive transactions in the EU model are substantially the same as those considered by the Italian GAAR, specifically the lack of economic substance (so-called non-genuineness in the EU model) and the contrast with the object or purpose of the relevant tax law provisions.

17. *Supra* n. 4.

17.2.2. EC Recommendation C(2012) 8806 of 6 December 2012 and subject-to-tax rule

In general, Italy does not have subject-to-tax clauses in its DTCs since, as the state of residence, it adopts the credit method to relieve juridical double taxation, that is, in situations in which the same income is taxable in the hands of the same person by more than one Member State.[18] Accordingly, a case of double non-taxation is unlikely to arise when Italy acts as the state of residence. In such circumstance, if an item of income is not subject to tax in the source state, no foreign tax will be creditable and such income will be fully taxable in Italy. In this regard, a case of double non-taxation can originate only where Italy, as state of residence, does not retain the right to tax a certain income on the basis of domestic law, because, for example, it provides an exemption from income tax or does not have the right to tax that income in accordance with some provisions of the treaty, such as article 15, paragraph 3, article 19 and article 20 of the OECD MC.

A general subject-to-tax rule may be found in the Protocol to the Convention between Italy and France. Specifically, paragraph 15 of the Protocol stipulates that “In the cases where, in accordance with the provisions of this Convention, income must be exempted by one of the States, the exemption shall be granted if and to the extent such income is taxable in the other State”.

A different type of general subject-to-tax clause may be found in the Convention between Italy and Germany.[19] Paragraph 16(d), of the Protocol reads as follows: “For the purposes of subparagraph (a) of paragraph 3 of Article 24, items of income of a resident of a Contracting State shall be deemed to arise in the other Contracting State if they have been effectively subjected to tax in the other Contracting State in accordance with the Convention”. This clause does not apply symmetrically, as it is in the one provided by the Italy-France DTC, but deals only with the case in which Germany is the state of residence and, vice versa, Italy represents the state of source. Since Germany adopts the exemption method as suggested by

18. *See* S. Mayr and P. Conci, *IFA Branch Report: Italy*, in *Cahiers de Droit Fiscal International. Double Non-Taxation*, p. 463 (IFA Cahiers 2004). *See also* P. Tarigo, *Doppia non imposizione e trattati italiani*, Dir. Prat. Trib., p. 11127 (2009).

19. Protocol to the Italy-Germany Double Tax Convention, 18 Oct. 1989, para. 16(d). For a comment, *see* M. Lampe, *General Subject-To-Tax Clause in Recent Tax Treaties*, 39 European Taxation 4, p. 183 (1999) Journals IBFD; and A. Rust, *Avoidance of Double Non-Taxation in Germany,* in *Avoidance of Double Non-Taxation*, p. 111 (M. Lang ed., Linde Verlag 2003).

article 23A of the OECD MC, the clause has the purpose to avoid the situation where, although Italy grants an exemption to an item of income, Germany does not have the power to tax it. The reciprocal situation cannot happen, since Italy adopts the credit method as an ordinary relief method for double taxation.

The same rationale lies behind the "switch-over" clause provided by the Protocol to the same DTC. Under paragraph 16(d), Germany is allowed to shift from the exemption method to the credit system if the following circumstances are met: (1) the income is categorized or attributed differently in the two states; (2) it is not possible to solve the problem by mutual agreement; and (3) the relevant income is either subject to double taxation or is not taxed or, again, it faces a reduced taxation.

Specific subject-to-tax rules relate to those allocation rules enshrined in DTCs that attribute the right to tax to a single contracting state, thus preventing the other state from taxing the same item of income.

When the power to tax an item of income is granted to the state of residence, the subject-to-tax clause provides the reversion of taxation to the state of source where the state of residence exempts such item.

An example of this kind of subject-to-tax rule may be found in some DTCs in the provision where they deal with the treatment of the income earned by teachers and professors resident of a contracting state for a teaching or research activity performed in the other contracting state. For instance, article 20 of the Italy-Australia DTC reads as follows:

> a professor or teacher who visits one of the Contracting States for a period not exceeding two years for the purpose of teaching or carrying out advanced study or research at a university, college, school or other educational institution in that State and who immediately before that visit was a resident of the other Contracting State shall be exempt from tax in the first-mentioned State on any remuneration for such teaching, advanced study or research in respect of which he is, or upon the application of this Article will be, subject to tax in the other State.[20]

20. Italy-Australia Double Tax Convention, 12 Dec. 1982, art. 20.

Similar clauses are contained in the DTCs with New Zealand,[21] Malaysia,[22] South Africa,[23] Mauritius,[24] Albania[25] and Iceland.[26]

Another subject-to-tax clause inserted in some Italian DTCs deals with the treatment of pensions. In general, pensions and other similar remunerations paid to a resident of a contracting state in consideration of past employment shall be taxable only in the state of residence. However, in the DTC with Syria, it is stated that "1. Subject to the provisions of paragraph 2 of Article 19, pensions and other similar remuneration paid to a resident of a Contracting State in consideration of past employment shall be taxable only in that State. 2. The provisions of paragraph 1 shall not apply if the recipient of the income is not subject to tax in respect of such income in the State of which he is a resident and according to the laws of that State. In such a case, such income may be taxed in the State where they arise".[27] Analogous provisions are contained in the treaties with Ghana,[28] Lebanon,[29] Georgia[30] and Zambia.[31]

A tailored subject-to-tax provision concerning interest is included in the Italy-United Kingdom DTC. The clause, which is aimed at preventing the application of the exclusive right to tax by the state in which the payee is resident, as set out in paragraphs 3 and 4 of article 11, reads as follows:

> the reliefs from tax provided for in paragraph 2, 3 or 4, as the case may be, of this Article shall not apply if the beneficial owner of the interest is exempt from tax on such income in the Contracting State of which he is a resident and such recipient sells or makes a contract to sell the holding from which such interest is derived within three months of the date such recipient acquired such holding.[32]

A reversion of taxation in favour of the state of source may also concern the profits from the operation of ships or aircraft in international traffic. This clause is included in article 18, paragraph 2 of the Protocol to the Italy-Malta DTC. It stipulates that:

21. Italy-New Zealand Double Tax Convention, 6 Dec. 1979, art. 20.
22. Italy-Malaysia Double Tax Convention, 28 Jan. 1984, art. 19.
23. Italy-South Africa Double Tax Convention, 16 Nov. 1995, art. 20.
24. Italy-Mauritius Double Tax Convention, 9 Mar. 1990, art. 20.
25. Italy-Albania Double Tax Convention, 12 Dec. 1994, art. 20.
26. Italy-Australia Double Tax Convention, 10 Sept. 2002, art. 20.
27. Italy-Syria Double Tax Convention, 23 Nov. 2000, art. 19.
28. Italy-Ghana Double Tax Convention, 19 Feb. 1994, art. 19.
29. Italy-Lebanon Double Tax Convention, 22 Nov. 2000, art. 18, para. 2.
30. Italy-Georgia Double Tax Convention, 31 Oct. 2000, art. 18, para. 2.
31. Italy-Zambia Double Tax Convention, 27 Oct. 1972, art. 18.
32. Italy-United Kingdom Double Tax Convention, 21 Oct. 1988, art. 11, para. 10.

> where profits derived from the operation of a ship in international traffic by an enterprise whose place of effective management is situated in Malta are exempt from tax under the provisions of section 86 of the Merchant Shipping Act, 1973, or under any identical or similar provisions, such profits may be taxed in Italy unless it is proved to the satisfaction of the competent authorities of Italy that not more than twenty per cent of the capital of the company owning the relative ship is owned, directly or indirectly, by persons not resident of Malta.[33]

A rare provision which resembles closely a subject-to-tax clause is the so-called "remittance clause" contained in the treaties with Ireland[34] and Malaysia.[35] It provides that persons who qualify as residents of Ireland or Malaysia are taxable only on income derived from Italian sources to the extent that such income is effectively remitted in those countries. Conversely, Italy, as source state, has to grant an exemption or apply a reductive rate on such income only in so much and to the extent that the income is remitted in the state of residence. The underlying rationale rests on the consideration that such persons are not subject to potential double taxation to the extent that their foreign income is not remitted to their state of residence.

When the power to tax is granted to the state of source, the specific subject-to-tax clauses regulate the reversion of taxation to the state of residence where the state of source fails to tax such an item.

An example of this kind of clause may be found in some DTCs where they deal with the taxation of remuneration for government services and public pensions. Ordinarily, DTCs apply the "paying state principle" to this income. The subject-to-tax clause inserted in some DTCs provides that if the paying state does not exercise its power to tax such income, the resident state is allowed to tax that income. An example of this provision in respect of remuneration for government service is contained in the DTC with Poland which affirms that:

> such remuneration shall be taxable only in the other Contracting State if the services are rendered in that State and the individual is a resident of that State who: (i) is a national of that State; or (ii) did not become a resident of that State solely for the purpose of rendering the services; or (iii) is not subject to tax in respect of such remuneration in the Contracting State from which the remuneration is paid.

33. Italy-Malta Double Tax Convention, 16 July 1981, art. 18, para. 2.
34. Protocol to the Italy-Ireland Double Tax Convention, 11 June 1971, para. 1(a).
35. Italy-Malaysia Double Tax Convention, 28 Jan. 1984, art. 23.

A similar provision, included in the Protocol to the Italy-Germany DTC, states that:

> Article 19 shall also apply to remuneration paid to German nationals (also when they are Italian nationals at the same time) who exercise their activities at German cultural institutions or at schools, insofar as such remuneration is paid out of German public funds and is subject to taxation in the Federal Republic of Germany.[36]

In some DTCs, the resident state is allowed to tax the income deriving from an employment exercised aboard a ship or aircraft operated in international traffic only if the source state does not tax such income. This clause, inserted in the treaty with France, reads as follows:

> notwithstanding the preceding provisions of this Article, remuneration derived in respect of an employment exercised aboard a ship or aircraft operated in international traffic may be taxed in the State in which the place of effective management of the enterprise is situated; if that State does not levy any tax on such remuneration, that remuneration may be taxed in the State of which the recipient is a resident.[37]

A clause implying a reversion of taxation to the state of residence can be found in the Convention with Russia with regard to the remuneration for certain services.[38] Specifically, article 9, paragraph 2 of the Italy-Russia DTC states that "remuneration which a resident of a Contracting State receives in consideration for services performed in the other Contracting State shall not be liable to taxation in that other State if it is subjected to taxation in the first-mentioned State".[39]

Finally, it may be relevant to highlight that sometimes subject-to-tax rules can also be framed as "deemed source" clauses, namely provisions that help at individualizing the origin of an item of income. In this regard, a deemed-source clause can be found in the Italy-Ivory Coast DTC, which reads as follows:

36. Protocol to the Italy-Germany Double Tax Convention, 18 Oct. 1989, para. 14(c), point (ii).
37. Italy-France Double Tax Convention, 5 Oct. 1989, art. 15, para. 3.
38. The provision mentions "remuneration in respect of work directly connected with a construction or assembly project", "remuneration paid to individuals stationed in the other Contracting State as press, radio or television reporters or representatives, from sources outside that other State for two years from their arrival in that other State" and "remuneration derived by residents of a Contracting State, sent as technical specialists to the other Contracting State, during a year from the date of arrival in that other State".
39. Italy-Russia Double Tax Convention, 26 Feb. 1985, art. 9, para. 2.

> for the application of paragraphs 2 and 3 of this Article, profits, income or, capital gains of a resident of a Contracting State, which have been subjected to taxation in the other Contracting State in accordance with this Convention, shall be deemed to be derived from sources situated in that other Contracting State.[40]

17.3. Transfer pricing rules, GAARs, specific anti-avoidance rules (SAARs) and linking rules

17.3.1. Transfer pricing

17.3.1.1. Transfer pricing and tax avoidance

According to article 110, paragraph 7 of Presidential Decree 917 of 22 December 1986 (Income Tax Code):

> The items of income stemming from transactions with non-resident entities that directly or indirectly control the enterprise, are controlled by it, or are controlled by the same entity controlling the enterprise, shall be evaluated on the basis of the normal value of the goods or services supplied.[41]

The adjustment is necessary only if the result is an increase in the taxable income. A downward adjustment is allowable only to the extent it is the result of a binding agreement concluded with the competent authorities of the other contracting state pursuant to a mutual agreement procedure under a DTC.

The definition of “normal value” essentially mirrors the OECD’s “arm’s length value”. Article 9, paragraph 3 of the ITC defines “normal value” as

> the average price or consideration paid for goods and services of the same or similar type, in free market conditions and at the same level of trade, at the time and place at which the goods were purchased or the services were performed, or, if no such data is available, at the time and place nearest thereto.[42]

40. Italy-Ivory Coast Double Tax Convention, 30 July 1982, art. 22, para. 5.
41. On TP, *see* G. Maisto, *Il transfer price nel diritto tributario italiano e comparato* (CEDAM 1985); E. Della Valle, *Il transfer price nel sistema di imposizione sul reddito*, I Riv. dir. trib., p. 133 (2009); F. Balzani, *Il TP*, in *Corso di diritto tributario internazionale*, p. 413 (V. Uckmar ed., CEDAM 2002); R. Cordeiro Guerra, *La disciplina del transfer price nell’ordinamento italiano*, I Riv. dir. trib., p. 421 (2000); A. Stesuri, *La determinazione del reddito di impresa nel TP*, GT - Riv. giur. trib., p. 433 (1999); and G. Zizzo, *Regole generali sulla determinazione del reddito di impresa*, in *Imposta sul reddito delle persone fisiche*, p. 577 (F. Tesauro, UTET 1994).
42. The provision specifies that reliable indications might be found in price lists or tariffs of the party that has supplied the goods or services or, if necessary, in price lists

Detailed regulations on TP can be found in Ministerial Circular 32 of 22 September 1980, which sets forth the instructions still representing the most exhaustive and complete source on TP regime in Italy. Among other topics, the Circular discusses the methods applicable to determine the transfer price for each type of transaction (that is, the transfer of movable goods, transfer of technology, loans and intra-group services). Following the 1979 OECD Guidelines, the Circular classifies these methods into two categories: "traditional transaction-based methods" and "profit-based methods". As to the first category, the Ministry indicates the comparable uncontrolled price (CUP) method as the preferable one. If the CUP method cannot be applied, the resale price method (RPM) has to be used, followed by the cost-plus method (CSM). Should all these traditional criteria be inapplicable, alternative methods need to be taken into consideration, such as the transactional net margin method (TNMM) and the profit split method (PSM).

The Supreme Court generally classifies TP among anti-avoidance rules. According to it, TP is

> an anti-avoidance rule intended to prevent, within the group of companies, transfer of profits by applying prices below or above the normal value of the goods supplied, with the purpose of avoiding taxation in Italy in favor of lower foreign taxation (cfr. SC. 22023/06, 11226/07, 11949/12) or otherwise in favor of situations that make fiscally convenient the allocation of income to foreign companies of the group.[43]

On this basis, for a period, the Supreme Court held that TP could apply only where the tax burden on the Italian company was, due to a higher tax rate being applicable, higher than the one borne by the non-resident company with which the transaction had been carried out.

Although shared by some scholars[44], this opinion appeared at odds with the wording of article 110, paragraph 7, which compels the resident company to use the arm's length value to calculate its tax base, in place of the actual

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of the Chamber of Commerce and in professional tariffs, taking normal discounts into account. For goods and services subject to price control, reference has to be made to the regulations in force. For a comment, *see* P. Adonnino, *La nozione di valore normale*, in *Il reddito di impresa nel nuovo Testo Unico*, p. 272 (A. and V. Uckmar ed., CEDAM 1988).

43. IT: Sup. Ct., sec. V, 25 Sept. 2013, 22010; IT: Sup. Ct., 16 May 2011, 11126; IT: Sup. Ct., sec. V, 16 May 2007, 11226; and IT: Sup. Ct., sec. V, 13 Oct. 2006, 22023. For a comment, *see* A. Ballancin, *La disciplina italiana del transfer price tra onere della prova, giudizi di fatto e l'(in)esistenza di obblighi documentali*, Rass. Trib., p. 1982 (2006).

44. *See*, for instance, C. Galli, *Transfer Pricing Rules for Transactions Involving Low-Tax Countries*, 15 International Transfer Pricing Journal 1, p. 44 (2008), Journals IBFD; P. Mastellone, *The Shifts in the Burden of Proof in Regard to Transfer Pricing*, 51 European

price, regardless of the tax rate applicable to the non-resident one, as long as the substitution produces an increase of that base. It also appeared inconsistent with the purpose of this instrument as set out in the Commentary on the OECD Model.[45]

These shortcomings led the Supreme Court to change its position, recognizing that TP represents primarily a rule for the proper allocation of the tax base. In its most recent case law, it therefore states that:

> The manipulation of transfer prices applied in transactions between related parties... is prosecuted, at international level, not so much because it is aimed at achieving an undue tax saving... but because it distorts the proper allocation between States of tax bases generated by cross-border transactions.

So, "While an anti-avoidance purpose exists, it does not exhaust the goals of this rule".[46]

17.3.1.2. Transfer pricing litigation

The last decade saw a remarkable increase in the number of TP cases. Most of them deal with the allocation of the burden of proof between the taxpayer and the tax authority.[47]

For a period, assuming the primacy of the anti-avoidance purpose, the Supreme Court held that the burden of proof rested on the tax authority, which had to demonstrate that the price agreed upon by the parties was able to determine an overall tax saving, taking into account both Italian taxes on the resident company and foreign taxes on the non-resident counterparty, rather than only the former. According to the Supreme Court, "since the

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Taxation 5, p. 211 (2011), Journals IBFD; D. Bergami and C. Rotondaro, *A New Challenge to Domestic Intercompany Relationships*, 7 International Transfer Pricing Journal 2, p. 57 (2000), Journals IBFD.

45. A. Ballancin, *Natura e ratio della disciplina sui prezzi di trasferimento internazionali*, Rass. Trib., p. 73 (2014).

46. IT: Sup. Ct., sec. V, 7 July 2015, 15005. *See also* IT: Sup. Ct., sec. V, 21 July 2015, 15298; IT: Sup. Ct., sec. V, 5 Aug. 2015, 16399; IT: Sup. Ct., 19 Dec. 2014, 27087; IT: Sup. Ct., sec. V, 8 May 2013, 10739; and IT: Sup. Ct., sec. V, 13 July 2012, 11949.

47. On this issue, *see* E. Ceriana, *Transfer price e attività di accertamento*, GT - Riv. giur. trib., p. 905 (2007); P. Mastellone, *The Shifts in the Burden of Proof in regard to Transfer Pricing*, 51 European Taxation 5, p. 211 (2011), Journals IBFD; E. Della Valle, *Oggetto ed onere della prova nelle rettifiche da transfer price*, GT - Riv. giur. trib., p. 772 (2013); F. Menti, *Il TP e l'onere di provare la conformità dei prezzi praticati a quelli di libera concorrenza*, Dir. Prat. Trib., p. 35 (2014); A. Ballancin, *Italy. National Report*, in *The Burden of Proof in Tax Law. 2011 EATLP Congress*, p. 167 (EATLP International Tax Series), Online Books IBFD.

burden of proof in tax avoidance cases always rests on the tax authority…”, the tax authority had to assess in the first place “if taxes in Italy at the time were really higher than the ones levied” by the other Country involved.[48]

As already pointed out, this position was later abandoned. The Supreme Court now recognizes that:

> the burden of proof on the tax authority - in TP matters - remains limited to the demonstration of the existence of transactions between associated companies, and of a clear difference between the agreed price and the market value (normal value), while it does not include the avoidance purpose of the operation.[49]

On this basis, the Supreme Court draws a distinction between assessments regarding positive items of income and assessments regarding negative items. In the first case:

> undoubtedly lies on the tax authority – according to the relevant general rules (Art. 2697 of the Civil Code) – the burden of demonstrating the validity of the adjustment based on TP, with reference to the difference between the agreed price and the normal value of the goods or services exchanged. While in the second, “since the problem of distributing costs incurred in transactions between associated enterprises involves also the issue of pertinence, as the one of existence, of the costs reported as a consequence of the supply of goods or services…”, the burden of demonstrating the existence and the pertinence of those negative items, and, if dealing with costs deriving from the supply of goods or services between a non-resident company and its resident subsidiary, also every element capable of allowing the tax authority to check the normal value of the agreed prices shall lie - in accordance to the principle of proximity to evidence - on the taxpayer.[50]

Following this line of reasoning, it can be argued that the distribution of the burden of proof in TP cases does not waive to rules ordinarily applied in other tax law cases.

Only a few decisions discuss the criteria for determining the “normal value”. In these decisions, the Supreme Court has taken the position that, according to article 9 of the ITC, the CUP method should be used first and that the tax authority, in applying it, should look for internal comparables, and therefore to taxpayer’s transactions with independent enterprises. It should only look for external comparables, and therefore for transactions between

48. IT: Sup. Ct., sec. V, 13 Oct. 2006, 22023.
49. *See*, for instance, IT: Sup. Ct., sec. V, 25 Sept. 2013, 22010; IT: Sup. Ct., sec. V, 8 May 2013, 10739.
50. IT: Sup. Ct., sec. V, 5 Aug. 2015, 16399; IT: Sup. Ct., sec. V, 16 May 2007, 11226.

independent enterprises dealing in the same market, if internal comparables are not available.[51]

17.3.2. LOB clauses

In the Italian DTC network, a LOB clause may be found in the 1999 DTC with the United States.[52]

Article 2 of the Protocol to the Convention states that, only upon satisfaction of some tests put together to reveal the presence of a sufficient link between the resident of one contracting state requesting the treaty benefits and the same contracting state, may the benefits of the treaty be available, in some cases in full, in others to a certain extent, as determined by the DTC or, on a discretional basis, by the competent tax authority.

Among these tests, the publicly traded test requires that all the shares in the class or classes of shares representing more than 50% of the voting power and value of a company have to be traded on a recognized stock exchange. For persons other than individuals that otherwise do not qualify for treaty benefits, two other tests are provided: the ownership test and the base erosion test. Under the ownership test, persons must own directly or indirectly at least 50% of each class of shares or other beneficial interest in the company for at least half the days of the taxable year. To comply with this test, it is also necessary that, in the case of indirect ownership, each intermediate owner meets at least one of the conditions. The base erosion test prescribes that less than 50% of the person's gross income for the taxable year is paid or accrued, directly or indirectly, to persons who are not resident of either contracting state in the form of payments that are deductible for income tax purposes in the person's state of residence. In applying the base erosion test, payments attributable to a permanent establishment of the person located in the other state are not taken into account.

If a resident of a contracting state does not satisfy any of the afore-mentioned tests, the resident is allowed access to the treaty benefits with respect

51. IT: Sup. Ct., sec. V, 25 Sept. 2013, 22010; IT: Sup. Ct., sec. V, 23 Oct. 2013, 24005; IT: Sup. Ct., sec. V, 13 May 2015, 9709. About this topic, *see* A. Vicini Ronchetti, *Transfer price tra normativa nazionale e internazionale*, Rass. Trib., p. 487 (2014).

52. For a comment, *see* G. Rolle and A. Turina, *Condizioni applicative e profili temporali della Convenzione Italia-USA*, Corr. Trib., p. 888 (2010); and R. Dominici, *La ratifica della Convenzione Italia-USA contro le doppie imposizioni: un decennio di innovazioni*, Fisc. Int., p. 209 (2010).

to specific items of income derived from the other state if he meets the requirements of the "active trade or business test", namely he is either engaged in the active conduct of a trade or business in his own state of residence, or the income is connected with, or incidental to, the trade or business, or the trade or business is substantial in relation to the activity carried on in the other state generating income.

Finally, if a resident of a contracting state does not satisfy the requirements of any of the above-mentioned tests, he may nonetheless be granted treaty benefits if the competent authority of the state from which the benefits are claimed so determines in its discretion.

LOB clauses are also included in the DTCs with Azerbaijan,[53] Estonia,[54] Latvia,[55] Lithuania,[56] Qatar,[57] Kazakhstan,[58] Kuwait[59] and Iceland.[60] They are more simple than the one included in the DTC with the United States, as they usually read as follows:

> Notwithstanding any other provision of this Convention, a resident of a contracting State shall not receive the benefit of any reduction in or exemption from taxes provided for in this Convention by the other contracting State if the main purpose or one of the main purposes of the creation or of the existence of such resident or any person connected with such resident was to obtain the benefits under this Convention that would not otherwise be available.[61]

17.3.3. Controlled foreign companies (CFCs) rules

Italy adopted a CFC legislation in 2000.[62] Over the years, this legislation has undergone extensive changes, although following the same approach,

53. Italy-Azerbaijan Double Tax Convention, 21 July 2004, art. 30, para. 1.
54. Italy-Estonia Double Tax Convention, 20 Mar. 1997, art. 28, para. 1.
55. Italy-Latvia Double Tax Convention, 21 May 1997, art. 30, para. 1.
56. Italy-Lithuania Double Tax Convention, 4 Apr. 1996, art. 30, para. 1.
57. Italy-Qatar Double Tax Convention, 15 Oct. 2002, art. 29, para. 1.
58. Italy-Kazakhstan Double Tax Convention, 22 Sept. 1994, art. 29, para. 1.
59. 1993 Protocol to Italy-Kuwait Double Tax Convention, 17 Dec. 1987, art. 1.
60. Protocol to Italy-Iceland Double Tax Convention, 10 Sept. 2002.
61. Protocol to Italy-Iceland Double Tax Convention, 10 Sept. 2002.
62. IT: art. 1, para. 1(a) Law 342 of 21 Nov. 2000. For a general overview on the Italian CFC rules, *see* G. Maisto, *Il regime di imputazione dei redditi delle imprese estere partecipate, c.d Controlled Foreign Companies,* IV Riv. dir. trib., p. 39 (2000); D. Stevanato, *Controlled Foreign Companies: concetto di controllo ed imputazione del reddito*, I Riv. dir. trib., p. 777 (2000); and R. Cordeiro Guerra, *Le imprese estere controllate e collegate*, in *Imposta sul reddito delle società (IRES)* p. 961 (F. Tesauro ed., Zanichelli 2004).

the so-called jurisdictional approach, meaning that the resident person must include in his tax base his share of all CFC's income.[63]

Originally it applied both to controlled entities (defined by reference to article 2359 of the Civil Code, as entities in which a person holds, directly or indirectly, the majority of the votes at the shareholders' meeting or sufficient votes to exert a decisive influence in the shareholders' meeting, or which are under the dominant influence of another person due to a special contractual relationship)[64] and affiliated ones (that is, entities in which the Italian person holds, directly or indirectly, a profit entitlement exceeding 20%, or 10% in the case of a listed company),[65] provided that they were resident of a state or territory included in a blacklist issued by the Ministry of Finance, taking into account a level of taxation significantly lower than the Italian one (less than 50% of the taxation that would apply in Italy)[66] and the absence of adequate exchange of information with the Italian tax authority.

In 2009,[67] its scope was extended to controlled entities residing in states or territories not included in the blacklist, if (1) they are subject to a taxation that is less than 50% of the one applicable in Italy; and (2) more than 50% of their proceeds qualifies as passive income.

In 2015, the involvement of the affiliated entities in the CFC legislation was abolished[68] together with the blacklist system.[69] Therefore the CFC legislation now applies to all controlled foreign entities, except those resident in EU Member States or in member states of the EEA with which Italy has an agreement that ensures an effective exchange of information, when their nominal level of taxation is less than 50% of the one applicable in Italy.

The application of this rule can be avoided provided that the resident person shows either that (1) the foreign entity predominantly carries on an actual business in the market of the country where it is located;[70] or that (2) the

63. In this regard, *see*, for example, R. Franzé, *Il regime di imputazione dei redditi dei soggetti partecipati residenti o localizzati in paradisi fiscali*, in *Diritto tributario internazionale* p. 929 (V. Uckmar ed., CEDAM 2007).
64. Art. 167 ITC.
65. Art. 168 ITC.
66. The criterion for determining a low-tax jurisdiction has been recently amended by Law 190 of 23 Dec. 2014. As a result, the Philippines, Malaysia and Singapore are no more included in the above list.
67. Art. 13 Law Decree 78 of 1 July 2009.
68. Art. 8, para. 13 Legislative Decree 147 of 14 Sept. 2015.
69. Art. 1, para. 142(b), n. 2, Law 208 of 28 Dec. 2015.
70. On this element, *see* G. Marino, *La nozione di mercato nella disciplina CFC: verso una probatio diabolica?*, I Riv. dir. trib., p. 1113 (2011).

participation in the foreign entity does not achieve the effect of positioning income in a country where the nominal level of taxation is less than 50% of the Italian one.

For entities residing in EU Member States, or in member states of the EEA with which Italy has an agreement that ensures an effective exchange of information, the application of the CFC rules still requires that (1) they are subject to a taxation that is less than 50% of the one applicable in Italy; and (2) more than 50% of their proceeds qualifies as passive income. In this case, it can be avoided provided that the resident person shows that the foreign entity does not amount to a purely artificial construction.

In both cases, the resident person has the possibility of submitting to the tax authority a request for an advance ruling on the applicability of the regime under article 11, paragraph 1(b) of Law 212 of 27 July 2000.

The income of the foreign entity shall be calculated following (with some minor exceptions) the same set of rules that is applicable to resident entities and is taxed at the average rate of the resident taxpayer, but not lower than the corporate income tax rate.

17.3.4. Linking rules

17.3.4.1. Hybrid instruments

Although no specific linking rule has been implemented so far in Italian tax legislation following the recommendation issued in Action 2 of the BEPS Project, Italian legislation contains nevertheless some provisions that could be referred to as “linking rules”.

One of these rules relates to hybrid instruments (instruments that can be classified differently, as equity in Italy and debt in the other country). Article 44, paragraph 2(a), second period, of the ITC[71] provides that:

> participation in the capital or equity, as well as securities and financial instruments… issued by companies and institutions mentioned in Art. 73, par. 1(d), [i.e. non-resident entities] are considered similar to shares on the condition that the related remuneration is fully not deductible for the non-resident issuer in

71. Art. 2, para. 1(a) Legislative Decree 247 of 18 Nov. 2005.

> determining the taxable income in the foreign country of residence; the non-deductibility for this purpose must result from a statement by the issuer itself or by other certain and reliable elements of proof.

Therefore a payment made under one of these instruments is not treated as dividend at the level of the receiving resident taxpayer if the distributing company can deduct fully or partially its amount in its state of residence.

This provision is consistent with the 2014 update of article 4 of the EU Parent-Subsidiary Directive[72] as well as with Action 2 of the OECD BEPS Project, which states that "in order to prevent D/NI outcomes from arising under a financial instrument, a dividend exemption that is provided for relief against economic double taxation should not be granted under domestic law to the extent the dividend payment is deductible by the payer".[73]

17.3.4.2. Dividends and participation exemption

Another rule that aims to counter cross-border mismatches may be found in the provisions dealing with dividends (article 89, paragraph 3 of the ITC) and capital gains stemming from the transfer of certain shares (article 87, paragraph 1(c) of the ITC). Under this rule, the 95% exemption ordinarily granted to these items of income, in order to avoid economic double taxation on them, is not applicable when the participated company is located in a no-tax or low-tax jurisdiction. Indeed, in this case, no economic double taxation, or an insignificant double taxation, occurs.[74]

17.3.4.3. Foreign tax credit

Another linking rule is included in the foreign tax credit (FTC) regime, which is the standard relief method adopted by Italy to avoid international juridical double imposition. Foreign taxes paid on foreign-source income

72. EU: Council Directive, 30 Nov. 2011, 2011/96/EU as amended by Council Directive, 8 July 2014, 2014/86/EU, EU Law IBFD.
73. OECD, *Action 2 2014 Deliverable – Neutralising the Effects of Hybrid Mismatch Arrangements*, International Organizations' Documentation IBFD.
74. For an overview of the Italian PEX regime, *see,* for example, G. Zizzo, *Participation exemption e riorganizzazioni societarie*, Il fisco, p. 4428 (2003); C. Garbarino, *Le plusvalenze esenti*, in *Imposta sul reddito delle società (Ires)*, p. 179 (F. Tesauro ed., Zanichelli 2004); and F. Ghiselli and A. Vicini Ronchetti, *Esenzione dei dividendi e delle plusvalenze derivanti dalla cessione delle partecipazioni*, in *La tassazione delle società nella riforma fiscale*, p. 149 (Il Sole 24 Ore 2004).

are creditable against the tax due in Italy up to an amount equal to the share of the Italian tax attributable to the foreign-source income.

Generally, all foreign taxes are creditable. However, article 165, paragraph 10 provides that “if income earned abroad is partially included in the computation of aggregate income, the foreign tax must be reduced accordingly”. The amount of the foreign taxes creditable is therefore limited when the income is partially exempt in Italy.

In the case of inbound dividends, this limitation has been extensively criticized, since it improperly connects the application of an instrument intended to prevent juridical double taxation (the FTC) to the application of an instrument (the dividend’s exemption) intended to avoid economic double taxation.[75]

17.3.4.4. Linking rules connected with the implementation of EU Directives

Other linking rules derive from the implementation of the EU Parent-Subsidiary Directive[76] and of the EU Interest and Royalties Directive.[77] According to article 27, paragraph 3-ter of the Income Tax Assessment Act (ITAA), dividends and similar income paid by an Italian entity to a foreign person are subject to a withholding tax of 1.375% provided that the recipient is a company or an entity that is (1) subject to corporate income tax and (2) resident in an EU or EEA Member State that allows an adequate exchange of information with the Italian tax authorities.

Similarly, under the domestic law implementing the EU Interest and Royalties Directive[78], outbound interest and royalties are exempt from Italian withholding taxes provided that the recipient is an associated company of the paying company and is resident in another EU Member State or a permanent establishment of such an associated company situated in another EU Member State.

75. *See* A. Contrino, *Contributo allo studio del credito per le imposte estere*, p. 147 (Giappichelli 2012).
76. EU: Council Directive, 30 Nov. 2011, 2011/96/EU, EU Law IBFD, as amended by Council Directive, 8 July 2014, 2014/86/EU, EU Law IBFD.
77. EU: Council Directive, 3 June 2003, 2003/49/EC, EU Law IBFD.
78. Art. 26-quater Presidential Decree 600 of 29 Sept. 1973.

17.3.5. Limits on the deduction of interest

In 2003, thin capitalization rules were inserted in ITC. Under them, if the proportion between debt directly or indirectly connected to qualified shareholdings and equity related to the same shareholdings exceeded 4 to 1, interest on the excess debt was assimilated for fiscal purposes to a dividend. It therefore could not be claimed as a deduction by the paying company and benefited from the dividend's exemption in the hands of the receiving shareholder, unless it could be demonstrated that the excess debt was justifiable on the basis of the arm's length borrowing capacity of the company.

Since these rules applied even when no tax advantages could stem from the excess debt, it could be argued that they did not have (at least, essentially) an anti-avoidance purpose but were meant to characterize correctly the relation between the company and its shareholders. However, they were extremely complex to administer. This led to their sudden abrogation and to the enactment in 2007 of a new and more manageable regime.

Article 96 of the ITC provides that net interest expenses (i.e. passive interest and like payments minus active interest and like proceeds) may be deducted up to 30% of the entity's EBITDA. The EBITDA, for the purposes of such a limitation, is equal to the net value of the production, gross of amortizations and depreciations and lease expenses related to the same assets. Net interest expenses in excess of this amount may be carried forward, without a time limit. Their deduction may be claimed in the year or years in which net interest expenses are lower than the 30% of EBITDA. A similar carry-forward mechanism is provided for the 30% of EBITDA in excess of net interest expenses.

Within the tax consolidation regime, net interest expenses in excess of one company's 30% of EBITDA may be used to offset the taxable income of the fiscal unit, provided that the 30% of EBITDA of another company participating in the unit exceeds its net interest expenses, and up to the amount of this surplus.

The new regime applies regardless not only of the tax advantages connected to the choice of financing the entity through debt instead of through equity, but also regardless of the relation between the financed entity and the financing person. It clearly leaves behind any anti-avoidance concern, in order to foster a more balanced distribution between debt and equity of companies' capitalization. On this basis, these rules look rather irrational insofar as

they apply the same threshold to all companies, regardless of the kind of business they carry on.[79]

17.3.6. Other SAARs

17.3.6.1. SAAR relating to tax losses carry-forward

Article 84, paragraph 1 of the ITC provides that the tax loss of a tax year may be used to offset 80% of the income of each of the subsequent tax years. The 80% threshold does not apply, according to paragraph 2, to the tax losses incurred in the first 3 tax years of activity.

Pursuant to paragraph 3, the carry-forward of the losses is prohibited when (1) there is a change of the shareholding structure of the company, meaning the majority of shares with voting rights is transferred or otherwise acquired by a third party, even temporarily; and (2) in the tax year of the transfer of the shares, in the 2 previous years or in the 2 following ones, the core business changes.

The prohibition does not apply if (1) during the 2 years preceding the tax year in which the transfer of the shares took place, the company has had a number of employees never lower than 10 units; and (2) the income statement of the year preceding the tax year in which the transfer of the shares took place shows an amount of proceeds from the core business and an amount of costs of employment higher than 40% of the average of the amounts of the same items as shown in the income statements of the previous 2 years.

The provision aims at fighting the trade of tax losses, enacted through the acquisition of the ownership of a company in economic crisis for the purpose of pouring a profitable business into it and then using its tax losses to offset the income stemming from this business.

79. For a critical comment, *see* M. Beghin, *La nuova disciplina degli interessi passivi: dagli incentivi alla capitalizzazione (indicati dalla Commissione Biasco) al contrasto al finanziamento (previsto dalla Legge finanziaria per il 2008)*, in *Saggi sulla riforma dell'IRES. Dalla relazione Biasco alla finanziaria 2008*, p. 121 (M. Beghin ed., Giuffré 2008).

17.3.6.2. SAAR relating to loss carry-forward in mergers and demergers

A SAAR also deals with the carry-forward after a merger of the tax losses accrued before it by the companies involved. According to article 172, paragraph 7 of the ITC, the carry-forward of these tax losses is allowed only if the income statement of the loss company regarding the year preceding the one of the merger shows an amount of proceeds from the core business and an amount of costs of employment higher than 40% of the average of the amounts of the same items as shown in the income statements of the previous 2 years. No minimum amount is required, meaning that this requirement targets companies in economic crisis more than "empty boxes".

If this condition is fulfilled, the tax losses may be used after the merger, but up to an amount equal to the value of the loss company's net assets, as it is shown in its last balance sheet, net of the amount of capital contributions performed in the last 24 months. Indeed, through these contributions, the net assets of the company could be easily inflated before the merger just to avoid incurring the restriction described.

Since there is no need for a change in the ownership of the loss company before the merger, the scope of this provision looks broader than the prevention of the trade of tax losses. It just deals with the combination of the tax losses of a company in economic crisis with the taxable income of a profitable one, through the merger of the two. Along these lines, it seems that the first condition has the purpose to strike transactions that, due to the economic situation of the loss company, presumably lack business reasons, while the intention of the second is to ensure some kind of link between the carry-forward of the tax losses and the economics of the organization that accrued them.

According to article 173, paragraph 10 of the ITC, the same restrictions apply in demergers to the beneficiary company, but only when it is a pre-existing company. Indeed, when the beneficiary is a new company (that is, established through the demerger), no combination of the tax losses of a company with the taxable income of another company occurs.[80]

80. *See* IT: Tax Authority, circular letter, 9 Mar. 2010, 9/E.

17.3.6.3. SAAR relating to dividend washing transactions

According to article 109, paragraph 3-bis of the ITC, in the case of a transfer of shares or like kind investments, if certain conditions are met, the deduction of the capital loss or of the current loss is prohibited up to an amount equal to the one of the exempt part of the dividends received, in relation to the shares transferred, during the 36-month period preceding the transaction.

The provision links the deduction of these losses to the treatment of the dividends received, on the assumption that the losses on the transfer of the shares derive from the payment of the dividends. It has therefore the purpose to avoid exempt dividends from turning into deductible losses, allowing the taxpayer to shelter from taxation income from other sources.

A similar rule, with the same underlying logic, may be found in article 109, paragraph 8. Indeed, this provision disallows the deduction of the costs incurred in acquiring the usufruct of shares when the related dividends are exempt pursuant to article 89 of the ITC.

17.3.6.4. SAARs included in Italian DTCs

Italian DTCs often include SAARs. The most famous of them is the beneficial owner (BO) clause, dealing with dividends, interests and royalties. It can be classified under the so-called look-through approach,[81] since it denies the treaty benefits granted by the source state if the taxpayer residing in the other contracting state is not the beneficial owner of the income.

The BO clause is included in almost all Italian DTCs, although its content is not uniform. For instance, in the DTC between Italy and Mexico, for the application of the BO clause to interests and royalties, it is required that the avoidance purpose be exclusive.[82] In the DTC with the United States, the BO clause goes beyond its traditional boundaries, covering also other

81. For an inquiry into the significance of the concept of "beneficial owner", *see* A. Ballancin, *La nozione di beneficiario effettivo nelle convenzioni contro le doppie imposizioni e nell'ordinamento tributario italiano*, Rass. Trib., p. 209 (2006); R. Lupi, *La clausola dell'effettivo beneficiario e il „Treaty shopping"*, in *Il diritto tributario nei rapporti internazionali*, p. 86 (L. Carpentieri et al. eds., Il Sole 24 ore 2003); and C. Perrone, *Brevi note sul significato convenzionale del concetto di beneficiario effettivo*, Rass. Trib., p. 151 (2003).

82. Italy-Mexico Double Tax Convention, 8 July 1991, art. 11, para. 8 and art. 12, para. 8.

items of income.[83] The same happens in the treaties with India,[84] Uganda[85] and Ghana,[86] where the BO clause applies also to the remuneration for technical services, and the treaty with Romania,[87] where it applies also to commissions.

Few DTCs signed by Italy define the beneficial owner. The DTC with Germany[88], for example, provides that:

> the recipient of the dividends, interest and royalties is the beneficial owner within the meaning of Articles 10, 11 and 12 if he is entitled to the right upon which the payments are based and the income derived therefrom is attributable to him under the tax laws of both States.

Among other SAARs, article 10, paragraph 5 of the DTC with the United Kingdom[89] should be mentioned, which grants tax credit on dividends provided that:

> the recipient of a dividend shows (if required to do so by the competent authority of the United Kingdom or Italy respectively on receipt of a claim by the recipient to have the tax credit set against United Kingdom or Italian income tax respectively chargeable on him or to have the excess of the credit over that income tax paid to him) that the shareholding in respect of which the dividend was paid was acquired by the recipient for bona fide commercial reasons or in the ordinary course of making or managing investments and it was not the main object nor one of the main objects of that acquisition to obtain entitlement to the tax credit referred to in sub-paragraph (b) or sub-paragraph (c) of paragraph 3 or in sub-paragraph (a) or sub-paragraph (b) of paragraph 4 of this Article, as the case may be.

Article 13, paragraph 4 of the OECD MTC is also worth noting, which attributes the power to tax to the source state in respect to:

> gains derived by a resident of a Contracting State from the alienation of shares deriving more than 50 per cent of their value directly or indirectly from immovable property situated in the other Contracting State.

83. Italy-United States Double Tax Convention, 25 Aug. 1999, art. 22, para. 3.
84. Italy-India Double Tax Convention, 19 Feb. 1993, art. 13, para. 2.
85. Italy-Uganda Double Tax Convention, 6 Oct. 2000, art. 13, para. 2.
86. Italy-Ghana Double Tax Convention, 19 Feb. 2004, art. 13, para. 2.
87. Italy-Romania Double Tax Convention, 14 Jan. 1977, art. 13, para. 2.
88. Protocol to Italy-Germany Double Tax Convention, 18 Oct. 1989.
89. Italy-United Kingdom Double Tax Convention, 21 Oct. 1988, art. 10, para. 5.

A similar provision is included in the DTCs with Canada,[90] Philippines,[91] Pakistan,[92] Estonia,[93] Ukraine,[94] Azerbaijan,[95] Ghana,[96] China,[97] Mexico,[98] India,[99] Israel,[100] Australia,[101] United States[102] and Finland.[103]

Another SAAR, which follows the look-through approach and is extensively used in Italian DTCs, may be found in article 17, paragraph 2 of the OECD MTC, whose purpose is to counter the diversion of the remuneration for the performances of entertainers or athletes to the so-called star companies. According to this provision, notwithstanding articles 7 and 15, the remuneration may be taxed in the contracting state in which the activities of the entertainers or athletes are exercised.

Many Italian DTCs explicitly recognize the applicability of domestic SAARs to cases arising in international context. This clause provided under article 24 of the OECD MTC, is included in the tax treaty with United Arab Emirates,[104] Armenia,[105] Qatar[106] and Jordan.[107] Similar provisions, although differently worded, are contained in the conventions with Macedonia,[108] Russia,[109] Vietnam,[110] Ukraine,[111] Azerbaijan,[112] Moldova,[113]

90. Italy-Canada Double Tax Convention, 3 June 2002, art. 13, para. 4.
91. Italy-Philippines Double Tax Convention, 5 Dec. 1980, art. 13, para. 3.
92. Italy-Pakistan Double Tax Convention, 22 June 1984, art. 13, para. 3.
93. Italy-Estonia Double Tax Convention, 20 Mar. 1997, art. 13, para. 1.
94. Italy-Ukraine Double Tax Convention, 27 Feb. 1997, art. 13, para. 2.
95. Italy-Azerbaijan Double Tax Convention, 21 July 2004, art. 13, para. 3.
96. Italy-Ghana Double Tax Convention, 19 Feb. 2004, art. 14, para. 4.
97. Italy-China Double Tax Convention, 14 Jan. 2013, art. 13, para. 4.
98. Italy-Mexico Double Tax Convention, 8 July 1991, art. 13, para. 2.
99. Italy-India Double Tax Convention, 19 Feb. 1993, art. 14, para. 4.
100. Italy-Israel Double Tax Convention, 8 Sept. 1995, art. 13, para. 4.
101. Italy-Australia Double Tax Convention, 14 Dec. 1982, art. 13, para. 2.
102. Italy-United States Double Tax Convention, 25 Aug. 1999, art. 13, para. 1.
103. Italy-Finland Double Tax Convention, 12 June 1981, art. 13, para. 2.
104. Italy-United Arab Emirates Double Tax Convention, 22 Jan. 1995, art. 24, para. 6.
105. Italy-Armenia Double Tax Convention, 14 June 2002, art. 25, para. 6.
106. Italy-Qatar Double Tax Convention, 15 Oct. 2002, art. 24, para. 6.
107. Italy-Jordan Double Tax Convention, 16 Mar. 2004, art. 24, para. 6.
108. Italy-Macedonia Double Tax Convention, 20 Dec. 1996, art. 25, para. 5.
109. Protocol to Italy-Russia Double Tax Convention, 9 Apr. 1996.
110. Italy-Vietnam Double Tax Convention, 26 Nov. 1996, art. 24, para. 5.
111. Protocol to Italy-Ukraine Double Tax Convention, 16 Feb. 1997.
112. Italy-Azerbaijan Double Tax Convention, 21 July 2004, art. 25, para 6.
113. Italy-Moldova Double Tax Convention, 3 July 2002, art. 25, para. 7.

Belarus,[114] Ethiopia,[115] Oman,[116] Croatia,[117] Georgia,[118] Uzbekistan,[119] Ghana,[120] Uganda,[121] Saudi Arabia[122] and Iceland.[123] Among the most relevant domestic anti-avoidance provisions recalled by this clause, what stand out are the rule that limits the possibility to deduct certain items of expenses,[124] the thin-capitalization rule, which qualifies certain passive interests as dividends for tax purposes,[125] or even domestic CFC rules.[126]

17.4. Application of GAARs, TP rules and SAARs

17.4.1. Interaction between GAAR, TP rules and SAARs

Although the GAAR and SAARs share the same purpose, namely to oppose tax avoidance practices, they work on two distinct levels. SAARs, with the objective of safeguarding the effectiveness of the obligations and prohibitions that compose the set of obligations and prohibitions that regulate the determination of the tax base and of the tax, create new obligations and new prohibitions, expanding this set. The GAAR is outside it, empowering the tax authority to disregard the ordinary regime of the transaction carried out in order to remove the tax advantages stemming from it.

These rules do not therefore clash.[127] The application of a SAAR does not exclude the application of the GAAR. When the taxpayer fulfils all the conditions foreseen by a SAAR to enjoy a tax benefit, the assumption should be that the enjoyment of the benefit is consistent with the purpose of the provisions that establish it, so the GAAR cannot apply. Indeed, it would be

114. Protocol to Italy-Belarus Double Tax Convention, 11 Aug. 2005.
115. Italy-Ethiopia Double Tax Convention, 8 Apr. 1997, art. 24, para. 6.
116. Italy-Oman Double Tax Convention, 6 May 1998, art. 24, para. 6.
117. Italy-Croatia Double Tax Convention, 20 Oct. 1999, art. 24, para. 6.
118. Italy-Georgia Double Tax Convention, 31 Oct. 2000, art. 25, para. 6.
119. Italy-Uzbekistan Double Tax Convention, 21 Nov. 2000, art. 24, para. 6.
120. Italy-Ghana Double Tax Convention, 19 Feb. 2004, art. 25, para. 6.
121. Italy-Uganda Double Tax Convention, 6 Oct. 2000, art. 25, para. 6.
122. Italy-Saudi Arabia Double Tax Convention, 13 Jan. 2007, art. 29, para. 1.
123. Protocol to Italy-Iceland Double Tax Convention, 10 Sept. 2002.
124. Art. 110, paras. 10-12, ITC.
125. Art. 96 ITC.
126. Art. 167 ITC.
127. G. Zizzo, *Prime considerazioni sulla nuova disciplina antielusione*, in *Commenti agli interventi di riforma tributaria*, p. 435 (M. Miccinesi ed., CEDAM 1999); S. La Rosa, *Ancora sugli incerti confini tra abuso del diritto, elusione ed illecito fiscale*, II Riv. dir. trib., p. 353 (2012); S. La Rosa, *Nozione e limiti delle norme antielusione analitiche*, Corr. Trib., p. 3092 (2006); and P. Laroma Jezzi, *Il riporto delle perdite pregresse tra norme antielusive "speciali" e "generali"*, Rass. Trib., p. 200 (2002).

clearly in conflict with the logic underlying the choice of a SAAR to oppose tax avoidance practices, that is, certainty and predictability, to allow a systematic review of the outcome of its application in the light of the GAAR. However, the possibility cannot be ruled out that the obligations or prohibitions whose purpose is defeated are not (at least, directly) those safeguarded by the SAAR, but precisely those provided for by it. If this is the case, the GAAR should become applicable.

In the Italian tax system, the GAAR acts not only as a closing rule, intended to strike those avoidance practices that are outside the scope of SAARs, it also works as a guideline in the application of SAARs.

SAARs have two main shortcomings.[128] The first is connected with the risk of under-coverage, namely the risk of not catching all abusive practices carried out by taxpayers. This shortcoming can be overcome by coupling SAARs with a GAAR. The second is connected with the risk of over-coverage, namely the risk of catching, beside the targeted abusive practices, transactions that do not belong to the area of tax avoidance. To remove this risk, the Italian system allows taxpayers to disregard (certain) SAARs, when it can be shown, in the light of the circumstances of the specific case and of the definition of abuse provided by the GAAR, that the abusive effects that these provisions oppose cannot actually occur.

As pointed out in section 17.3.1., case law assigns to TP rules a scope broader than mere anti-avoidance. On this basis, their relation with the GAAR does not differ from the one that this latter rule has with any other rule regarding the determination of the tax base.

17.4.2. Procedural rules relating to GAAR and SAARs

Under article 11, paragraph 2 of Law 212 of 27 July 2000, taxpayers are allowed to disregard SAARs that "limit deductions, reliefs, tax credits or other subjective positions otherwise permitted by tax system", when it can be shown that the abusive effects that these provisions oppose cannot actually occur.[129] To this end, taxpayers shall request an advance ruling. Under article 11, paragraph 1(c), taxpayers may also request an advance ruling on

128. G. Zizzo, *Elusione ed evasione tributaria*, in *Dizionario di diritto pubblico*, p. 2173 (S. Cassese, Giuffrè 2006).
129. F. Pistolesi, *Gli interpelli tributari*, p. 97 (Giuffré 2007); and G. Fransoni, *Efficacia e impugnabilità degli interpelli fiscali con particolare riguardo all'interpello disapplicativo*, in *Elusione ed abuso del diritto tributario,* p. 77 (G. Maisto, Giuffré 2009).

the application of the GAAR to a specific arrangement or series of arrangements.

In the first case, taxpayers have a duty to submit the request, although failure to file the request does not prevent them from disregarding the above-mentioned SAARs, but it is punished with an administrative penalty.[130] In the second case, they just have a right that they may exercise in order to restrict the level of uncertainty connected to the presence of the GAAR. In both cases, the tax authority has 120 days to issue the ruling. If the term expires and no ruling has been issued, the ruling is deemed in favour of the taxpayer.

Rulings (or deemed rulings) are binding to the tax authority, though only in relation to its object and to the taxpayer who filed the request. On the other hand, taxpayers are not bound to them.

In applying the GAAR, the tax authority shall follow a specific procedure. Firstly, it shall deliver to the taxpayer a summons describing the reasons why it considers a certain arrangement or series of arrangement abusive and requesting him to file, within 60 days, a written statement on the topic.[131] More in detail, since according to article 10-bis, paragraph 9, the burden of proof of the abusive nature of the arrangement or series of arrangements lies on the tax authority, the summons shall describe the reasons why, in the tax authority's opinion, (1) the arrangement or series of arrangement lacks economic substance; and (2) the tax advantages are undue.

Secondly, if the taxpayer files the statement, arguing that (one or both of) those elements were absent or that there were sound non-tax reasons for entering into the arrangement or series of arrangements, when drafting the grounds of the notice of assessment, the tax authority shall specifically address these arguments, explaining the reasons why they were not

130. *See* art. 10, para. 7-ter Legislative Decree 471 of 18 Dec. 1997, according to which a penalty between EUR 2,000 and EUR 21,000 applies. The penalty is doubled if it is established that the conditions for disregarding the SAAR were lacking.

131. On this procedure, although in relation with art. 37-bis Presidential Decree 600/1973, *see* IT: Cost. Ct., 15 July 2015, 132 commented by G. Ragucci, *Il principio del contraddittorio nella giurisprudenza della Corte Costituzionale*, Rass. Trib., p. 1217 (2015), by G. Marongiu, *Una stella cometa a guida dell'abuso da "diritto vivente"*, Rass. Trib., p. 1213 (2015), and by F. Tundo, *La Corte costituzionale sulla nullità dell'accertamento "antielusivo" anticipato*, Corr. Trib., p. 2670 (2015); IT: Sup. Ct., sec. V, 14 Jan. 2015, 406. *See also* IT: Sup. Ct., sec. V, 12 Jan. 2009, 351 commented by F. Tundo, *Richiesta di chiarimenti ex Art. 37-bis, commi 4 e 5, del D.P.R. 29 settembre 1973, n. 600: inscindibilità di ratio e forma*, Rass. Trib., p. 1190 (2009); and L. Salvini, *La "nuova" partecipazione del contribuente dalla richiesta di chiarimenti allo statuto del contribuente e oltre*, I Riv. dir. trib., p. 20 (2000).

accepted. If the tax authority does not comply with these procedural rules, the notice is void.

17.4.3. Procedural rules relating to TP rules

17.4.3.1. Advance pricing agreements (APAs)

Special methods are available for taxpayers in order to settle upward TP adjustments. To begin with, taxpayers may conclude an advance TP agreement (APA) with the tax authorities (the "international ruling").

The advance TP agreement represents a useful instrument to avoid both double taxation issues and possible subsequent disputes between the tax authorities and the taxpayer. It was introduced by article 8 of Law Decree 269 of 30 September 2003,[132] and it has been extensively amended by Legislative Decree 147/2015.[133] The relevant provisions can now be found under the newly enacted article 31-ter of Presidential Decree 600/1973.

The APA procedure starts with a request by the taxpayer and it ends with an agreement between the taxpayer and the tax authority. Such an agreement is binding for the tax period in which the agreement has been entered and for the four subsequent periods, unless changes occur in the relevant factual or legal circumstances.

17.4.3.2. Mutual agreement procedure

Taxpayers also have the possibility to initiate a mutual agreement procedure (MAP) either under the DTCs concluded by Italy or under the EU Arbitration Convention of 23 July 1990. Detailed regulations on both MAPs are contained in circular letter 21/E, of 5 June 2012. To initiate a MAP, a

132. In the *Second Report on the International Standard Ruling Procedure*, issued 19 Mar.2013, the tax authority indicated that, since 2004, there had been 135 APA requests, 56 of which have been positively concluded. For details, *see* G. Peracin and S. Benettin, *Tax Administration Releases Data on International Standard Ruling Procedures and First International Advance Pricing Agreements*, 20 International Transfer Pricing Rules 4, p. 287 (2013) Journals IBFD.
133. For an overview, *see* G. Gaffuri, *Il ruling internazionale*, Rass. Trib., p. 488 (2004); P. Adoninno, *Considerazioni in tema di ruling internazionale*, IV Riv. dir. trib., p. 68 (2004); and C. Romano, *Il ruling internazionale*, in *Imposta sul reddito delle società (Ires)* p. 990 (F. Tesauro, Zanichelli 2007).

resident taxpayer shall file a request, within a precise time limit, to the Ministry of Economy and Finance.

Most Italian DTCs require the case to be brought before the domestic courts before the initiation of a MAP (*see*, for instance, the treaties with Belgium,[134] Russia[135] and Sweden[136]). Other treaties do not consider this mandatory, but they recommended it (for example, the treaties with Austria,[137] Switzerland[138] and Hungary[139]). Moreover, some DTCs (for example, those with Kazakhstan[140] and Austria[141]) include an arbitration clause, according to which the contracting states may devolve the decision to the Arbitration Court if they are not able to reach consensus on the matter. Devolution to arbitration is allowed only with the consent of the states and with that of the taxpayer, who must confirm that he is willing to be bound by the arbitrators' decision. Furthermore, it should be noted that, if a MAP is commenced, the Ministry may suspend the collection of the taxes challenged by the tax authorities until the procedure is concluded.[142]

The scope of the EU Arbitration Convention of 1990 is limited to TP issues among EU Member States.[143]

The procedure under the Arbitration Convention may involve two stages. In the first, a standard MAP is set forth. In the second, which takes place if the competent authorities do not reach an agreement under the MAP, an arbitration commission before which the taxpayer has the right to provide any useful information, evidence or data, for the final definition of the procedure is set up. The competent authorities are compelled to take a decision in order to eliminate the double taxation within a timespan of 6 months from the date

134. Italy-Belgium Double Tax Convention, 29 Apr. 1983, 148, art. 25, para. 1.
135. Italy-Russia Double Tax Convention, 9 Apr. 1996, art. 26, para. 4.
136. Italy- Sweden Double Tax Convention, 6 Mar. 1980, 439, art. 26, para. 1.
137. Italy-Austria Double Tax Convention, 29 June 1981, 762, art. 25, para. 1
138. Italy-Switzerland Double Tax Convention, 9 Mar. 1976, art. 26, para. 1.
139. Italy-Hungary Double Tax Convention, 16 May 1977, art. 26, para. 1.
140. Italy-Kazakhstan Double Tax Convention, 22 Sept. 1994, art. 25, para. 4.
141. Italy-Austria Double Tax Convention, 18 Oct. 1984, art. 25, para. 4.
142. IT: Ministry of Finance, Decree of 28 Feb. 2014, art. 5, implementing Legislative Decree 149 of 14 Aug. 2012.
143. EU: Convention 90/436/EEC, 23 July 1990, on the elimination of double taxation in connection with the adjustment of profits of the associated enterprises, EU Law IBFD. For an overview from an Italian perspective, *see* P. Adonnino, *Some Thoughts on the EC Arbitration Convention*, 43 European Taxation 11, p. 403 (2003), Journals IBFD; P. Adonnino, *La Convenzione europea 90/436 sulla cosiddetta procedura arbitrale. Limiti e problemi*, I Riv. dir. trib., p. 1211 (2002); and C. Garbarino and G. Comi, *Mutual agreement procedure: la Convenzione Arbitrale europea sul TP*, Fiscalità e commercio internazionale 8/9, p. 5 (2012).

on which the commission delivers its opinion. If they reach an agreement, this decision may deviate from the commission's opinion.

Regarding the initiation of the MAP, in a recent decision, the Joint Chambers of the Supreme Court recognized the right of taxpayers to appeal before the tax courts the denial issued by the competent authority following a request for opening a MAP under the Arbitration Convention.[144]

144. IT: Sup. Ct., sec. V, 19 June 2015, 12760.

Chapter 18

Luxembourg

Werner Haslehner

18.1. The meaning of avoidance, abuse and aggressive tax planning

Tax avoidance is not defined in Luxembourg's legal system. There is even some difficulty in pinpointing the proper translation of the term in its doctrine; this is only partly due to the multilingualism of Luxembourg's legal sources. In French, the predominant language of substantive tax laws as well as the language used in court, tax avoidance is commonly translated as *évasion fiscale*, although it can sometimes be equated instead with *évitement fiscal*.[1] Also, several of Luxembourg's tax treaties refer to *évasion fiscale* in their French language version where they use "fiscal evasion" in the English language version, although the same English term is at times translated as *fraude fiscale*.[2] Neither term is used in Luxembourg's income tax code, however, which makes no direct reference to tax avoidance. Despite this inconsistency and lack of clarity, particularly in the context of tax treaties, it seems that *évasion fiscale* is used consistently in legal writing in Luxembourg to refer to tax avoidance and understood to be its equivalent.

The relevant German term, *Steuerumgehung*, has been indirectly defined in Luxembourg's general anti-avoidance rule (GAAR), sec. 6 of the StAnpG,[3] which codifies the general concept of *abus de droit* in the context of taxation. In its first paragraph, this provision states "[t]ax liability can neither be circumvented nor reduced by an abuse of arrangements provided for in private law".[4] The provision thus relates to the circumvention of a tax liability, which is a form of tax avoidance (if not necessarily fully congruent with it from a more general perspective),[5] and confines its legal relevance to abusive circumstances. If the term "tax avoidance" should have any legal relevance under Luxembourg's legal regime, it therefore has to be confined

1. For further background, *see* the French National Report.
2. *See*, for example, the Luxembourg-US DTC (1996) and Luxembourg-Hong Kong DTC (2007).
3. *Steueranpassungesetz* [Tax Adaptation Bill] of 16 October 1934.
4. In the original German: "*Durch Missbrauch von Formen und Gestaltungsmöglichkeiten des bürgerlichen Rechts kann die Steuerpflicht nicht umgangen oder gemindert werden.*"
5. *See* sec. 18.2.1.2.

to circumstances in which the conditions of an abusive arrangement are fulfilled. It can therefore be argued that tax avoidance can never legally exist, if the term is appropriate only for arrangements that are covered by sec. 6 of the StAnpG: as that provision results in ignoring those arrangements and replacing them with an appropriate alternative legal structure, to which the appropriate tax consequences are applied, any instance of (attempted) tax avoidance would been doomed to fail (and any successful "avoidance" of tax liability should not be called tax avoidance in a legal sense).

The term "abuse" is not defined in Luxembourg's tax statutes; rather, it has been left for the courts to be filled with meaning.[6] It is not surprising, therefore, that tax jurisprudence, has long been concerned with its meaning. It is a long-accepted general principle in Luxembourg jurisprudence, going back to the late 19th century,[7] that taxpayers are in principle free to choose whatever structure they deem most appropriate and least onerous from a tax perspective.[8] The limits to that freedom imposed by sec. 6 of the StAnpG are at the heart of all relevant tax disputes in the area and have evolved significantly over the course of the last 50 years. In its early case law, the highest administrative court had effectively equated cases covered by the GAAR with sham transactions (DE: *Scheingeschäfte*, FR: *simulation*) and thus required a very high threshold of "pretended transactions" to trigger its consequences.[9] This has been deemed inappropriate for two

6. This is despite the fact that Luxembourg's GAAR is based on old German law, which contained a definition of abuse in sec. 5(2) *Reichsabgabenordnung*, and reintroduced a (different) definition in 2008 in sec. 42 *Abgabenordnung*. Luxembourg's sec. 6 *Steueranpassungsgesetz* dating from 1934 (imposed by Germany during Luxembourg's occupation and later adopted by Luxembourg's parliament) does not include a definition. *See* J.-P. Winandy, *Fraude à la loi et abus de droit en droit fiscal luxembourgeois, Annales du droit luxembourgeois* (2001) p. 349 (p. 395).

7. *See* Cour Supérieure de Justice of Luxembourg 8 July 1892, Pas. 3, p. 353 ("*Printz*"): "*… il … est vrai, en effet, que les parties peuvent choisir entre les différents modes de conventions celui qui, par rapport à l'application des lois fiscales, est le moins frayeux*" ("… it is certainly true that the parties may choose among the different forms of agreements that which is the least frightening with respect to the application of tax laws"); to the same effect, Cour Supérieure de Justice of Luxembourg, 5 May 1883, Pas. 3, p. 154. (both cited after A. Steichen, *Manuel de droit fiscal* (5e édition (Luxembourg 2015), p. 261.)

8. The leading case related to modern income tax is Conseil d'État (CE) 9 January 1963, N°5677 ("*Hélios*"): "*… en principe le contribuable est entièrement libre de choisir, pour l'exploitation de son entreprise, la forme qui lui semble la plus appropriée et la moins onéreuse au point de vue fiscal*" ("… in principle, the taxpayer is completely free to choose, within the course of his business, any form that seems to him the most appropriate and the least burdensome from a tax perspective").

9. Conseil d'État (CE) 9 January 1963, no. 5677 ("*Hélios*"): "*… la liberté du choix des formes et des conventions se heurte cependant aux prescriptions de la loi fiscale à partir du moment où la forme choisie ou le contenu apparent des conventions ne correspond*

reasons: on the one hand, Luxembourg's law contains a separate provision that explicitly covers such situations and imposes somewhat different legal consequences (*see* sec. 5 of the StAnpG).[10] On the other hand, the notion of abuse of legal forms and agreements requires the (legal) existence of such; where an act is not based on real intentions, it is legally void and therefore cannot be abused for tax purposes.[11]

Academic literature has also not settled on a uniform definition of abuse with respect to taxation.[12] In particular, there is disagreement as to the legal force of the concept of abuse outside the scope of application of sec. 6 of the StAnpG, and especially with regard to indirect taxation.[13] This appears to stem from the different doctrinal traditions in the most influential legal systems for Luxembourg, the French on the one hand and the German on the other.[14] It has been accepted by the Supreme Administrative Court, however, that the provision emanates from the economic conception of tax law, which might indicate a broader scope of application.[15]

The concept of abuse and its scope are not much discussed in Luxembourg's jurisprudence, which instead focuses on the concrete question of the applicability of sec. 6 of the StAnpG. In this regard, the courts have moved away from the earlier, somewhat confusing and restrictive notion that conflated abuse with sham transactions, which seems to stem from a similar conflation

pas aux objectifs réellement visés par les intéressés" ("… however, the freedom of choice of [legal] forms and agreements comes up against the requirements of tax law where the chosen form or the apparent content of the agreements do not reflect the real objectives of the interested parties").

10. *See* K. Köszeghy, *Addressing 'Abuse' in Luxembourg's Tax Law with a New GAAR* (Doctoral Dissertation, 2014), p. 26.

11. *See* A. Steichen, *Manuel de droit fiscal* (5th edition, Saint Paul, 2015), p. 264.

12. For a review of the criteria brought forward, *see* K. Köszeghy, *Addressing 'Abuse' in Luxembourg's Tax Law with a New GAAR* (Doctoral Dissertation, 2014), pp. 126-128.

13. *See* A. Steichen, *Manuel de droit fiscal* (5th edition, Saint Paul, 2015), p. 264 in favour of the existence of a general principle of *abus de droit/fraude à la loi*; also J. Schaffner, *Droit Fiscal International* (2nd edition, Editions promoculture 2005), p. 644; for the opposing view, *see* J.-P. Winandy, *Fraude à la loi et abus de droit en droit fiscal luxembourgeois, Annales du droit luxembourgeois* (2001), p. 349 (p. 435). Winandy maintains that the *Abgabenordnung* and thus the GAAR are applicable to VAT, however – which significantly reduces the practical importance of the different views.

14. For a review of these positions and their background, *see* K. Köszeghy, *Addressing 'Abuse' in Luxembourg's Tax Law with a New GAAR* (Doctoral Dissertation, 2014), pp. 144-148.

15. Cour Adm. 18 March 2014, no. 33125C; Cour Administrative (Cour Adm.) 18 March 2014, no. 32984C.

in French case law,[16] and has now settled on four distinct criteria for its application.[17] The four criteria are:
(1) the use of forms and institutions of private law;
(2) a reduction in tax payable;
(3) the use of an "inappropriate path"; and
(4) the absence of valid non-tax reasons capable of justifying the use of the chosen path.

Recent years have shown an increase in the number of judgments in the area, so that this scope of application can be considered fairly settled,[18] although several questions still remain. It is notable that Luxembourg case law has thus far not adopted the notion of "wholly artificial" arrangements in its interpretation and application of the anti-abuse doctrine.[19] Nonetheless, the four criteria can be effectively pooled in the division between "objective" and "subjective" elements that is familiar from the case law of the European Court of Justice (ECJ), whereby the reduction in tax and the use of an inappropriate path are tantamount to the former (i.e. conduct of the taxpayer that fulfils formal conditions of the law while defeating the purpose of the relevant legislation), and the absence of valid non-tax reasons for the taxpayer's conduct is equivalent to the latter (i.e. an intention to circumvent/abuse the law).[20]

It should be noted that instances of what might be considered "tax avoidance" can also be resolved outside the scope of any special anti-avoidance legislation, purely on the basis of a purposive construction of the relevant tax provisions that takes the purpose of the legislator seriously. In a recent example of that approach, the Supreme Administrative Court (*Cour administrative*) denied the benefits of Luxembourg's patent box rule by reference to an interpretation of the beneficial provision in line with its legislative purpose without any reference to sec. 6 of the StAnpG, holding that the

16. K. Köszeghy, *Addressing 'Abuse' in Luxembourg's Tax Law with a New GAAR* (Doctoral Dissertation, 2014), pp. 132-146.
17. E.g. Trib. Adm., 27 June 2013, no. 30540 and Tribunal Administratif (Trib. Adm.), 23 July 2015, no. 34419.
18. E.g. Cour Adm. 18 March 2014, no. 33125C; Cour Adm. 18 March 2014, no. 32984C; Trib. Adm. 14 January 2015, no. 33678; Cour Adm. 16 February 2016, no. 35978C; Cour Adm. 16 February 2016, no. 35979C.
19. *See* O. Hoor, *Le Luxembourg au sein de la planification fiscale internationale: L'importance de la substance et des conditions de libre concurrence*, *Les Cahiers du Droit Luxembourgeois* (2013), p. 17.
20. For a more detailed discussion of the various elements, *see* sec. 18.2.1.

(partial) exemption was intended only for royalties paid in exchange for an effective use of intellectual property, following verified economic reality.[21]

In many circumstances, the principle of economic ownership (*wirtschaftlicher Eigentümer*) enshrined in Luxembourg's tax code[22] with respect to the attribution of income to persons other than the titleholder under civil law can be relevant to resolve attempted tax avoidance schemes, although this appears to be invoked only rarely by the tax administration.[23] In addition, Luxembourg doctrine also recognizes tax law to be based on the principle of economic substance, which allows the recharacterization of legal arrangements in line with their economic substance without the need to prove "abuse".[24]

So far, the tax administration has not issued any general guidance on the meaning of abuse or the application of the GAAR by way of an administrative regulation or *circulaire*,[25] leaving taxpayers to determine the limits to acceptable tax planning themselves, based on case law and legal advice. A commonly used practice to restore legal certainty in the absence of public guidance is for taxpayers to seek clarification on their tax position from the tax office through an advance tax decision (so-called "ruling"). If the tax administration confirms the tax treatment of a clearly described factual and legal arrangement, it cannot later claim such an arrangement to be treated differently on the basis of the GAAR.[26]

> Luxembourg's tax ruling practice used to be based only on the general principle of good faith, according to which the taxpayer could rely on an answer provided from the competent tax office to a question submitted in writing, if it was based

21. Cour Adm. 30 July 2014, no. 33148C. *See* F. Castellani, S. Richard and A.-S. Le Bris, *La Notion d'abus de droit en matière fiscale: analyse d'arrêts de jurisprudence récente des jurisdictions administratives luxembourgeoises, ACE Comptabilité, fiscalité, audit, droit des affaires au Luxembourg* (2015), pp. 12-19 (p. 17).
22. Sec. 11 StAnpG.
23. For a recent example, also concerning the IP box regime, *see* Cour Adm. 25 February 2016, no. 36612C. *See further* S. Biewer and B. Höfer, *Luxembourg Branch Report, Tax treaties and tax avoidance: application of anti-avoidance provisions*, IFA 95a (2010), pp. 487-507 (p. 490).
24. *See* S. Biewer and B. Höfer, *Luxembourg Branch Report, Tax treaties and tax avoidance: application of anti-avoidance provisions*, IFA 95a (2010), pp. 487-507 (p. 490), citing H. Dostert, *Impôts au Grand-Duché du Luxembourg*, Etudes Fiscales, nos. 50/51 (1976), p. 16. *See also* A. Steichen, *Précis de droit fiscal de l'entreprise* (éditions Saint Paul, 2013), p. 24.
25. Specific guidance has been provided for certain circumstances, e.g. the application of sec. 6 StAnpG to the acquisition of losses (*Mantelkauf*): Circ. of 2 September 2010, LIR no. 114/2 following Cour Adm. 15 July 2010, no. 25957C.
26. Trib. Adm. 16 December 2015, no. 35489; confirmed by Cour Adm. 12 July 2016, no. 37448C; Trib. Adm. 23 May 2016, no. 35703.

on sufficiently clear information, given without restrictions or reservations and had an impact on the taxpayer's tax arrangements.[27] Following the "Lux Leaks" scandal, this long-standing ruling practice was formalized with effect from January 2015, by inserting a new article within the Luxembourg general tax law setting out the general conditions for a binding advance tax decision:[28] In particular, it specifies that such decision is valid for five years at most, and does not bind the tax administration if it was based on incomplete information, the actual facts deviated from those described in the request or in case of changes of national, international or EU law. Further procedural details are featured in a Grand-Ducal regulation, which institutes a tax ruling commission in charge of reviewing the requests received by the Luxembourg tax authorities in order to achieve coherence of decisions taken by individual tax officers.[29]

18.2. The reaction to avoidance and aggressive tax planning in the BEPS context

18.2.1. The domestic general anti-avoidance rule: Sec. 6 of the StAnpG

Luxembourg addresses tax avoidance primarily through the measure of sec. 6 of the StAnpG, which states:

> (1) Tax liability can neither be circumvented nor reduced by an abuse of arrangements provided for in private law.
>
> (2) In case of such abuse, taxes are to be levied as they would be in case of a legal arrangement that is appropriate for the economic transactions, facts and circumstances.[30]

While the wording of the provision has not been substantially changed since its inception, the concrete criteria for its application have only been clarified in recent years through case law of Luxembourg's administrative courts. In particular, and despite the historical background of the provision,

27. A. Steichen, *Manuel de droit fiscal* (2006), p. 552. *See further* Cour Adm. 27 July 2011, no. 28115C.
28. Luxembourg general tax law, *Abgabenordnung*, sec. 29a.
29. *Règlement grand-ducal du 23 décembre 2014 relatif à la procédure applicable aux décisions anticipées rendues en matière d'impôts directs et instituant la Commission des décisions anticipées* (Mémorial 264 du 29 décembre 2014, p. 5612)
30. In the original German: "(*1*) *Durch Missbrauch von Formen und Gestaltungsmöglichkeiten des bürgerlichen Rechts kann die Steuerpflicht nicht umgangen oder gemindert werden.* (*2*) *Liegt ein Missbrauch vor, so sind die Steuern so zu erheben, wie sie bei einer den wirtschaftlichen Vorgängen, Tatsachen und Verhältnissen angemessenen rechtlichen Gestaltung zu erheben wären.*"

it is becoming increasingly clear that its interpretation does not need to be aligned with that of the German tax courts,[31] which taxpayers, tax administration and the courts still refer to in some of its decisions, because of various differences in wording that have developed since 1977.[32] In the administrative courts' jurisprudence, the application of the GAAR requires the fulfilment of four distinct criteria, namely (i) the use of forms and institutions of private law; (ii) the reduction of tax liability; (iii) the use of an "inappropriate path" to achieve the intended economic result; and (iv) the absence of non-tax reasons justifying the choice of that path.[33] The significance of these criteria is briefly elaborated below.

So far, neither the case law of the ECJ nor the EC Recommendation C(2012) 8806 of 6 December 2012 seems to have had any direct influence on the interpretation of Luxembourg's GAAR.

18.2.1.1. Use of forms and institutions of private law

Sec. 6 of the StAnpG addresses exclusively the abuse of legal arrangements, to the exclusion of mere factual arrangements.[34] The reference to forms and institutions (taken together: "arrangements") specifically of "private law" has given rise to doubts and litigation. It has been argued, in particular, that the use of an option granted by tax law, such as the election of two companies to be treated as a single taxpayer for tax purposes (group taxation) could not be treated as abusive, as it was not an arrangement provided for by private law.[35] This in itself should be correct, although it had been understood in German doctrine at the time when Luxembourg adopted the GAAR that the notion of private law arrangements ought not to be interpreted

31. E.g. Trib. Adm. 14 January 2015, no. 33678.
32. E.g. Trib. Adm. 27 June 2013, no. 30540; Trib. Adm. 21 May 2013, no. 31058. For the development of the German GAAR (sec. 42 *Abgabenordnung*), *see* the German National Report. Notably, despite the almost exactly same wording of sec. 6 StAnpG with the Austrian GAAR (sec. 22 *Bundesabgabenordnung*), there have been no references to Austrian jurisprudence on the issue in Luxembourg's courts.
33. Cour Adm. 18 March 2014, no. 32984C; Trib. Adm. 14 January 2015, no. 33678; Trib. Adm. 27 June 2013, no. 30540; Trib. Adm. 21 May 2013, no. 31058; Trib. Adm. 15 July 2015, no. 34419.
34. J.-P. Winandy, *Fraude à la loi et abus de droit en droit fiscal luxembourgeois, Annales du droit luxembourgeois* (2001), p. 349 (p. 396); A. Steichen, *Manuel de droit fiscal* (5th edition, Saint Paul, 2015), p. 264.
35. The taxpayer also made explicit reference to the fact that the German legislator had seen a need to delete the reference to "private" law arrangements from its GAAR in sec. 42 *Abgabenordnung*, presumably to close a lacuna in protection against tax planning arrangements that remained open in Luxembourg.

narrowly.[36] However, an abuse of private law arrangements will typically be found in steps prior to such election: the courts held that the creation of a separate company, in the particular case, had already been abusive.[37]

For a legal arrangement to be considered abusive, it must first be correctly qualified.[38] A requalification of an instrument based on general principles of interpretation, such as economic substance over form, thus does not come within the scope of the GAAR, but precedes it (and is thus possible independent of the fulfilment of the various criteria, in particular any subjective element). A further limitation has been argued to be that only legal acts within a taxpayer's "economic sphere" to the exclusion of his "private sphere" is covered by the GAAR.[39] The exact meaning of this supposed distinction is unclear, however, and no case law has emerged to provide any clarification on this point.[40] Nevertheless, it seems reasonable to confine the application of the GAAR to arrangements with an identifiable economic purpose, as the GAAR requires the assessment of whether the path chosen to achieve a certain economic effect has been adequate.[41] In the absence of an identifiable economic purpose, such an assessment would appear to be an impossible endeavour.

18.2.1.2. Circumvention or reduction of tax liability

Application of the GAAR requires the chosen arrangement to result in a circumvention or reduction of tax liability compared to another (appropriate) arrangement. Sec. 6 of the StAnpG still refers to tax liability (*Steuerpflicht*), in contrast to the modern German GAAR, which, since 1977, prohibits the "circumvention of tax law" (*Steuergesetz*) in general.[42] This has prompted the question of whether arrangements aimed at coming within the scope of certain favourable tax provisions would be covered by sec. 6 of the StAnpG.[43] The Supreme Administrative Court has recently confirmed that

36. A. Riewald, *Reichsabgabenordnung und Steueranpassungsgesetz* (1941), p. 78.
37. Cour Adm. 18 March 2014, no. 32984C.
38. A. Steichen, *Manuel de droit fiscal* (5th edition, Saint Paul, 2015) 265.
39. J.-P. Winandy, *Fraude à la loi et abus de droit en droit fiscal luxembourgeois, Annales du droit luxembourgeois* (2001), p. 349 (p. 397): The typical example for a merely personal private law arrangement is marriage, which supposedly cannot be considered abusive within the meaning of sec. 6 StAnpG.
40. K. Köszeghy, *Addressing 'Abuse' in Luxembourg's Tax Law with a New GAAR* (Doctoral Dissertation, 2014), p. 173.
41. *See* sec. 18.2.1.3.
42. *See* E. Reimer, Germany, sec. 15.1.1.
43. J.-P. Winandy, *Fraude à la loi et abus de droit en droit fiscal luxembourgeois, Annales du droit luxembourgeois* (2001), p. 349 (p. 398).

this is indeed the case.[44] While acknowledging the narrower scope compared to the German GAAR, the court held that the system of investment tax allowances forms a direct part of the rules determining tax liability, since the overall benefit is deducted directly from income tax, and thus comes within the scope of sec. 6 of the StAnpG. In an apparent effort to keep the provision effective as a remedy against a variety of abusive arrangements, the courts have also held that it is not necessary for the taxpayer to have achieved an actual tax benefit in the relevant year; instead, a mere potential tax benefit that would result if an additional step would be taken in the future can be sufficient to trigger the application of the GAAR.[45]

18.2.1.3. An inappropriate arrangement

An abuse of law as addressed by sec. 6 of the StAnpG presupposes the use of an inappropriate legal arrangement, which has been considered by some to be the key condition of the provision.[46] The courts regularly explain that the existence of merely "unusual" (*inhabituel*) private law arrangements is not enough to conclude that they would also be "inappropriate" (*inadéquat*), since taxpayers are free to choose the path attracting the lowest tax burden. For an arrangement to be considered inappropriate, it is necessary to show that a certain economic outcome is realized in such a way that it allows the achievement of a tax effect that the legislator cannot be said to have wanted to give.[47] What is required is thus an assessment of the legislator's intention underlying the relevant tax provisions. It is consequently very difficult to determine in the abstract what kind of arrangements would be considered inadequate. Several authors have attempted to generalize the

44. E.g. Cour Adm. 18 March 2014, no. 33125C; Cour Adm. 18 March 2014, no. 32984C.
45. Trib. Adm. 14 January 2015, no. 33678: In that case, a taxpayer transferred her former principal residence to a newly created company at the end of the period for exemption of such properties after taking residence elsewhere, thus ensuring that any future sale of that property would only lead to taxable profits to the extent that its value increased after said transfer. The taxpayer thus attempted to lock in the tax benefit for selling a residential home without actually selling it within the period foreseen for that tax benefit by the taxpayer. For a critical review, *see* F. Castellani, S. Richard and A.-S. Le Bris, *La Notion d'abus de droit en matière fiscale: analyse d'arrêts de jurisprudence récente des jurisdictions administratives luxembourgeoises, ACE Comptabilité, fiscalité, audit, droit des affaires au Luxembourg* (2015), pp. 12-19 (p. 17).
46. J.-P. Winandy, *Fraude à la loi et abus de droit en droit fiscal luxembourgeois, Annales du droit luxembourgeois* (2001), p. 349 (p. 401).
47. Cour Adm. 18 March 2014, no. 33125C; Cour Adm. 18 March 2014, no. 32984C: "*… il faut, …, que l'objectif économique soit atteint par cette voie dans le contexte économique donné d'une manière telle qu'elle permet l'obtention d'un effet fiscal que le législateur ne peut pas être considéré comme ayant voulu accorder dans le cadre d'une application de la loi fiscale conforme à son intention.*"

condition, arguing that an inadequate path is one that is complex, difficult to understand, impractical or especially (unnecessarily) an administrative burden.[48] These criteria seem only useful to determine what a reasonable economic arrangement would have been as compared to what is unreasonable. Luxembourg's courts do not seem to rely on such an abstract notion of what a "reasonable" taxpayer would have done, however, and instead squarely focus on legislative intent. While not necessarily much easier to know with certainty, this seems the preferable approach, which is also more closely aligned with the approach of the ECJ in this respect.

18.2.1.4. Tax benefit as the sole purpose

It seems to be generally accepted that sec. 6 of the StAnpG relies on a "sole purpose" test.[49] Courts regularly endorse this view, stating the need to examine whether a structure "is motivated by economic considerations or whether it has the sole purpose of reducing the tax liability"[50] of one of the concerned entities. Recent judgments by the Supreme Administrative Court leave some doubt in this respect, however, as they suggest – although confirming the court of first instance's decision – the need for the existence of non-tax motives that are "real" in the sense that they are backed by "sufficient economic benefit" beyond the mere tax benefit.[51]

As this is the "subjective" element of the GAAR, the burden of proof is of particular significance in this context. It is incumbent on the tax administration to show that the lack of an "economic justification" of a chosen arrangement is "plausible", whereas the taxpayer must then show the existence of economic considerations that justify that arrangement.[52] Despite this apparent mismatch, it is important to note that the tax authorities still

48. *See* A. Steichen, *Manuel de droit fiscal* (5th edition, Saint Paul, 2015), p. 266; J.-P. Winandy, *Fraude à la loi et abus de droit en droit fiscal luxembourgeois, Annales du droit luxembourgeois* (2001), p. 349 (p. 401).
49. K. Köszeghy, *Addressing 'Abuse' in Luxembourg's Tax Law with a New GAAR* (Doctoral Dissertation, 2014), p. 182; A. Steichen, *Manuel de droit fiscal* (5th edition, Saint Paul, 2015), p. 267.
50. *See* Trib. Adm. 27 Juni 2013, no. 30540: "*…il convenient d'examiner, … si la structure … est motivée par des considérations économiques, ou si, au contraire, la structure mise en place a pour **seul objectif** la réduction de la charge fiscale*" (emphasis added). Confirmed in substance on appeal in Cour Adm., 18 March 2014, no. 33125C, which did not make use of the same phrase, however.
51. Cour Adm. 16 February 2016, no. 35978C; Cour Adm., 16 February 2016, no. 35979C; Cour Adm. 18 March 2014, no. 33125C; Cour Adm. 18 March 2014, no. 32984C: "… *il faut que ces motifs puissent être considérés comme réels et présentant un avantage économique suffisant au-delà du seul bénéfice fiscal obtenu.*"
52. Cour Adm. 18 March 2014, no. 33125C; Cour Adm. 18 March 2014, no. 32984C.

have to provide concrete evidence that an arrangement was only motivated by tax purposes. Making passing reference to further suggestive elements, such as the absence of effective taxation in the country of residence of the company or absence of a double tax treaty between Luxembourg and the country of residence of the company, is not sufficient to prove a lack of economic justification, according to the case law of the court of first instance.[53]

It should finally be noted that this element is often cited as the "essential criterion" to distinguish legitimate tax advantage achieved by a taxpayer and "abuse" in the sense of the GAAR, especially by the court of first instance.[54]

18.2.2. Impact of EU law, EC Recommendation C(2012) 8806 of 6 December 2012, the subject-to-tax rule and the Proposal for an Anti-Avoidance Directive of 28 January 2016

EU law has thus far had a limited impact on Luxembourg's anti-abuse rules, and only clearly affected domestic law to the extent that binding secondary EU law has been implemented in recent years.

One intriguing question is whether Luxembourg's GAAR, which dates back more than 80 years, is still operational in the context of the significant developments in EU law with respect to the limitation of restrictive anti-abuse rules by the ECJ's interpretation of the fundamental freedoms; another, whether the GAAR is still "fit for purpose" in the modern world, taking into account the eagerness to strengthen such provisions exhibited by the European Commission and other Member States.

53. Trib. Adm. 15 July 2015, no. 34419 : "*… force est de constater que l'administration n'a pas utilement pris position pour expliquer et justifier l'abus de droit, mais qu'elle s'est limitée à affirmer que la Société* (...) *serait domiciliée aux Iles Vierges Britanniques où elle ne serait pas soumise à une imposition effective et que le Luxembourg n'aurait pas signé d'accord d'échange de renseignements avec les Iles Vierges Britanniques pour en conclure qu'il s'agirait dès lors d'une société écran et que les paiement faits à la société* (...) *constitueraient un abus de droit et ceci sans un indice concret pour remettre en cause la réalité économique de ces transactions.*"

54. *See*, especially, Trib. Adm. 15 July 2015, no. 34419: "*Le critère essentiel qui permet de distinguer l'abus au sens du sec. 6 StAnpG de l'hypothèse du bénéfice légitime d'un avantage fiscal étant en particulier la vérification d'une motivation autre que fiscale du recours à une certaine construction ou opération*"; also Trib. Adm. 14 January 2015, no. 33678; Trib. Adm. 27 June 2013, no. 30540.

With respect to the first question, it is notable that Luxembourg's tax courts do not appear to have addressed any potential impact of ECJ case law in cases such as *Cadbury Schweppes* on domestic law. They have not referred to the ECJ's jurisprudence on abuse. It is quite clear, however, that this is not for lack of awareness of the jurisprudence;[55] it is thus quite possible that the gradual development towards more clarity with regard to the content of sec. 6 of the StAnpG described in section 18.2.1. has been subtly influenced by that case law. Also, neither the tax administration nor the courts have explicitly adopted the threshold of "wholly artificial arrangements" to apply the GAAR.[56] It is arguable, however, that the requirement for the tax administration to provide concrete proof of a lack of an economic justification for a chosen structure combined with the possibility for taxpayers to exonerate themselves by showing a commercial justification, effectively brings Luxembourg's rules in line with that concept as developed by the ECJ.[57] Together with the equivalence of the criteria applied by courts to the "objective" and "subjective" elements demanded by the ECJ to identify situations of tax abuse described above, it is reasonable to assume that Luxembourg's GAAR is compatible with EU law requirements. At the very least, it is sufficiently open to be interpreted in such a way.

With regard to the second question, it has to be pointed out that Luxembourg's GAAR remained unaffected by the European Commission's Recommendation C(2012) 8806,[58] which had proposed a standardized GAAR.[59] It is not entirely clear, however, whether this lack of reaction by the legislator should be understood as a conscious decision that no change

55. ECJ 12 September 2006, Case C-196/04, *Cadbury Schweppes*, ECLI:EU:C:2006:544 has been cited by the *Cour Administrative* at least once in the context of a challenge to the municipal business tax (*Gewerbesteuer*) by a Dutch company with activities in Luxembourg on the basis of the freedom of establishment (Cour Adm. 16 December 2010, no. 26997C).

56. References to artificial arrangements (*constructions artificielles*) are sometimes made by the tax administration and adopted in a general description of the abuse of law doctrine by the court of first instance. *See*, for example, Trib. Adm. 15 July 2015, no. 34419; Trib. Adm. 14 January 2015, no. 33678; Trib. Adm. 27 June 2013, no. 30540.

57. *See* S. Biewer and B. Höfer, *Luxembourg Branch Report, Tax treaties and tax avoidance: application of anti-avoidance provisions*, IFA 95a (2010), pp. 487-507 (p. 504), who argue that the abuse of law concept in Luxembourg only covers such wholly artificial arrangements; they also correctly point out that in the absence of any discrimination in the application of sec. 6 StAnpG against cross-border situations, a more restrictive application of the GAAR also should be in line with EU law.

58. Commission Recommendation of 6 December 2012 on aggressive tax planning, OJ L 338 (12.12.2012), p. 41 (2012/772/EU).

59. The Commission suggests the following wording in § 4.2: "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."

is necessary to make Luxembourg's anti-abuse regime more robust. In response to the European Commission's 2014 follow-up on its recommendation, Luxembourg had indicated to consider whether to adopt a (new) GAAR following the recommendation. However, it also indicated to await more clarity concerning international developments on the issue before doing so.[60] By contrast, the legislator did take action to implement targeted anti-abuse rules (TAARs)[61] pursuant to the amended Parent-Subsidiary Directive[62] by way of specific provisions,[63] despite (accurate) counsel from its state council (*Conseil d'État*) that the existing sec. 6 of the StAnpG should have been considered sufficient to comply with EU law.[64] The state council expressed concern that the wording suggested by the directive was insufficiently precise and its transposition risked creating legal uncertainty for taxpayers.[65] In light of this discrepancy between the state council's advice and the legislator's action, it remains to be seen how the legislator will react to the recently agreed Anti-Tax Avoidance Directive, which also

60. European Commission (DG Taxud), Platform for Tax Good Governance, Discussion paper on General Anti-Abuse Rules (GAAR), 19 December 2014 (Platform/12/2014/EN), available at https://ec.europa.eu/taxation_customs/sites/taxation/files/docs/body/discussion_paper_gaar.pdf, last accessed 10 April 2017.

61. For the purposes of this chapter, I understand TAARs to be anti-abuse rules that have a limited scope, but are general in their structure; by contrast, I understand special anti-abuse rules (SAARs) to be those that are limited in their scope and specific in their structure, so as to aim at situations that are defined in the SAAR.

62. Council Directive (EU) 2015/121 of 27 January 2015 amending Directive 2011/96/EU on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States, OJ L 21 (28.1.2015), pp. 1-3, Art. 1: "2. Member States shall not grant the benefits of this Directive to an arrangement or a series of arrangements which, having been put into place for the main purpose or one of the main purposes of obtaining a tax advantage that defeats the object or purpose of this Directive, are not genuine having regard to all relevant facts and circumstances. An arrangement may comprise more than one step or part. 3. For the purposes of paragraph 2, an arrangement or a series of arrangements shall be regarded as not genuine to the extent that they are not put into place for valid commercial reasons which reflect economic reality."

63. Arts. 147(2) and 166 (2*bis*) LIR following amendment in the law of 18 December 2015 on the transposition of Directive 2014/86/EU and 2015/121/EU (Official Journal of the Grand Duchy of Luxembourg, A-No. 245, p. 5993). These include effectively literal translations of the directive's suggested provision.

64. This view must be based on a restrictive interpretation of the provisions of Directive 2015/121/EU, however, since they explicitly refer to the "main purpose or one of the main purposes", suggesting that a "sole purpose" test as applied by the courts in the context of sec. 6 StAnpG might be too narrow. However, to the extent that the "sole purpose" test is a requirement from the case law of the ECJ, the provisions of the directive must be interpreted to mean the same despite the apparent broader scope of application.

65. Avis du Conseil d'État sur projet de loi no. 6847 (1.3.2016).

requires a GAAR modelled on the TAAR included in the Parent-Subsidiary Directive.[66]

With respect to the European Commission's recommendation to include subject-to-tax clauses in Member States' tax treaties,[67] no reaction can be identified in recently concluded tax treaties. Such clauses, it should be noted, have so far not typically been added to Luxembourg's tax treaties, although several specific examples exist.[68]

18.3. Transfer pricing rules, GAARs, specific anti-avoidance rules (SAARs) and linking rules

18.3.1. Tax treaties and anti-avoidance rules

In Luxembourg, tax treaties take precedence over domestic law.[69] They are also recognized to merely limit taxing rights, but not to create them in the absence of domestic legal provisions to that effect. These two principles have to be taken into account in any discussion of the application of various anti-avoidance rules in a cross-border context in Luxembourg. It also needs to be taken into account that Luxembourg has made an observation on the Commentary on Article 1 of the OECD Model concerning the application of anti-abuse provisions, stating that it "does not share the interpretation of paragraph 9.3, 22.1 and 23 which provide that there is generally no conflict between anti-abuse provisions of the domestic law of a Contracting State and the provisions of its tax conventions. Absent an express provision in the Convention, Luxembourg therefore believes that a State can only apply its domestic anti-abuse provisions in specific cases after recourse to the mutual agreement procedure".[70] The requirement for a mutual agreement

66. *See* O. Hoor, K. O'Donnell and S. Schmitz-Merle, *EU Commission Releases Draft Directive on BEPS: A Critical Analysis from a Luxembourg Perspective*, European Taxation (2016), p. 192 (p. 195), who suggest that no changes to Luxembourg's law should be required as a consequence of the proposed directive.
67. Commission Recommendation of 6 December 2012 on aggressive tax planning, OJ L 338 (12.12.2012), p. 41 (2012/772/EU). Proposed wording in § 3.2: "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."
68. *See* sec. 18.3.3.
69. J. Schaffner, *Droit Fiscal International* (2nd edition, 2005) 60; A. Steichen, *Précis de Droit Fiscal de l'entreprise* (2013), p. 15, both referring to case law from the 1950s.
70. This principle has also been included in some Luxembourg tax treaties, e.g. Art. 27 Czech Republic-Luxembourg DTC (2013).

procedure should not be read to give the tax administration carte blanche to apply anti-abuse provisions when such application has been confirmed by the other contracting state in direct consultations. Tax treaties are not only obligations vis-à-vis the other contracting state, but also give rights to taxpayers. It should thus rather be understood in the sense that an implicit anti-abuse proviso can only be assumed to exist where a certain conduct would be seen as abusive from both contracting states' perspective.[71]

Explicit provisos allowing the application of domestic (general) anti-avoidance rules are found only in relatively few tax treaties,[72] although more specific rules for the limitation of treaty benefits in limited circumstances are more common.[73]

18.3.2. Transfer pricing rules

Luxembourg's approach to TP is a multi-faceted one. Although the arm's length principle has long been applied for transactions between related companies, a general rule to formalize that approach has only been introduced with effect from January 2015.[74] Previously, arm's length profit adjustments were frequently based on the concepts of "hidden dividend" and "hidden capital contribution", which the Luxembourg courts interpret broadly in line with the relevant German case law on the same concepts.[75] No specific requirements existed with regard to transfer documentation and filing. In addition, two administrative circulars[76] were issued in 2011 by the Luxembourg tax authorities referring to the OECD guidelines. These circulars had only a limited scope of application, concerning intra-group financing transactions. The change came to explicit and full effect via a special provision applicable to the entire income tax system in the wake of State aid

71. *See* A. Steichen, *Manuel de droit fiscal* (5th edition, Saint Paul, 2015), p. 272.
72. Art. 27 Hong Kong-Luxembourg DTC (2007); Israel-Luxembourg Protocol to DTC (2004); Belgium-Luxembourg Protocol to DTC (1970/2009); Art. 29 Luxembourg-Poland DTC (2012); Art. 29 India-Luxembourg DTC (2008).
73. *See* sec. 18.3.3.
74. *Loi modifiée du 4 Décembre 1967 concernant l'impôt sur le revenu* [Income Tax Law] (LIR), Art. 56. *See* O. Hoor, *Luxembourg Reshapes Its Transfer Pricing Landscape*, European Taxation 131 (2015).
75. Trib. Adm. 22 July 2015, no. 34190: "*L'article 164* (*3*) *LIR prévoit en droit national un mécanisme correcteur par rapport à des transactions qui ne sont pas conclues suivant le principe de pleine concurrence ou du 'dealing at arm's length'*."
76. *Circulaire du directeur des contributions* LIR. no. 164/2 of 28 January 2011 and no. 164/2bis of 8 April 2011.

investigations launched by the Commission into several tax rulings provided by Luxembourg's tax authorities in relation to TP.[77]

In recent years, an increasing number of TP cases have been heard by the Luxembourg administrative courts, although the overall number remains relatively small. In a case dated July 2015,[78] the Court of First Instance heard a case concerning a Luxembourg resident company that regularly financed without consideration by way of interest-free loans the activity and investments of an Italian entity of which it was the sole shareholder. The tax administration sought to amend the tax assessment on the basis that a notional arm's length interest on the loan provided to the Italian subsidiary ought to be included in the profits of the Luxembourg parent. To that end, the authorities made use of various arguments and legal bases: the tax office relied, in the first place, on article 164(3) of the LIR, which regulates hidden dividend distributions to ensure that a company's profits for tax purposes be calculated disregarding accounting profits and losses that arise from direct or indirect interaction of a company with its shareholders.[79] It relied, secondly, on the administrative circular based on the same provision, which sets out specific conditions to apply the arm's length principle to intra-group financing companies.[80] Upon appeal by the taxpayer, the tax director, in its preliminary decision to uphold the tax office's assessment, also invoked article 9 of the tax treaty together with article 56 of the LIR in its then applicable form and sec. 6 of the StAnpG to the same effect. The court accepted the tax administration's reassessment of the taxpayer's profits, including notional interest payments on the interest-free loan in question. Analysing the various legal grounds argued by the tax administration, the court concluded that Art. 9 of the Italy-Luxembourg tax treaty was effectively implemented via Art. 164(3) of the LIR, since it was based on the same principle – taxation in line with the arm's length standard. Similar reasoning was adopted a year earlier in a case where one entity agreed to contribute cash without any financial consideration to a related enterprise. The court requalified that transaction as a hidden distribution of dividends.[81] In another case, dated January 2014, the court confirmed the Luxembourg

77. *Loi modifiée du 4 Décembre 1967 concernant l'impôt sur le revenu* [Income Tax Law] (LIR), Art. 56. *See* O. Hoor, *Luxembourg Reshapes Its Transfer Pricing Landscape*, European Taxation (2015), p. 131.
78. Trib. Adm. 22 July 2015, no. 34190. *See* W. Haslehner, *Luxembourg: Profit Adjustments for Interest-free Loans in Accordance with Article 9*, in E. Kemmeren et al., *Tax Treaty Case Law around the Globe 2015* (IBFD 2016).
79. *See* O. Hoor, *Hidden Dividend Distributions in Luxembourg: A Technical Guide*, European Taxation (2011), p. 383.
80. *Circulaire* LIR No. 164/2 of 28 January 2011.
81. Trib. Adm. 29 September 2014, no. 33059.

tax authorities' refusal to deduct a loss made on the sale of a related entity within a consolidated group (fiscal unity). The latter was sold at a price of EUR 1 and was heavily in debt. The court reasoning concluded, among other things, that the sale price was not fixed in application of the arm's length principle, but was a result of the related entities close relationship.[82] Finally, a similar judgement was adopted by the administrative courts of appeals in a decision dated March 2015, in which all the shares of a company were sold at a price of EUR 1 to another company of the consolidated unit. The court concluded that the plaintiff failed to demonstrate that a similar price would have been paid had the shares been sold to unrelated parties in light of the total the company's assets and its performance perspectives.[83]

As a general rule, TP documentation will be checked by the tax authorities in the course of a tax assessment procedure.[84] Taxpayers have a general duty to cooperate with tax authorities and provide information to prove their financial circumstances. In the course of the codification of the arm's length principle in 2015, the legislator clarified this with respect to transactions between associated enterprises by inserting an additional paragraph in the relevant provision of the fiscal code (*Abgabenordnung*).[85]

18.3.3. Limitation on benefits (LOB) clauses and rules excluding tax treaty benefits

LOB clauses are not a common feature of Luxembourg's tax treaties, but can be found in some of them. The Luxembourg-USA double tax treaty of 1996 contains an LOB clause in its article 24. Based on this article, entitlement to certain benefits of the Convention is only granted to so-called qualified residents. The LOB clause featured in the Luxembourg-USA double tax treaty is similar to other LOB clauses contained in other treaties negotiated by the United States as it is generally in line with the US Model.

Most Luxembourg tax treaties exclude specific tax-exempt entities or those with access to preferential tax regimes from treaty benefits. Most often, this concerns so-called 1929 Holding companies (a regime that was abolished

82. Trib. Adm. 13 January 2014, no. 31612.
83. Cour Adm. 26 March 2015, no. 34024C.
84. O. Hoor, *Luxembourg Reshapes Its Transfer Pricing Landscape*, European Taxation (2015), p. 131 (p. 140).
85. Art. 171(3) *Abgabenordnung*. The requirement to keep and provide documentation has anyhow been applied already before, at the very least in the context of intra-group financing transactions, following the above-mentioned circular.

in 2006, however).[86] Such an exclusion can be viewed as a version of a subject-to-tax rule. Among other subject-to-tax clauses included in certain double tax conventions (DTCs) concluded by Luxembourg, some condition treaty benefits in the source state on the effective taxation in the state of residence.[87] Others stipulate a right to tax for the residence state if the source state does not exercise a taxing right granted in the treaty. Such clauses are rarely found in Luxembourg's tax treaties, however. For an example of such a clause in line with Art. 23(4) of the OECD MC, *see* Art. 23(2)(c) of the Luxembourg-Singapore DTC (2013). Another example, limiting relief from taxation where the other contracting state taxes on a remittance basis, can be found in Art. 26 of the Luxembourg-Malaysia DTC (2002). More commonly, Luxembourg's DTCs include a special subject-to-tax clause in connection with a participation exemption granted in the tax treaty for inter-company dividends.[88] These mirror the subject-to-tax clause enshrined in domestic legislation with respect to the participation exemption regime.[89]

18.3.4. CFC rules

Luxembourg does not have CFC rules in its legislation. The concepts of abuse of law, economic substance and beneficial ownership can be used by the Luxembourg tax authorities as alternative tools in the absence of any specific CFC rules to deal with base companies.[90-91]

86. *See*, for example, Art. 28 Canada-Luxembourg DTC (1999); Art. 29 Ireland-Luxembourg DTC (1972/2014); Germany-Luxembourg Protocol to DTC (2009); Art. 1 Brazil-Luxembourg DTC (1978); Art. 30 Luxembourg-India DTC (2008); Art. 29 Luxembourg-Netherlands DTC (1968/2009).
87. *See* A. Steichen, *Tax competition in Europe*, Luxembourg Report, (EATLP 2002), p. 18.
88. *See*, for example, Art. 25(2)(c) Luxembourg-US DTC (1996).
89. Arts. 147 and 166 LIR each require taxation in the other country that is "equivalent" to that in Luxembourg, which is understood to mean a tax rate no lower than 50% of that applicable in Luxembourg at the time of the distribution of a dividend.
90. J. Schaffner refers to a case concerning base companies in Ireland benefitting from the International Financial Services Center regime, which the tax administration challenged on the basis of the doctrine of abuse of law. J. Schaffner, *Droit Fiscal International* (2nd edition, Editions promoculture 2005), pp. 642-643.
91. *See* A. Steichen, *Tax competition in Europe*, Luxembourg Report (EATLP 2002), p. 8.

18.3.5. Linking rules

Luxembourg does not have linking rules with general application. It has, however, implemented the anti-hybrid provision included in Directive 2014/86/EU limiting the exemption of inter-company dividends to situations where the payment had not been treated as deductible in the source country.[92]

18.3.6. Interest deduction limitation rules

Luxembourg's tax code does not contain general thin capitalization or interest deduction rules. However, administrative practice imposes a 85/15 debt-to-equity ratio and denies the deduction of interest to the extent that interest payments are made with respect to debt exceeding that ratio. This result relies on an effective requalification of excessive debt as equity capital on the basis that a third party would not have supported a company with further debt beyond that ratio, i.e. the arm's length principle as enshrined in the provisions concerning hidden dividends (Art. 164 of the LIR). Since this only aims at excessive interest deductions, an effective debt-to-equity ratio of 99/1 can also be retained without consequences if the excessive portion of debt is granted interest free.[93]

18.4. Interaction of GAAR, TP rules and SAARs

There appears to be no clear hierarchy between the different anti-avoidance rules in Luxembourg. The tax administration may tend to invoke them in parallel, and courts have not addressed the relationship explicitly.[94] However, both as a matter of principle and court practice, the use of the GAAR (sec. 6 of the StAnpG) should be a measure of last resort, suggesting that it only applies where all other more specific anti-avoidance rules fail to apply.[95] With respect to the TAARs included in line with the amended Parent-Subsidiary Directive 2015/121/EU in 2015, Luxembourg's state

92. Art. 166 (2*bis*) LIR.
93. A. Steichen, *Précis de Droit Fiscal de l'entreprise* (2013), pp. 290-291 and 400-401.
94. *See* Cour Adm. 25 February 2016, no. 36612C for a recent example of a parallel use of sec. 11 StAnpG, purposive construction of Art. 50bis LIR and sec. 6 StAnpG.
95. E.g. Trib. Adm. 22 July 2015, no. 34190: The court held that Art. 164(3) LIR (a SAAR concerning hidden distributions) formed a sufficient basis to tax notional interest income in a case of an interest-free loan provided to a foreign subsidiary, and decided that it was therefore unnecessary to decide whether the requirements of sec. 6 StAnpG were also fulfilled.

council had also concluded that these would not exclude the subsidiary application of sec. 6 of the StAnpG.[96]

With regard to the hierarchy of TP rules (i.e. Arts. 56 and 164(3) of the LIR) and the GAAR in the context of applying the arm's length principle, the situation is similarly unresolved. The Supreme Administrative Court did not address the issue of a priority of either over the other in a case where the taxpayer argued that sec. 6 of the StAnpG could not be used to determine the right price for transactions between related enterprises.[97]

96. *Avis du Conseil d'État sur projet de loi* no. 6847 (1.3.2016).
97. Cour Adm. 16 February 2016, no. 35978C; and Cour Adm. 16 February 2016, no. 35979C.

Chapter 19

Netherlands

Maarten de Wilde and Ciska Wisman

19.1. The meaning of avoidance and aggressive tax planning and the BEPS initiative

19.1.1. The meaning of tax avoidance in the Dutch tax system

19.1.1.1. The general approach towards tax avoidance in the Netherlands

This chapter deals with the phenomena of tax avoidance and tax planning by multinationals and the addressing of these in the Netherlands' corporate tax system. Nation states are sovereign and hence autonomous in designing their corporate tax systems. The corporate tax systems of most countries, including the Netherlands, essentially seek to effectively tax business profits once at the location of investment. These systems generally subject multinational enterprises to corporate taxation by reference to their physical presences (permanent establishment, place of effective management) and legal presences (corporate entity taxation, separate-entity approach) in the geographic territories of the taxing jurisdiction concerned. The Dutch tax system is no exception. National tax systems, however, differ, creating disparities in taxable-entity classification, taxable-income qualification, tax base assignment and applicable tax rates. Such a non-alignment has created effective tax level differentials and gaps and overlaps, and thereby the potential of initiating both double taxation and double non-taxation. Furthermore, because corporate tax laws are designed by reference to physical and legal presences, there is a potential for disconnecting taxable base from those locations in which actual business is conducted.

The combination of these properties of countries' corporate tax regimes has fuelled competition and planning responses. Globalization, the opening-up of markets, the rise of the multinational firm, the internet and intangibles seem to have sped up this process. Countries, it seems, have entered into a tax-induced competition for corporate investment by reducing effective corporate tax burdens and, with that, have initiated a "race to the bottom".

Tax-induced competition for “paper” profits is generally considered particularly harmful, contravening general notions of good governance. Multinationals seem to have responded by engaging in a strategic optimization of tax costs and after-tax profits. Tax cost reduction strategies may involve a tax-induced shifting of real investment into comparatively lower-taxing countries. Such strategies, however, may also involve an assignment of paper profits and taxable bases to places where these may effectively remain untaxed, or at least enjoy significant effective tax rate reductions. This raises some fundamental concerns, which are addressed in this chapter.

A perceived undue “gaming of the system” by countries and international firms has attracted media attention and political attention and has driven public discontent in recent years. The matter has by now been widely debated, in the Netherlands and elsewhere, by policymakers, scholars and tax practitioners. A broad range of terms is used to address the issues concerned. In regard to the practices of nation states, these include “harmful tax competition” and “aggressive tax competition” via “beneficial tax regimes”, “preferential tax regimes” and even, as they are sometimes even labelled, “predatory tax regimes”. A broad range of terms is used to characterize the behaviour of multinationals as well, including “tax evasion”, “tax avoidance”, “tax planning”, “aggressive tax planning”, “abusive tax planning”, “abuse”, “misuse”, “circumvention”, “fraud”, “improper advantage” and “wrongful use”. In the end, common to all seems to be a dissatisfaction with non-taxation outcomes, contradicting a generally felt notion that multinationals should contribute to society by paying their fair share of corporate taxes.

The Dutch legal system lacks a concrete and readily available definition of “tax avoidance”. Perhaps this is due to the term being difficult to interpret in a strict legal sense without rendering its subsequent use susceptible to manipulation. Perhaps it is also due to the term having a more societal and moral import. From an ethical and societal perspective, the utilization of business strategies to minimize effective tax burdens through artificial means – irrespective of their legality – may be considered unethical, contravening moral duties to contribute to society. Broadly defined, corporate tax avoidance seems to involve multinational firms escaping, through artificial yet legal structures, their ethical responsibilities to contribute in accordance with their means to the financing of public expenditure from

which everyone benefits. Tax avoidance does not equal illegal tax evasion or fraud.[1] It is legal, albeit deemed immoral by society.

The absence of a legal definition of tax avoidance in the Dutch corporate tax system does not mean, however, that no rules or provisions exist that seek to strike down undesirable tax outcomes. Indeed, a broad range of anti-abuse provisions applies throughout the Dutch corporate tax system, each having its own areas of applicability and eligibility tests, and all using individual definitions and terminologies. The corporate tax landscape in this area may be described as dispersed, fragmented and, indeed, technically complex. A common denominator seems to be the fact that all seek to counter some form of uncalled-for use of the corporate tax system involving a setting-up of contracts and/or legal arrangements – or a series thereof – having some more or less artificial or non-business-like properties for the purpose of dodging or deferring corporate taxation.

Regular fact-finding and interpretation approaches in Dutch taxation should be mentioned as a first measure to counter certain forms of misuse, as these already go quite a long way in addressing undue tax effects. Fact-finding and interpretation in Dutch taxation, for instance, allow a filtering of disguised transactions to minimize their influence on applicable tax law. Available doctrines also allow courts to proceed to a requalification of legal transactions for tax purposes – even to impose an autonomous qualification. These further provide courts with the means to interpret tax legislation extensively – for instance, in line with its object and intent. As an *ultimum remedium* interpretative tool, a national general anti-avoidance rule (GAAR) applies in the form of the *fraus legis* doctrine. *Fraus legis* addresses legal arrangements typically lacking real practical meaning which have predominantly been set up to avoid tax contrary to the intent of the tax legislation. The doctrine allows courts to eliminate legal facts or to substitute these for constructed ones to determine a tax outcome in line with the purpose of the law (*see* section 19.2. for details).

Second, the taxable-profit calculation mechanism in Dutch business taxation, of which the arm's length standard (ALS) forms an integral part, should be mentioned here as well.[2] The mechanism includes an assessment of whether a certain (non-)payment or (non-)receipt originates from the

1. Dividing lines between legal tax avoidance and illegal tax evasion and any legal consequences of crossing these lines are not discussed in this chapter.
2. Article 8 Dutch Corporate Income Tax Act (CITA) in conjunction with Article 3.8 Dutch Personal Income Tax Act (PITA). Legislative references concern the CITA, unless otherwise specified.

business operations carried on or whether it should be considered to have non-business motives. The assessment particularly addresses inter-affiliate transactions. Any advantages or disadvantages that originate from affiliation are considered non-business-like and accordingly do not affect corporate profit for tax base determination purposes. This cancels out artificialities arising from inter-affiliation. The key question is whether the transaction(s) undertaken are supported by reference to the functions performed by the parties concerned, the assets used and the risks assumed. Non-arm's length effects are transformed into business-like outcomes for tax base calculation purposes. But even genuine business expenses may be non-deductible under the so-called Cessna costs doctrine, a doctrine developed in case law that applies in the presence of excessive and unreasonable expenses.[3] Excessive expenses are non-deductible to the extent that they may objectively be considered unreasonable. Such unreasonableness is interpreted by reference to an objectified, sensible entrepreneur accepting a certain expense-to-utility ratio from a business economics perspective (*see* sections 19.2.1. and 19.3.1-3. for details on tax base calculation). Worth noting here is that exit taxation in the Netherlands essentially also forms part of the taxable-profit calculation mechanism.[4] Exit taxes secure a corporate taxation of unrealized accrued capital gains upon their extraction from the tax jurisdiction of the Netherlands, for instance in the process of a cross-border business reorganization.

Third, the Dutch tax system contains a wide variety of specific anti-avoidance rules (SAARs), all of which seek to protect the Netherlands' corporate tax base. The tax system includes provisions addressing artificial tax base erosion via interest payments,[5] non-resident corporate shareholder taxation for both equity income and debt-receivable income,[6] dividend tax avoidance

3. *See* Supreme Court, 9 March 1983, BNB 1983/202 (*Cessna Plane I*); and Supreme Court 8 March 2002, BNB 2002/210 (*Cessna Plane II*), on the costs of the use and possession of a private plane used to travel to business appointments instead of using scheduled flights.
4. Article 8 in conjunction with Article 3.8 PITA and in conjunction with Articles 15c and 15d. Exit taxation is not further discussed in this chapter, due to the exit involving true transfers of operational business activities.
5. Articles 10a, 10b, 13l and 15ad.
6. Articles 17(3)(b) and 17a(c). Article 17(3)(b) has recently been amended to implement the GAAR as introduced in the Parent-Subsidiary Directive (PSD); *see further* section 19.3.8.2.

arrangements[7] and dividend-stripping strategies,[8] undue tax deferral in cases of shareholding transfers,[9] undue tax avoidance in the area of certain shareholding and asset transfers involving the tax consolidation regime[10] and undue tax avoidance and tax deferral relating to business restructurings – implementing the Merger Directive.[11] In addition, the Dutch tax system contains a number of recapture mechanisms to neutralize certain deduction and no-inclusion outcomes relating to specific arrangements involving inter-affiliate debt and equity financing and refinancing transactions,[12] as well as measures to counter certain types of double dipping in the area of cross-border loss utilization involving permanent establishments and double tax relief.[13] Dutch corporate taxation also contains mechanisms that seek to counter strategies set up to inflate effective (cross-border) loss utilization possibilities involving a cessation of business activities.[14] Other provisions seek to strike down undue loss relief in cases involving holding and financing companies,[15] third-party shareholding transfers and business cessation,[16] and certain forms of profit and loss offset within the context of the application of the Dutch tax consolidation regime.[17] Moreover, Dutch taxation includes a switch-over from exemption to credit mechanisms to counter a sheltering of passive income in a low-tax jurisdiction abroad, both with a view to juridical double tax relief[18] and economic double tax relief.[19] The Dutch tax system also includes a controlled foreign company (CFC)-like regime to address undue tax deferral via substantial shareholdings in passive, low-taxed subsidiaries.[20] Various targeted anti-mismatch provisions

7. Article 1(7) Dutch Dividend Withholding Tax Act (DWTA), relating to abusive transactions involving cooperatives; and Article 4(7) DWTA (in conjunction with related provisions), into which the national beneficial ownership test has been incorporated. Article 1(7) DWTA has recently been amended to implement the GAAR as introduced in the PSD; *see further* section 19.3.8.6.
8. Article 4(7) DWTA.
9. Article 12a.
10. Articles 15ai, and 15aj.
11. Articles 13h, 13i, 13j and 13k; and Articles 14, 14a, 14b and 14b; and, in connection thereto, Articles 3.54a, 3.55, 3.56 and 3.57 PITA. For completeness' sake, the authors also refer here to Article 14c (rollover relief for restructurings from an incorporated business into a sole proprietor), though matters are left further unassessed.
12. Articles 13b and 13ba.
13. Articles 33b and 33d.
14. Article 13d in conjunction with Article 13[e]; and Articles 15i and 15j.
15. Article 20(4)-(6).
16. Article 20 in conjunction with Article 20a.
17. Article 15 in conjunction with Articles 15ae, 15af, 15ag and 15ah. Provisions involving currency exchange losses on participations (Article 28b) and the so-called compartmentalization approach (Article 28c in conjunction with Articles 34c) are not discussed.
18. Article 15e(7) in conjunction with Articles 15g, 15h and 23d; *see also* Article 33c.
19. Article 13(9)-(14) in conjunction with Article 13aa and Article 23c.
20. Article 13a.

apply as well, addressing certain double deduction outcomes and deduction and no-inclusion outcomes involving the use of hybrid entities,[21] transfer pricing (TP) mismatches[22] and hybrid income mismatches – implementing, inter alia, the latest amendments to the Parent-Subsidiary Directive (PSD).[23]

The Netherlands has also adopted a range of anti-treaty abuse rules in a number of the tax treaties in its treaty network, ranging from general anti-abuse provisions[24] to targeted anti-treaty shopping rules in the form of principal purpose tests (PPTs)[25] and limitation on benefits (LOB) clauses.[26] These apply on top of the traditional beneficial ownership requirements, which are found in virtually all of the tax treaties in the Netherlands' treaty network. (A selection of SAARs is discussed in sections 19.3.4.-19.3.8. and 19.4.)

19.1.1.2. The presence of administrative regulations clarifying the meaning of tax avoidance

The questionnaire queried whether administrative regulations clarify the meaning of "tax avoidance" in the Netherlands' tax system. No explicit guidance is available. Some indications may be inferred, however, from statements made and positions taken in several decrees and resolutions, a selection of which is forwarded in this section. The operation of the ALS and several of the SAARs in the Dutch tax system are supported by a range of specific administrative regulations. This also holds for the rollover regimes facilitating business restructurings. Interpretative decrees issued by the State Secretary for Finance in his role as the executive can be legally relied upon by taxpayers. The tax administration is bound to such decrees applying the tax legislation. Legislative decrees and regulations issued by the State Secretary for Finance in his capacity as a quasi-legislator, mandated a capacity to issue such decrees and regulations on the basis of a legislative tax act, have the force of law.

With respect to TP and profit attribution, the Netherlands to a large extent conforms to international concepts. The ALS is codified in Article 8b of the

21. Articles 15ac(4)-(6) and 13l(6)(a)-(b).
22. Article 10b.
23. Article 13(17).
24. *See*, for example, Article 23(1) Double Tax Convention Netherlands-Germany.
25. *See*, for example, Double Tax Convention Netherlands-China; Double Tax Convention Netherlands-Switzerland; and Double Tax Convention Netherlands-United Kingdom.
26. *See*, for example, Double Tax Convention Netherlands-Japan; and Double Tax Convention Netherlands-United States.

corporate income tax act (CITA) (*see* section 19.3.1.3.). An autonomous approach is taken when it comes to the practical application of the ALS in the national tax system. Several interpretative decrees and resolutions of the ministry of finance provide guidance on the interpretation and application of the ALS in certain specific situations, for instance with a view to intangibles and captives. The OECD Transfer Pricing Guidelines and the OECD Report on the Attribution of Profits to Permanent Establishments form points of departure.[27] (TP and business profit calculation are further discussed in sections 19.2.1. and 19.3.1.3.)

Regarding the SAARs in the Dutch tax system (*see* sections 19.3.4.-19.3.8. and 19.4. for a discussion of selected SAARs), some implicit clarification on the meanings of "tax avoidance" and "business-like motives" can be found in administrative regulations. In a decree concerning the interpretation of the domestic beneficial ownership test targeting dividend-stripping strategies, the State Secretary for Finance has noted that the anti-dividend-stripping provisions in the Dividend Withholding Tax Act (DWTA) are not aimed at targeting durable, non-tax-driven intra-group reorganizations. As a guiding principle, no dividend-stripping issues emerge in the case of a durable restructuring and a regular dividend distribution policy.[28] (The national beneficial ownership test and dividend stripping are further discussed in section 19.3.8.7.)

The decree on the interest deduction limitation regime in Article 10a of the CITA, for instance, provides examples of what the government understands under a "non-business-like re-routing of capital", on the basis of which the motive test is interpreted as not having been met and in consequence of which interest deductibility is restricted.[29] The State Secretary for Finance indicated that any creation of a mismatch between a deductible interest expense in the Netherlands and an exempt interest receipt, for instance by means of utilizing hybrid entities or hybrid financial instruments, could be seen as characteristic of such a re-routing.[30] Some guidance on the

27. *See* Decree of 14 November 2013 No. IFZ 2013/184 M, International Tax Law. Transfer pricing method, application of the arm's length principle and the Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations (OECD Guidelines) (TP Decree). An official English translation of this decree is available at https://www.government.nl/documents/decrees/2014/03/25/ifz2013-184m-international-tax-law-transfer-pricing-method-application-of-the-arm-s-length-principle-and-the-transfer-pricing-g. *See also* Decree of 15 January 2011, No. IFZ2010/457 M, International Tax Law. Profit Attribution Permanent Establishments (Profit Attribution Decree).
28. Decree of 21 November 2011, No. DGB 2011/6870M, section 5.
29. Decree of 25 March 2013, No. BLKB2013/110M. Application of Article 10a CITA.
30. Id.

application of Article 10a of the CITA can also be found in parliamentary history. A number of instances have been recorded of legislators making reference to "permissible and non-permissible tax savings".[31] Taxpayers seem to have some leeway in seeking the optimal financial structuring of their business activities – some tax saving is permissible – as Article 10a is not meant to be applied to regular business transactions to which tax saving is of marginal importance.[32] The presence of business-like motives, however, does not mean that the taxpayer has an unhindered free choice in the execution of the contemplated transactions. Examples of business-like motives include consistent dividend policies or the taking-on of external debt.[33] The legislator did not draw an exact line of demarcation between what may be considered permissible and non-permissible for the purpose of application of Article 10a of the CITA. (The operation of Article 10a is further discussed in section 19.3.7.2.)

A number of decrees have been put into place in support of the application of the rollover relief regimes in the CITA, facilitating business restructurings such as mergers, exchanges of shares and split-offs.[34] Rollover relief is unavailable under the CITA if the restructuring is mainly aimed at escaping or unduly deferring tax. Loosely aligning with Merger Directive terminology, a rebuttable presumption applies that any business restructuring of any kind is deemed to be based on tax avoidance objectives if the restructuring does not take place for valid commercial reasons such as a restructuring or a rationalization of the active business activities of the parties involved in the restructuring transaction. The decrees add that the presence or absence of such a tax motive is determined by reference to a comparison of scenarios before and after the business restructuring transaction(s). Taxpayers have the opportunity to show evidence in support of the presence of business motives underlying the restructuring transaction(s). (The operation of rollover relief is further discussed in section 19.3.8.4.)

31. *See*, for example, Parliamentary Papers House of Representatives, 2005-2006, 30 572, No. 8, at 45-46.
32. *See*, for example, Parliamentary Papers Senate, 2007-2008, 31 205 and 31 206, No. C, at 27-29.
33. *See*, for example, Parliamentary Papers House of Representatives, 1995-1996, 24 696, No. 3, at 14-22.
34. Decrees of 27 January 2015, No. BLKB 2015/34M. CIT, Mergers; No. BLKB 2015/38M. CIT, Splits; and No. BLKB 2015/33M. CIT, Split-offs.

19.1.1.3. Tax rulings and horizontal monitoring – Providing legal certainty and transparency

Corporate taxpayers may obtain legal certainty on their corporate tax positions in the Netherlands relating to their substantial business activities by means of a ruling.[35] Taxpayers may make a request of the tax administration – i.e. the competent tax inspector in association with a specialist resource unit within the tax administration, the advance pricing agreement (APA)/advance tax ruling (ATR) team – in the pre-tax return filing stage to conclude or provide a ruling in the form of an APA or an ATR. An APA provides for legal certainty on TP issues, and an ATR gives certainty on the tax implications in the Netherlands with regard to the legal organization of contemplated business activities. In tax treaty scenarios, taxpayers may also request that the competent authorities commence mutual agreement procedures for the purpose of establishing bilateral or multilateral ATRs/APAs or to proceed to arbitration to the extent available under the treaty concerned. Rulings are regularly agreed to in Dutch tax practice and often relate to TP, the application of the participation exemption, the presence or absence of a permanent establishment, the deductibility of an interest payment or a combination thereof.

Tax rulings are administrative efficiency tools providing legal certainty in technically complex corporate tax cases. Rulings are by no means meant to facilitate tax avoidance. Cases lacking economic substance are ineligible for obtaining a ruling.[36] No rulings are issued in cases where taxpayers seek to artificially avoid Dutch taxation or foreign-source taxes in tax treaty scenarios. The same holds for scenarios involving arrangements set up to erode foreign tax base in the event that the tax administration would try to strike down such arrangements in the reverse situation, for instance on the basis of Article 10a of the CITA. In cases lacking sufficient substance, the tax administration proceeds to a spontaneous exchange of the relevant information with the treaty partner concerned.[37] In its treaty negotiations, the Dutch government strives to agree with its treaty partners that these partners inform the Netherlands upfront in the event they consider invoking an anti-abuse provision in the tax treaty concerned.[38] The Netherlands in

35. *See* Decrees of 3 June 2014, No. DGB 2014/3098 (APA); No. DGB 2014/3099 (ATR); and No. DGB 2014/296M.
36. Substance criteria have been issued to provide guidance on this matter; *see* Decrees of 3 June 2014, No. DGB 2014/3101; and No. DGB 2014/3102.
37. Article 3a Implementing Order to the Law on International Assistance.
38. Letter of 5 October 2015 from the State Secretary for Finance to the House of Representatives presenting an assessment of the outcome of the BEPS Project and the outlook for the Dutch tax climate for businesses (available in English at https://www.

return may proceed to spontaneously exchange relevant information regarding corporate entities through which hardly any functions are performed and which incur merely insignificant economic risks.

In addition to concluding rulings, the Dutch tax system also allows corporate taxpayers to gain legal certainty as to their overall tax position in the pre-tax return filing stage by voluntarily engaging in a so-called compliance covenant with the tax administration on the basis of "mutual trust, understanding and transparency". This is referred to as horizontal monitoring (*horizontaal toezicht*). Horizontal monitoring seeks to reduce administrative burdens and to provide legal certainty by settling tax uncertainties in the pre-tax return filing stage. It is available for large and medium-sized multinational enterprises that have a solid tax control framework or are willing to develop such a framework. A tax control framework is an internal control instrument focusing on a business's tax process and is part of a company's control framework, drafted for the purpose of issuing in-control statements to stakeholders. A compliance covenant essentially is a contractual arrangement between the taxpayer and the tax administration on mutual cooperation. Taxpayers commit themselves to active and timely submission of current or impending tax positions of significant importance that may allow for differing legal interpretations. The tax authorities agree to quickly decide on these matters. Tax positions and their consequences are then openly discussed and assessed. Tax returns are subsequently filed with due observance of the consensus previously reached, and the tax assessment is issued accordingly. Horizontal monitoring is generally seen as an administrative-efficiency enhancement tool, easing capacity pressures involving the use of traditional retrospective control instruments by the tax administration. The horizontal monitoring project is coordinated within the tax administration by a specialized resource unit.

Moreover, the Netherlands considers itself a front-runner in the area of tax transparency and, amongst others, has joined recent international and European transparency initiatives involving countries proceeding to a spontaneous exchange of information on tax rulings (the EU Administrative Cooperation Directive, the OECD base erosion and profit shifting (BEPS) Action 5 and the 14 July 2015 Netherlands-Germany Memorandum of Understanding). It should be noted that the European Commission recently

government.nl/documents/letters/2015/10/19/letter-presenting-an-assessment-of-the-outcome-of-the-beps-project-and-the-outlook-for-the-dutch-tax-climate-for-businesses); Letter of the State Secretary for Finance, 5 October 2015, *Betreft Appreciatie uitkomst BEPS-project en vooruitblik Nederlands fiscaal vestigingsklimaat*, No. IZV/2015/657 M. (Letter of 5 October 2015).

decided that the Netherlands has granted selective tax advantages via an APA to an individual company in an incidental case in breach of EU State aid rules.[39] However, the European Commission currently views the Dutch ruling practice generally as non-problematic and without irregularities.[40]

19.1.1.4. Case law on the meaning of tax avoidance

As noted, a large number of anti-tax avoidance rules and anti-abuse provisions apply throughout the Dutch tax system. These have produced a vast body of case law, identifying applicable law with a view to addressing undue and tax-induced taxpayer behaviour in individual cases by reference to the individual merits of applicable rules and doctrines, their scopes of application, objectives, eligibility tests and terminologies. Applicable law for this purpose is identified by reference to fact-finding and interpretation, *fraus legis*, tax base determination rules and doctrines, and the application of the body of specific tax avoidance regimes in domestic legislation and the tax treaty network. The system should meet EU law where applicable, also generating sizeable bodies of case law. (A selection of relevant case law and doctrines is given below in sections 19.2., 19.3. and 19.4.)

No clear-cut description of tax avoidance can be derived from the courts' tax case law. The Dutch tax system, as said, does not provide for a general definition or interpretation of the term. Some general remarks on approaches in case law may, nevertheless, be put forward here. In general terms, the courts seem willing to take a substance-over-form approach, in line with the spirit of the law. Fact finding and interpretation seek to discover true facts and the object and intent of applicable rules. *Fraus legis* seeks to unveil predominant tax motives, for instance by reference to the artificiality of the legal arrangements. Tax base determination resorts to business-like characteristics underlying inter-affiliate transactions and transfer prices. The ALS is interpreted by reference to substance and third-party comparability. When it comes to applying SAARs, courts assess, for instance, whether tax base is artificially eroded or whether passive and mobile profits are sheltered in a low-tax jurisdiction abroad.

39. European Commission, Press Release, 21 October 2015, IP/15/5880. The Netherlands appealed (*see also* section 19.3.3.)
40. European Commission, Press Release, 11 June 2014, IP/14/663.

19.1.1.5. Judicial competence exercised by the courts rather than bodies that are not strictly judicial

The questionnaire queried whether the judicial competence is also exercised by bodies that are not strictly judicial, such as arbitration courts or economic-administrative instances, and, if so, whether the case law is consistent among the different bodies with judicial competence. In the Netherlands, no arbitration courts or economic-administrative instances have been put in place, at least not in the area of direct taxation. Hence, an assessment of the presence or absence of any consistencies or inconsistencies in approaches to tax avoidance cannot be performed.

19.1.1.6. Influences of tax effects in other jurisdictions, OECD soft law and ECJ case law on tax avoidance

Dutch corporate tax law and the tax treaties in the Dutch international tax treaty network are interpreted and applied autonomously. Foreign tax implications generally do not affect Dutch taxation. This holds true with regard to both the application of the domestic system and the treaties. It follows that mismatches arise where the operation of the Netherlands' tax system in a cross-border scenario differs from its equivalent's operation abroad. This renders the system sensitive to double (non-)taxation and tax avoidance. These remain unresolved unless explicitly dealt with by the legislature. To protect the Dutch tax base from erosion, the corporate tax code contains a range of provisions rendering tax effects in the Netherlands – e.g. taxation, tax-deduction, non-taxation and loss offset – dependent on overseas implications, for instance by reference to a subject-to-tax clause,[41] a "compensating levy test",[42] local tax-deductibility[43] or local loss relief entitlements.[44]

OECD and EU soft-law initiatives have a significant influence on corporate taxation in the Netherlands. The Netherlands, for instance, closely adheres to the OECD's interpretation of the ALS and third-party comparability under the OECD TP Guidelines. When it comes to addressing harmful tax competition and undue planning responses, the Netherlands keeps to international developments as well, for instance those involving recent transparency initiatives and the adoption of the modified nexus approach as recommended under Action 5 of the OECD's BEPS package (i.e. to bring to

41. Articles 13a and 13aa.
42. Article 10a(3).
43. Articles 13(17) and 15ac(4)-(6).
44. Articles 13d(9) and 15i(3).

an end any tax-induced artificial intangible asset shifting). In addition, EU soft law, for instance in the area of harmful tax competition and the Code of Conduct on business taxation, has had a significant impact on the Dutch tax system. The Netherlands considers that international mismatches should be resolved via cross-border tax coordination. The Netherlands therefore backs recent EU coordination initiatives to address base erosion and profit shifting (EU BEPS) via an EU instrument (*see also* section 19.1.1.8.).[45]

The case law of the Court of Justice of the European Union (ECJ) on tax abuse has a profound impact on the Dutch tax system, as the Netherlands is an EU Member State and EU law has a direct effect in the Netherlands' legal order. In the law-making process, for instance, draft tax bills are consistently assessed as to their compatibility with EU law. The Netherlands has implemented anti-abuse provisions in the PSD and the Merger Directive. A considerable body of case law exists on the compatibility or incompatibility with primary and secondary EU law of anti-avoidance provisions in the Dutch tax system. In this respect, matters essentially and continuously revolve around artificiality, tax-dodging motives and the intent of the law (*see further* section 19.2.).

19.1.1.7. Impact of the BEPS package on Dutch international policies on tax avoidance

On 5 October 2015, the OECD published the Final Reports of the OECD/G20 BEPS Project. The package is now entering the transposition stage. It seeks to ensure a single taxation of business income at the location of value creation and is built on three pillars: transparency, substance, and coherence. That same day, the State Secretary for Finance sent a letter to the house of representatives presenting an assessment of the BEPS outcomes and an outlook for the Dutch tax climate for businesses.[46] He subsequently presented a follow-up letter on this matter on 19 November 2015[47] in which he welcomed the BEPS package and noted that some of the outcomes may be implemented directly in the Dutch tax system, whereas others require internationally coordinated actions, for instance within the context of the European Union. According to the State Secretary for Finance, BEPS

45. Letter of 5 October 2015, *supra* n 38; and Letter of the State Secretary for Finance, 19 November 2015, No. IZV/2015/936 U (Letter of 19 November 2015). *See also* Council of the European Union, Council conclusions on corporate taxation – base erosion and profit shifting, Press Release, 8 December 2015, 910/15 (Council Press Release).
46. Letter of 5 October 2015, *supra* n. 38.
47. Letter of 19 November 2015, *supra* n. 45.

measures should target tax avoidance through artificial structuring but leave the real economy unharmed.

The Netherlands supports the BEPS package and aims to strike a balance between adequately addressing BEPS issues and preserving the attractiveness of the Dutch investment climate, combating tax avoidance and simultaneously maintaining its appeal for corporate headquarters and other companies conducting real business activity. If concrete anti-BEPS measures were to produce unwanted effective tax rate increases harming the real economy, the State Secretary would consider compensating for these with generic tax rate reductions. BEPS outcomes have been observed to correspond with the "crown jewels" of the Dutch tax climate for business investment, i.e. the participation exemption, the absence of source taxes on outbound royalty and interest payments, the extensive tax treaty network and an efficient, professional and constructive tax administration that is prepared to provide corporate taxpayers legal certainty on their tax positions in the pre-tax return filing stage.

19.1.1.8. Concrete impact of the BEPS package on addressing tax avoidance in legislation and case law

When it comes to addressing tax avoidance and implementing BEPS outcomes, the line taken by the Netherlands seems to match the OECD's. The Netherlands has been particularly active in transparency and information exchange. Country-by-country reporting (CbCR – BEPS Action 13) has been implemented as per 1 January 2016.[48] A tradition exists of championing improvements in the area of international dispute resolution mechanisms, with a view to both mutual agreement and arbitration (BEPS Action 14). Moreover, the Netherlands, as said, has joined international and European initiatives in the area of information exchange, for instance on tax rulings (BEPS Action 5). On 14 July 2015, the Netherlands and Germany signed a Memorandum of Understanding introducing a spontaneous exchange of information on cross-border tax rulings.

Addressing tax avoidance via substantive rules, recent developments in the Netherlands have focused on substance. The Netherlands adheres to agreed-upon minimum standards for preferential regimes – involving the taxation of proceeds from intellectual property commercialization under the innovation box regime[49] – requiring substantial activity as a threshold

48. Articles 29b et seq.
49. Article 12b.

for granting beneficial treatment (the (modified) nexus approach – BEPS Action 5). The Netherlands has committed to including anti-abuse provisions in its tax treaties, which ties in with agreed-upon minimum standards on preventing treaty abuse (BEPS Action 6). The recommendations on preventing the artificial avoidance of permanent establishment status (BEPS Action 7) have been adopted and are now part of Dutch international tax treaty policy. In the area of TP (BEPS Actions 8-10), the State Secretary for Finance has noted that current policies and approaches correspond with the modified OECD TP Guidelines.[50] The Netherlands has joined the ad hoc group devoted to developing a multilateral instrument to implement the treaty-related BEPS outcomes.

The general attitude towards coherence is that the tax climate for businesses should not be harmed by taking unilateral measures. BEPS effects that arise from a non-alignment of international tax systems should be addressed through internationally coordinated actions to preserve level playing fields. The State Secretary refers for this purpose to the recent activities undertaken at Commission and Council levels to achieve such a coordination by means of an EU instrument (EU BEPS).[51] Such an instrument would have the form of an anti-BEPS directive and would technically be lifted from the technical work that has been undertaken in the context of the proposal for a common consolidated corporate tax base (CCCTB). Such an anti-BEPS directive would address BEPS Action 2 (mismatches), Action 3 (CFCs), Action 4 (interest deduction), Action 6 (treaty abuse/GAAR), Action 7 (permanent establishment) and Action 13 (CbCR), as well as introduce an EU-wide exit taxation mechanism and a switch-over provision to secure effective minimum corporate tax rates. The Code of Conduct Group would have a complementary role with a view to providing guidance as to securing an effective transposition of the European Union's anti-BEPS measures into

50. Letter of 5 October 2015, *supra* n. 38.
51. Letter of 5 October 2015, *supra* n. 38; and Letter of 19 November 2015, *supra* n. 45. *See* Council Press Release, *supra* note 45; European Commission, *5 Key Areas for Action*, 17 June 2015, (COM(2015) 302); Council of the European Union, *BEPS: Presidency roadmap on future work*, 8 July 2015, (10649/15); Note from Presidency to Permanent Representatives Committee/Council, *Proposal for a Council Directive on a Common Consolidated Corporate Tax Base (CCCTB) – State of play*, Brussels, 1 December 2015 (OR. en), 14509/15 LIMITE, FISC 169; ECOFIN 916, Note from Presidency to Working Party on Tax Questions – Direct Taxation, *Proposal for a Council Directive on a Common Consolidated Corporate Tax Base (CCCTB)*, Brussels, 2 December 2015 (OR. en), 14544/15, LIMITE, FISC 171 (Council Presidency draft anti-BEPS Directive); and Note from Presidency to Working Party on Tax Questions – Direct Taxation, *Proposal for a Council Directive on a Common Consolidated Corporate Tax Base (CCCTB) – Explanatory notes*, Brussels, 2 December 2015 (OR. en), 14544/15, ADD 1, LIMITE, FISC 171 (Council Presidency draft anti-BEPS Directive explanatory notes).

the Member States' tax systems. On 15 December 2015, the presidency of the Council published a consolidated text and accompanying explanatory notes of a possible split of the CCCTB proposal related to anti-BEPS aspects.[52] The European Commission is expected to submit a proposal for an anti-BEPS directive in early 2016. The Dutch State Secretary for Finance noted that EU competitiveness considerations should not be overshadowed in addressing BEPS issues via EU-wide coordinated measures.

Furthermore, the Netherlands has implemented recent amendments to the PSD. The PSD's GAAR has been implemented via the existing corporate income tax regime for non-resident shareholding companies[53] and via the dividend withholding tax regime for Dutch resident cooperatives.[54] Both regimes focus on artificiality and tax-avoidance motives and, for instance, do not apply in the presence of sufficient substance according to Dutch standards (*see further* sections 19.3.8.2. and 19.3.8.6.). The PSD's anti-mismatch provision has been implemented via the participation exemption regime.[55] Briefly put, the participation exemption is unavailable with regard to profit repatriations received from a participation if these are tax-deductible at the level of the distributing entity abroad (*see further* section 19.3.6.).

The BEPS package has not affected Dutch case law as of the time of writing. The general view seems to be that, for *trias politica* reasons and the primacy of the democratically legitimized legislature, any addressing of international mismatches is on the table of the legislature rather than the judiciary. The only room analytically available for addressing non-taxation as a consequence of international mismatches would, it seems, be in extending the scope of the *fraus legis* doctrine. To this date, however the Supreme Court has assessed the question of whether tax-induced taxpayer behaviour and artificial structuring is contrary to the intent of the law by reference to the internal consistency of the Dutch tax system. So far, no considerations have been recorded in case law with a view to applying *fraus legis* in cases involving non-taxation outcomes that emerged from the utilization of disparities in the international tax regime (except for certain so-called profit drainage scenarios; *see* section 19.2.1.6.). "External inconsistency reasoning" is alien to *fraus legis* jurisprudence. Only time will tell whether the Supreme Court would be willing to further extend the scope of application

52. Council Presidency draft anti-BEPS Directive, *supra* n. 51; and Council Presidency draft anti-BEPS Directive explanatory notes, *supra* n. 51.
53. Article 17(3)(b).
54. Article 1(7) DWTA.
55. Article 13(17).

of *fraus legis* to also address international mismatches, for instance in response to societal calls for such.

19.1.2. The meaning of tax planning, abusive tax planning and aggressive tax planning in the Dutch tax system

19.1.2.1. The general approach towards tax planning in the Netherlands

The Dutch legal system not only lacks a concrete and readily available definition of "tax planning", the same holds for the terms "abusive tax planning" and "aggressive tax planning". Perhaps this is also due to the fact that these terms seem to have more a societal and moral import than a strict legal meaning. The terms all share a reference to tax-motivated behaviour, a steering of economic activity or the legal organization thereof towards an advantageous outcome in terms of taxes payable. Notably, governments also use taxation as a macroeconomic steering device for promoting or dissuading taxpayers from engaging in certain activities. The Netherlands, for instance, introduced an innovation box regime some years back to attract real innovative activity. Tax planning as such does not seem to be considered problematic or immoral. Abusive tax planning or aggressive tax planning, however, is (the terms are considered interchangeable in this chapter). Any differences between "fair" or perhaps "legitimate" tax planning and "abusive" or "aggressive" tax planning seem incremental ones. This raises the question of where to draw a dividing line, a matter which has also been discussed in the Netherlands.

From an ethical and societal perspective, the matter seems to revolve around a moral duty to society to contribute a fair share of taxation in accordance with one's means in order to finance public expenditure from which everyone benefits. One is not morally obliged to pay more than one should; however, one is not morally entitled to pay less. It follows that paying less tax than one morally should – regardless of whether such an outcome is legal in a strict juridical sense – may be felt to be unethical. Planning outside the current tax framework constitutes tax fraud and is illegal and, it seems, similarly unethical. Seen from that perspective, a broad dividing line may be drawn in the sense that tax planning may be considered non-problematic as long as one does not pay less tax than one should. If one engages in tax planning and ends up paying less than should, albeit within the framework of applicable tax law, such tax planning may be considered abusive or aggressive, irrespective of its being legal. That being said, the opinion that

the liabilities of multinationals to pay tax do not extend beyond their strictly legal obligations to do so has also been expressed.

Company tax systems, as said, essentially seek to effectively tax business profits once at the location of value creation, whereby that location equals the location of investment. If the underlying objective of international corporate taxation is a single taxation of business income at the investment location, it follows that any tax planning that seeks an outcome in accordance with that objective should be considered ethically fair or legitimate. This may be the case with regard to any highly technical and complex corporate tax planning, as long as such planning seeks to escape juridical and/or economic multiple taxation of business income. This may be considered to similarly hold true with regard to any tax-induced shifting of real investment to benefit from effective tax rate differentials, for instance by making use of a country's beneficial regime that follows the internationally agreed-upon (modified) nexus approach (OECD BEPS Action 5). If such tax competition is considered fair, the same would need to hold for any responses in terms of tax-induced shifting of real investment. By that same view, any ensuing investment location distortions should not be considered immoral.

From this perspective, it also follows that aggressive or abusive planning may then be understood as any tax planning within the framework of applicable tax law that artificially seeks to disconnect corporate tax base from those locations in which actual business is conducted to arrive at an outcome of being subject to a less-than-single taxation. Aggressive tax planning in that sense involves a legal yet substantively artificial assigning of taxable base to a place where it effectively remains untaxed, or at least produces a significant reduction in the effective tax burden. Such a tax-induced paper profit shifting contravenes widely felt moral notions of fair contribution. This seems to render aggressive and abusive tax planning equivalents of tax avoidance. As said, abusive planning outside the framework of current tax law constitutes fraud and is illegal. Hence, such planning is the equivalent of tax evasion.[56]

Aggressive tax planning accordingly involves a tax-driven legal structuring, a "tax engineering", that is, of corporate activity to minimize tax costs and maximize after-tax profits. Typically, such planning strategies may involve setting up artificial transactions or series of transactions with the sole aim of avoiding taxation strictly in line with the legislative texts concerned

56. As noted, dividing lines between legal tax avoidance and illegal tax evasion are not discussed in this chapter.

but contrary to the intent of the law. Such planning may also involve a legal shifting or sheltering of mobile resources such as intangible assets or monetary assets to low or no-taxing jurisdictions. Textbook profit-shifting arrangements include intra-group debt financing and licensing arrangements. Such arrangements generate in principle tax-deductible interest and royalty payments in the jurisdictions where real investment takes place. Corresponding receipts may then be steered towards group companies – such as cash box companies and IP box companies – in tax haven jurisdictions, thereby initiating BEPS issues. Such intra-group income streams may be routed via intermediate group companies in favourable jurisdictions to sidestep source taxation (treaty shopping). Moreover, such planning may also involve a strategic use of differentials between at least two tax systems, i.e. the utilization of disparities or mismatches in entity classification, income qualification or tax base allocation, with the objective of reducing tax liability. Terms used in practice to refer to such types of planning entities include "hybrid instruments", "hybrid entities", "hybrid transfers", "dual residence entities", "(double) deduction and no inclusion transactions" and "foreign tax credit transactions".

Aggressive tax planning involving artificial arrangements set up to avoid tax contrary to the law is addressed in the Netherlands' tax system by means of regular fact-finding and interpretation methods, including the *fraus legis* doctrine and the taxable-profit calculation mechanism (*see* section 19.1.1.1. and, for details, sections 19.2.1. and 19.3.1.3.). The Netherlands' corporate tax base is protected against sheltering, shifting and base erosion strategies by means of SAARs (*see* section 19.1.1.1. and, for details, sections 19.3.4.8. and 19.4.). Aggressive planning using mismatch arrangements is addressed in the Dutch tax system on the basis of mechanical anti-hybrid rules (*see* section 19.3.6.).

19.1.2.2. The presence of administrative regulations clarifying the meaning of tax planning

Similar to the questionnaire's queries relating to the term "tax avoidance", addressed in section 19.1.1.2., the questionnaire also queried whether administrative regulations clarify the meaning of "tax planning", "aggressive tax planning" or "abusive tax planning". The preceding paragraphs have analysed the term tax avoidance and aggressive tax planning as constituting conceptual equivalents. As noted in section 19.1.1.2., no explicit guidance is available, although some inferences may be made from statements and

positions in a number of decrees and resolutions. We refer again here to those referenced in that section.

19.1.2.3. Tax rulings – Providing legal certainty; *trias politica*

Taxpayers may obtain legal certainty on their corporate tax positions by means of a ruling. Rulings aim at providing legal certainty in technically complex corporate tax cases. It is not possible to conclude rulings with the tax administration outside the framework of applicable law. So-called *contra legem* rulings are ineffective and considered null and void for tax purposes. The ruling practice is generally considered as an administrative efficiency tool of the executive rather than a means for international tax coordination. Dutch constitutional law does not provide room for the ruling system to be used as a unilateral tax coordination tool (due to *trias politica* reasons and the primacy of the legislature). When it comes to addressing double taxation and double non-taxation outcomes due to any disparities, the general view is that these cannot be resolved by the Netherlands unilaterally. Correspondingly, these issues cannot be resolved through the Dutch ruling practice either.

19.1.2.4. Case law on the meaning of tax avoidance

It is established case law of the Supreme Court that taxpayers are allowed as a general rule to legally arrange their economic and business affairs in the manner that is most tax advantageous. Any escaping of tax imposts is allowed, provided that the means used for that purpose may be considered admissible and normal – which may be taken to mean non-artificial and having real practical meaning. This notion forms part of the *fraus legis* doctrine discussed below in section 19.2.1.1. and is known in Dutch tax jurisprudence as *verschillende-wegenleer*, which may loosely be translated as “admissible tax planning”.

Tax motivated and undue planning, for instance through artificial, non-business-like or unreasonable means, however, is addressed in the Dutch tax system via a broad range of means. These include the operation of fact-finding and interpretation methods, including *fraus legis*, the taxable-profit calculation mechanism (including the ALS) and the operation of the SAARs and targeted anti-mismatch provisions in the Dutch corporate tax system. These were noted in section 19.1.1.1. and will be further elaborated upon in upcoming sections.

19.1.2.5. Relationships between tax avoidance, tax planning and aggressive or abusive tax planning concepts

The Dutch corporate tax system, as noted, lacks concrete legal definitions of the terms "tax avoidance", "tax planning", and "aggressive" or "abusive" tax planning. It may be inferred from the observations above that the term "tax avoidance" addresses the societal phenomenon of an escaping, through artificial yet legal means, of any ethical duties towards society to contribute a fair share of taxation in accordance with one's means to finance public expenditure from which everyone benefits. Focusing on the perspective of the individual economic operator, legitimate, ethically fair or admissible and normal tax planning seems to involve a tax planning by that operator in line with the essential objective of international corporate taxation of taxing business income once at the location of production. Tax planning may then be considered fair to the extent it involves any securing of a single corporate taxation of business profits at the investment location. The same seems to hold for any shifting of real investment in response to a fair tax competition between countries. Aggressive or abusive planning may be understood as any planning within the framework of applicable tax law that seeks to artificially disconnect corporate tax base from those locations in which actual business is conducted to arrive at an outcome of being subject to a less-than-single taxation. Such planning involves a tax-driven legal engineering of corporate activity to minimize tax costs and maximize after-tax profits. Tax avoidance and aggressive tax planning seem analytical equivalents, at least from a Dutch corporate tax perspective.

19.1.2.6. Absence in the Netherlands of tax arbitration courts or economic-administrative instances

Similar to the questionnaire's queries under section 19.1.1.5. relating to the term "tax avoidance", the questionnaire also queried in regard to tax planning whether judicial competence is also exercised by bodies that are not strictly judicial and, if yes, whether the case law is mutually consistent. As noted, no arbitration courts or economic-administrative instances have been put in place in the area of direct taxation in the Netherlands. Therefore, the requested assessment cannot be performed.

19.1.2.7. Influences of tax effects in other jurisdictions, OECD soft law and ECJ case law on tax planning

Similar to the questionnaire's queries under section 19.1.1.6. relating to the term "tax avoidance", the questionnaire also sought to assess the influences on the meaning of the terms "tax planning" and "aggressive" and "abusive" tax planning in the Dutch tax system exerted by their meanings in other jurisdictions, OECD soft law and the case law of the ECJ. As noted in section 19.1.1.6., Dutch corporate tax law and the tax treaties in the Dutch treaty network are interpreted and applied autonomously. This renders the system vulnerable to double taxation and double non-taxation outcomes and provides planning opportunities. OECD and EU soft-law initiatives addressing tax avoidance have a significant influence. The case law of the ECJ on tax abuse has a profound impact on the Dutch tax system. Matters revolve around artificiality, tax-dodging motives and the intent of the law.

19.1.2.8. Impact of the BEPS package on Dutch international policies on aggressive tax planning

Similar to the questionnaire's queries under section 19.1.1.7., the questionnaire also sought to assess the repercussions of the BEPS package on the meaning of tax planning, abusive tax planning and aggressive tax planning in the Dutch tax system. As noted in section 19.1.1.7., the Netherlands supports the BEPS package and seeks to strike a balance between an adequate addressing of BEPS issues and preserving the attractiveness of the Dutch investment climate.

19.1.2.9. Concrete impact of the BEPS package on addressing aggressive tax planning in legislation and case law

Similar to its queries under section 19.1.1.8., the questionnaire sought to assess the types of repercussions the BEPS package has had in legislative amendments, in the exercise of competence by the tax administration and/or in the judicial interpretation by courts. As noted in section 19.1.1.8., the BEPS package has already had some significant impact on addressing aggressive tax planning. The line taken by the Netherlands seems to match the OECD's. In the area of transparency and information exchange, the Netherlands, as said, has been particularly active. Developments in the Netherlands have further focused on substance. Considering further coherence in direct taxation to be achieved through international coordination,

the Netherlands has implemented recent amendments to the PSD, focusing on artificiality and tax-avoidance motives.

19.2. The reaction to avoidance and aggressive tax planning in the BEPS context

19.2.1. Domestic general anti-avoidance rules (GAARs)

19.2.1.1. National GAAR; *fraus legis*

19.2.1.1.1. Fraus legis *as* ultimum remedium *interpretative tool*

In its ruling of 26 May 1926, the Dutch Supreme Court introduced a GAAR in the Netherlands' domestic tax system: *fraus legis*.[57] The *fraus legis* doctrine has been a part of Dutch jurisprudence since. *Fraus legis* serves as an *ultimum remedium* interpretative tool for legal discovery and may be invoked by the tax authorities to counter evidently dubious misuse by taxpayers of applicable legislative acts. As an *ultimum remedium*, *fraus legis* constitutes a *lex specialis*. It may only be applied if the applicable law in a particular tax case cannot be discovered in accordance with its purpose and intent by reference to the consideration of regular methods of fact finding and interpretation in Dutch taxation. These regular methods serve as *leges generales* in this respect.

Next to *fraus legis*, a second GAAR can be found down in the Dutch tax legislation: *richtige heffing*, a concept which may be loosely translated as "correct taxation". It is laid down in Article 31 et seq. of the Dutch General Law on Taxation (GLT).[58] The provisions on *richtige heffing*, however, have rarely been invoked, and not at all since the 1980s, in consequence of developments in case law in the area of *fraus legis*. Today, *fraus legis* is generally considered to encompass *richtige heffing*. Both share the substantive conditions for application, i.e. the aim of securing a tax advantage which defeats the object or purpose of the law. *Fraus legis*, however, allows courts to either ignore or substitute legal arrangements, whereas the application of *richtige heffing* only allows these arrangements to be set aside. Moreover, *richtige heffing* may only be invoked in a separate procedure. Although *fraus legis* seems the more encompassing and efficient anti-abuse tool, no

57. Supreme Court, 26 May 1926, *NJ* 1926, 723 (*Three Days*).
58. *See*, for a case to which the concept was applied, Supreme Court, 2 March 1988, BNB 1988/135 (*Diamond Construction*).

plans exist at this time to abolish Article 31 et seq. of the GLT – although the State Secretary for Finance has stated that Article 31 et seq. GLT will not be invoked any longer in practice.

19.2.1.1.2. *Regular fact-finding and interpretation methods already go a long way in addressing abuse*

The regular fact-finding and interpretation methods preceding the application of *fraus legis* may also be seen as instruments addressing certain forms of unwanted use or misuse of the Dutch tax system. These, as said, already go quite a long way in addressing tax avoidance and aggressive planning, as, for instance, they filter disguised transactions from influencing applicable tax law,[59] allow courts to proceed to a requalification of legal transactions for tax purposes[60] – even an autonomous qualification[61] – and provide courts the means to extensively interpret tax legislation in line with its object and intent. This makes it perhaps worthwhile to first address these general methods before proceeding to an assessment of the *fraus legis* doctrine.

Legal discovery in Dutch taxation under the application of regular methods takes place in two steps. The first step includes an autonomous qualification of facts and circumstances for tax purposes. This, for instance, allows tax courts to disregard disguised legal transactions and arrangements created by taxpayers for tax purposes if they do not reflect actual legal realities (simulation). Due to their not reflecting legal reality, such arrangements are disregarded for tax purposes as well. Moreover, an autonomous facts discovery in taxation also allows courts to move away from legal realities in qualifying them for tax purposes if these legal realities do not align with economic reality. This area of tax law is of relevance, for instance, when it comes to the characterization of financial instruments either as debt capital or as equity capital for tax law purposes, since a growing number of instruments incorporate elements of both. A subordinated profit-participating loan that is issued under a term exceeding 50 years, for example, is requalified as equity for Dutch corporate tax purposes on the basis of established Supreme

59. *See* Supreme Court, 21 March 1984, BNB 1984/235; and Supreme Court, 10 August 2001, BNB 2001/364.
60. *See*, for instance, Supreme Court, 27 January 1988, BNB 1988/217 (*Unilever*); Supreme Court, 11 March 1998, BNB 1998/208; and Supreme Court, 25 November 2005, BNB 2006/82 (*Prêt Participatif*).
61. *See* Supreme Court, 15 December 1999, BNB 2000/126; and Supreme Court, 15 June 2012, BNB 2012/239. It has been argued in the literature that the concepts of requalification and autonomous qualification are not about interpretation of the law. This is not further discussed here.

Court case law.[62] Such a requalification for tax purposes holds regardless of the fact that such a loan legally constitutes debt.[63] Interest payments on such hybrid loans are not deductible in the Netherlands, putting to an end any risks of creating deductions in the Netherlands for payments akin, economically, to non-deductible dividend payments. To preserve the internal consistency of the Dutch tax system, interest receipts on such hybrid loans may be exempt from corporate taxation pursuant to the participation exemption regime, provided that the applicable eligibility criteria are met.[64]

In addition, so-called loss-financing loans (*bodemloze-putleningen*), i.e. loans in respect of which it is clear from the outset that the amount will never be repaid because of the financial position of the debtor, and so-called sham loans (*schijnleningen*), i.e. loan agreements that have the actual intent of making a capital contribution, are requalified for tax law purposes as equity capital. Notably, such sham loans also constitute equity for civil-law purposes, perhaps rendering such loans examples of disguised legal transactions. Sham loans, however, are typically listed in Dutch doctrine as one of the three common examples of (re)qualification. Worth noting here as well is the fact that the Supreme Court has held that equity for civil-law purposes cannot be requalified as debt for corporate-tax purposes, inter alia for legal certainty reasons, regardless of whether the financing arrangement involved has, economically speaking, debt-like characteristics.[65]

The second step in regular fact finding and interpretation involves an assessment of applicable tax rules and their interpretation and application to the present case. A broad range of interpretative aids are available to the courts in this respect. The principal of legality found in Article 104 of the Dutch Constitution requires the literal text of the legislative act to form the point of departure (grammatical interpretation). If the text is technically complex and detailed, or somewhat indistinct or ambiguous, a broad range of interpretative methods are available to apply to the legislative acts involved. Interpretative aids include reference to the legal system of which the legislative texts are part (systematic interpretation), reference to the

62. *See*, for instance, Supreme Court, 27 January 1988, BNB 1988/217 (*Unilever*); Supreme Court, 11 March 1998, BNB 1998/208; and Supreme Court, 25 November 2005, BNB 2006/82 (*Prêt Participatif*).
63. Under Dutch civil law, the (provisional) obligation to repay the principal amount upon the expiry of the terms under the loan agreement constitutes a key criterion for qualifying a financing arrangement as a loan for civil law purposes. *See*, for instance, Supreme Court, 8 September 2006, BNB 2007/104.
64. Article 13.
65. Supreme Court, 7 February 2014, BNB 2014/79 (*Redeemable Preference Shares*) and BNB 2014/80 (*Banks Syndicate*).

parliamentary proceedings under which the acts and terms involved were created (historical interpretation) and interpretation by reference to the object and intent underlying the relevant legislative texts and terms (teleological interpretation). Traditionally, grammatical interpretation was dominant in Dutch taxation. Some recent developments in case law, however, show that the Dutch Supreme Court seems willing to resort to teleological reasoning to a greater extent than previously and is even prepared to move away from a crystal clear legislative text to close doors to any potential misuse.[66]

19.2.1.1.3. *Requirements for* fraus legis: *Motive requirement and norm requirement*

Fraus legis can be successfully invoked in court by the tax authorities in cases where a taxpayer (i) having the predominant aim of avoiding taxation enters into a transaction or series of transactions which has that sought-after effect pursuant to applicable tax legislation under the regular methods of fact finding and interpretation (motive requirement); and (ii) such an effect as sought after by the taxpayer contravenes the purpose and intent – i.e. the spirit – of the applicable tax legislation (norm requirement).[67] In such cases, the *fraus legis* doctrine allows courts to interpret and apply the tax law on such a transaction or series of transactions in accordance with the spirit of the law. For this purpose, courts may eliminate the legal facts of the case or substitute for those legal facts a set of constructed facts akin to them to arrive at an outcome in which the tax effects so established are in line with the purpose and intent of the tax law (the doctrines of substitution[68] and elimination[69]).

Fraus legis applies only as an *ultimum remedium*, for its application involves a reconstruction of legal facts and circumstances that contravenes actual legal realities to arrive at an outcome in line with the spirit of the law. Tensions accordingly created with the principles of legality and legal

66. *See* Supreme Court, 6 November 2015, V-N 57.12.
67. Supreme Court, 15 September 1982, BNB 1982/298; Supreme Court, 7 December 1983, BNB 1984/21; Supreme Court, 16 May 1984, BNB 1984/199; and Supreme Court, 13 July 2001, BNB 2001/398.
68. Supreme Court, 11 June 1986, BNB 1986/283 (*Semigrants*).
69. Supreme Court, 22 July 1982, BNB 1982/245; Supreme Court, 20 March 1985, BNB 1985/171; and Supreme Court, 14 June 1989, BNB 1989/240. A partial elimination of transactions also seems feasible; *see* Supreme Court, 21 September 1983, BNB 1983/316; and Supreme Court, 20 March 1985, BNB 1985/148. Substitution and elimination may even have a third-party effect; *see* Supreme Court, 11 May 1988, BNB 1988/290; and Supreme Court, 23 November 1988, BNB 1989/10.

certainty render the application of *fraus legis* subject to strict justification requirements, i.e. the predominant tax-avoidance motive and the contravention of the intent of the law.[70] As noted in section 19.1.2.4., as a general rule, taxpayers are allowed to legally arrange their economic and business affairs in a manner that is most tax advantageous.[71] Any escaping of tax imposts is allowed, provided that the means used for that purpose may be considered admissible and normal – which may be taken to mean non-artificial and having real practical meaning (*verschillende-wegenleer*/admissible tax planning).[72] But even transactions with a practical meaning in terms of the business outcome sought may still be targeted on the basis of *fraus legis* if the legal routing towards such an outcome may be considered to have a predominant tax-avoidance motive. A mere disconnect between the applicable tax legislation and its purpose and intent is not sufficient. Moreover, a mere moral discontent with the legal arrangement set up by the taxpayer, for instance on the part of the tax authorities, is not sufficient to successfully invoke *fraus legis*. The doctrine is seen as not intended to serve as a correction mechanism for sloppy tax law drafting on the part of the tax legislator. For instance, *fraus legis* cannot be invoked, it seems, in cases in which the tax legislator was aware of the tax avoidance risks at the time of drafting the legislative text and/or subsequently – or perhaps should have been aware of those risks as being obvious – but failed to properly address them.[73] That holds, although some occasions have been recorded, particularly in some more recent cases, in which the Supreme Court offered the tax legislator, who did not address certain tax avoidance opportunities although being explicitly pointed to these by commentators, a helping hand.[74] This seems to render any drawing of an exact dividing line between the role of the judiciary and that of the legislature in tax avoidance cases in the Netherlands a somewhat elusive affair.

70. *See* Supreme Court, 21 November 1984, BNB 1985/32; Supreme Court, 29 January1986, BNB 1986/130; and Supreme Court, 9 February 1994, BNB 1994/231.

71. Supreme Court, 12 October 1955, BNB 1955/360; Supreme Court, 21 November 1984, BNB 1985/32; Supreme Court, 19 January 1994, BNB 1994/87; Supreme Court, 13 March 2009, BNB 2009/123; and Supreme Court, 5 June 2015, V-N 2015/27.16. *See also* Supreme Court, 11 July 1990, BNB 1990/293; Supreme Court, 6 September 1995, BNB 1996/4; Supreme Court, 13 July 1994, BNB 1994/269; and Supreme Court, 27 November 1996, BNB 1997/98.

72. Supreme Court, 13 March 2009, BNB 2009/213.

73. *See* Supreme Court, 17 June 1987, BNB 1987/289; Supreme Court, 11 May 1988, BNB 1988/289; Supreme Court, 27 June 1990, BNB 1990/317; Supreme Court, 8 July 1992, BNB 1992/308; Supreme Court, 12 April 2002, BNB 2002/187-189; and Supreme Court, 10 July 2009, BNB 2009/237. *See also* Supreme Court, 6 November 1991, BNB 1992/97; and Supreme Court, 15 July 1997, BNB 1997/296-297 (*Turbo Arrangement*).

74. *See*, for instance, Supreme Court, 15 March 2013, BNB 2013/151; and Supreme Court, 23 May 2014, BNB 2014/171, BNB 2014/172, BNB 2014/173, BNB 2014/176 and BNB 2014/178. *See also* Supreme Court, 8 June 1983, BNB 1983/236.

Any presence of artificiality in the transaction or series of transactions does not seem to constitute a necessary condition for applying *fraus legis*. This holds even though the absence of any real practical meaning supporting the legal constructions created by the taxpayer is generally seen as being supportive of any observation that their outcomes in terms of tax effects under normal fact-finding and interpretation methods contravene the purpose and intent of the applicable tax legislation.[75] The same holds, for instance, in regard to the likelihood of repetitiveness or circularity as a property of the legal arrangement (i.e. the prospect of a tax-carrousel).[76] Artificiality may also be seen as support for an observation that the taxpayer's intent was to avoid taxation.

19.2.1.1.4. *No* fraus tractatus *except for treaty cases under the PPT*

Under Dutch tax law as it currently stands, *fraus legis* can only be applied with regard to the interpretation of domestic laws. This extraordinary method of interpretation is unavailable when it comes to the interpretation of the tax treaties that the Netherlands has concluded. According to case law of the Supreme Court, the interpretation of treaty terms under the application of *fraus legis* – *fraus tractatus*, *fraus pacti* or *fraus conventionis* – may constitute a treaty override to the extent that such an interpretation conflicts with the context of the convention.[77] *Fraus legis* accordingly falls outside the available room for tax treaty interpretation, it seems.

This observation holds perhaps save for scenarios involving the application and interpretation of double tax conventions in the Dutch treaty network containing a general anti-abuse provision. The State Secretary for Finance has maintained that treaty abuse can only be targeted on the basis of explicit anti-abuse provisions in the treaties themselves, for instance on the basis of PPTs similar to those promoted by the OECD in the context of BEPS Action 6 (preventing treaty abuse).[78] It may be argued that *fraus legis* (i.e. to target abuse of domestic law via the treaty system) and *fraus tractatus* (i.e. to target treaty abuse) may be applied in such scenarios pursuant to a PPT. No case law, however, has yet been handed down in support of this position.

75. Supreme Court, 9 February 1994, BNB 1994/231; Supreme Court, 21 October 2005, BNB 2006/114; and Supreme Court, 10 February 2012, BNB 2012/127.
76. Supreme Court, 22 July 1982, BNB 1982/243; Supreme Court, 15 September 1982, BNB 1982/298; Supreme Court, 27 January 1993, BNB 1993/111; Supreme Court, 19 January 1994, BNB 1994/87; and Supreme Court, 8 October 2002, BNB 2004/433.
77. Supreme Court, 5 December 1993, BNB 1994/259.
78. Letter of 5 October 2015, *supra* n. 38; and Letter of 19 November 2015, *supra* n. 45.

The Supreme Court has yet to rule on the matter, and no cases in this area are pending at this time. The Netherlands has proved willing to include a general anti-abuse provision in its tax treaties (an example can be found in Article 23(1) of the Germany-Netherlands tax treaty). The Netherlands is also willing to introduce LOB provisions in its double tax conventions (*see* section 19.3.4.).

19.2.1.1.5. Fraus legis *counterpart for taxpayers having upright intentions*

It is worth noting that the Dutch tax system also provides for a conceptual counterpart of *fraus legis*, namely the doctrine of a "fair application of the tax law" (*leerstuk van de redelijke wetstoepassing*). That doctrine also applies if the applicable law in a particular tax case cannot be discovered in accordance with its purpose and intent by reference to regular interpretation methods. Fair application of the tax law applies in cases involving taxpayers with upright intentions being confronted with a harsh tax outcome contrary to the intent of the law. Tax judges may resort to the doctrine in such cases to preserve the integrity and internal consistency of the Dutch tax system and to arrive at an outcome in which the tax effects established are in line with the purpose of the law. Hence, this constitutes a doctrine similar to *fraus legis*, yet one applied to the benefit of taxpayers rather than to their detriment. Courts apply the doctrine prudently so as not to breach the *trias politica*, for shortcomings in the tax legislation are considered primarily a matter for the legislature to resolve. A conceptual equivalent of the doctrine of fair application of the tax law available for the executive to employ is the so-called hardship clause (*hardheidsclausule*) in Article 63 of the GLT. This provision allows the State Secretary for Finance to resolve unreasonable tax outcomes that work to the detriment of taxpayers in individual cases.

19.2.1.2. Similarities between *fraus legis* and the EC GAAR as proposed in the EC Recommendation (2012)

19.2.1.2.1. *EC Recommendation GAAR: Objectified intention, subjective test, objective test*

On 6 December 2012, the European Commission issued a Recommendation on aggressive tax planning.[79] The communication defines aggressive tax planning as "any taking advantage of the technicalities of a tax system or

79. Commission Recommendation on aggressive tax planning, Brussels, 6 December 2012, C(2012) 8806 final (2012/772/EU) (Commission Recommendation).

of mismatches between two or more tax systems for the purpose of reducing tax liability". The Commission considers aggressive tax planning to include the creation of double deductions whereby an expense or loss is deducted in more than one country. Aggressive tax planning, according to the Commission, also includes the creation of double non-taxation outcomes whereby an item of cross-border income escapes taxation altogether.

The Recommendation proposes that Member States adopt a GAAR in their domestic tax systems that would read as follows: "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". This GAAR undoubtedly echoes case law of the ECJ on abuse (*see* section 19.2.1.3.).[80] The provision essentially refers to "artificial arrangements" (objectified intention) set up "for the essential purpose" (subjective test) of avoiding taxation, i.e. seeking a reduction of tax liability which, however, contradicts the intent of the law (objective test).

19.2.1.2.2. *Similarities between* fraus legis *and the EC Recommendation GAAR*

The GAAR as recommended by the Commission is similar to the *fraus legis* doctrine. Both the recommended provision and *fraus legis* resort to the essential or predominant objective pursued by the taxpayer to reduce its tax liability (subjective test, motive requirement) contrary to the intent of the applicable law (objective test, norm requirement).

Moreover, the Commission provision refers to artificiality as an objectification of the taxpayer's intention. The anti-abuse provision proposed by the Commission would therefore apply only in the presence of an artificial arrangement or an artificial series of arrangements. Artificiality does not seem to constitute a necessary condition for establishing *fraus legis*, although artificiality generally is considered to be of supportive argumentative value with a view to the application of both the motive requirement and the norm requirement. Moreover, artificiality, at least to a certain extent, seems an implicit component of the *fraus legis* doctrine, since the tax

80. *See*, for instance, ECJ, 9 March 1999, C-212/97 (*Centros*); ECJ, 14 December 2000, C-110/99 (*Emsland-Stärke*); ECJ, 21 February 2006, C-255/02 (*Halifax*); ECJ, 12 September 2006, C-196/04 (*Cadbury Schweppes*); ECJ, 5 July 2007, C-321/05 (*Kofoed*); and ECJ, 10 November 2011, C-126/10 (*Foggia*).

implications in cases involving genuine and substantive economic activity would seem to be eligible to be discovered by reference to the regular methods of fact finding and interpretation. Furthermore, the Supreme Court's *fraus legis* jurisprudence has consistently involved cases in which a transaction or series of transactions encompassed a certain degree of artificiality.

The discovery of the legal effects under the application of the anti-abuse approaches under the Recommendation and in Dutch taxation is quite similar as well. Under the recommended GAAR, any artificial arrangements set up to avoid tax in breach of the law's intent will be taken into consideration by reference to their economic substance. *Fraus legis* does something similar, in effect, as the doctrine allows the tax court involved to proceed to a reconstruction of the facts of the case with a view to its substance to arrive at an application of the tax law in accordance with its spirit.

19.2.1.2.3. *Differences between* fraus legis *and the EC Recommendation GAAR*

Some differences may also be observed, however. A key difference between the Commission Recommendation and the *fraus legis* doctrine emerges in terms of addressing non-taxation as a result of international mismatches in entity classification, income qualification or the division of tax base. The GAAR the Commission proposed seeks to counter aggressive tax planning consisting in, inter alia, a "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".[81] Accordingly, the Commission's Recommendation includes any non-taxation outcomes that result in consequence of international mismatch arrangements. The Dutch Supreme Court, however, has so far taken a more cautious approach, placing the matter of addressing international mismatches to a great extent in the hands of the Dutch tax legislator (this, again, for *trias politica* reasons). This holds even though the Supreme Court has held *fraus legis* to apply in so-called profit drainage scenarios, involving artificial intra-group financing arrangements set up to erode Dutch corporate tax base without a so-called compensating levy on the intra-group interest payments in the hands of the group creditor. (*Fraus legis* case law in that area is discussed in detail in section 19.2.1.6.)

81. Commission Recommendation, *supra* n. 79.

19.2.1.3. Compatibility of *fraus legis* with the EU/EEA concept of abuse

19.2.1.3.1. Fraus legis *and the EU/EEA concept of abuse: Nearly identical concepts*

Fraus legis seems compatible with the European Union/European Economic Area's concept of abuse of law. The has been developed by the ECJ in its case law since the mid-1970s.[82] The concept applies both in primary and secondary EU law. Like the Supreme Court, the ECJ allows taxpayers to legally arrange their economic affairs to mitigate tax bills, upholding the principle of legal certainty.[83] However, EU law, like the *fraus legis* doctrine, does not allow taxpayers, either individuals or entities, to improperly or fraudulently circumvent the national tax legislation of the Member State involved. EU law cannot be misused for that purpose and does not protect taxpayers that intend to reduce their tax bills through artificial means in breach of the purpose of the applicable rules.

The European Union's concept of abuse of law is founded on elements essentially akin to those on which *fraus legis* has been built. Both seek to establish an equilibrium between allowing legitimate tax bill mitigation and inter-Member State tax competition without providing taxpayers a shield for abuse. The ECJ does not allow taxpayers to engage in abusive tax practices under a protective umbrella of EU law. As in the GAAR proposed by the Commission in its 2012 Recommendation, the ECJ has also developed an objective test and a subjective test supported by an objectified intention test. Under EU law, the court discovers abuse by reference to, first, "a combination of objective circumstances in which, despite formal observance of the conditions laid down by the rules, the purpose of those rules has not been achieved"; and, second, "a subjective element consisting in the intention to obtain an advantage from the rules by creating artificially the conditions laid down for obtaining it".[84]

82. ECJ, 3 December 1974, 33-74 (*Van Binsbergen*).
83. *See*, for instance, ECJ, 12 May 1998, C-367/96 (*Kefalas*); ECJ, 9 March 1999, C-212/97 (*Centros*); ECJ, 14 December 2000, C-110/99 (*Emsland-Stärke*); ECJ, 21 February 2006, C-255/02 (*Halifax*); ECJ, 12 September 2006, C-196/04 (*Cadbury Schweppes*); ECJ, 5 July 2007, C-321/05 (*Kofoed*); ECJ, 22 December 2010, C-103/09 (*Weald Leasing*); and ECJ, 10 November 2011, C-126/10 (*Foggia*).
84. ECJ, 14 December 2000, C-110/99 (*Emsland-Stärke*).

19.2.1.3.2. *Utilization of disparities allowed if economic activities are genuine*

Under established case law of the ECJ in the field of direct taxation, taxpayers may use tax disparities to their benefit. The Member States may, however, justify a restrictive national tax measure countering such a disparity utilization under the fundamental freedoms where such a tax measure specifically relates to wholly artificial arrangements (the objectified intention test) aimed at (the subjective test) circumventing the application of the legislation of the Member State concerned (the objective test). In *Cadbury* – the well-known EU direct tax case concerning the compatibility of UK CFC legislation with the freedom of establishment – the ECJ observed that "in order for a restriction on the freedom of establishment to be justified on the ground of prevention of abusive practices, the specific objective of such a restriction must be to prevent conduct involving the creation of wholly artificial arrangements which do not reflect economic reality, with a view to escaping the tax normally due on the profits generated by activities carried out on national territory".[85] A wholly artificial arrangement could, for instance, involve the use of a "letter box" or "front" entity. No hard rules, however, can be drawn from the ECJ's case law to decide in which exact circumstances a wholly artificial arrangement is present (or absent). A sufficiency of economic activity and substance (or an absence thereof) differs per individual situation and would need to be assessed on a case-by-case basis.

Whereas it is clear that the European Union's concept of abuse requires contravening the intent of the law, there is some debate as to the relationship between the subjective test (the tax motive) and the objectified intention test (artificiality). Is either one of the two decisive, or should both tests be met simultaneously? Is it the subjective intention of the taxpayer that is of predominant relevance, or is it the presence or absence of an objective factor key, i.e. the presence or absence of a genuine economic activity, real substance supporting the transactions and arrangements concerned? If the subjective intention of the parties involved is decisive, abuse might perhaps be discovered even in the presence of substance. If the existence of objective factors suffices, abuse might be considered absent in the presence of substance, regardless of the presence of a subjective tax avoidance motive. Or should matters indeed be seen in the sense that both tests simultaneously apply, implying that abuse would only be present if both the subjective test and the objectified intention test have been met? If so, abuse would then

85. ECJ, 12 September 2006, C-196/04 (*Cadbury Schweppes*).

be absent in the presence of substance, regardless of whether the taxpayer involved has a tax avoidance motive.

19.2.1.3.3. *Artificiality as a constituent test in both EU law and* fraus legis

In *Cadbury*, the court determined that "there must be, in addition to a subjective element consisting in the intention to obtain a tax advantage, objective circumstances showing that, despite formal observance of the conditions laid down by … law, the objective pursued by [the] freedom of establishment has not been achieved [i.e. the actual pursuit of a genuine economic activity -MdW-CW]". It may be inferred from this that both tests simultaneously apply and both need to be met to establish the presence of abuse, which can be taken to mean that abuse is absent if substance is present, "despite the existence of tax motives".[86]

The approach taken in EU law seems to differ slightly from that taken in *fraus legis*, since in *fraus legis*, as noted, in addition to the norm requirement, the subjective intention of the taxpayer is key, whereby the artificiality of the transactions or arrangements serves a more supportive function in discovering the intention of the taxpayer and the contravention of the intent of the law. However, again as noted, artificiality seems implied in *fraus legis* cases, because tax implications in cases involving genuine economic activity would seem to be discoverable by means of regular methods of fact finding and interpretation in Dutch tax law. *Fraus legis*, at least implicitly, seems eligible to be invoked by the Dutch tax authorities only in cases in which legal arrangements that lack substance have been set up.

The abuse-of-law concept in EU law in the field of direct taxation seems quite strict. Only wholly artificial arrangements constitute abusive practices that can successfully be targeted under it. It seems that the ECJ allows taxpayers to make use of available tax advantages, for instance those that follow from the disparities in the tax systems of the Member States, as long as these taxpayers carry on a genuine economic activity. Abuse of law cannot be invoked by reference to tax-induced motives only. At this point, the concept seems to go hand in hand with *fraus legis*, for the latter is only eligible to be invoked as a last resort in cases where a taxpayer's predominant motive is to obtain a tax advantage. In addition the Supreme Court, as said, allows any escaping of tax imposts, provided that the means used for that purpose may be considered admissible and normal. Should those means be

86. Id.

interpreted as carrying on genuine activity, the concepts analytically match in full.[87]

Matters boil down to the observation that *fraus legis* and the European Union's abuse-of-law concept are nearly identical doctrines. Accordingly, *fraus legis* seems not to contradict EU law. The Supreme Court has ruled on a number of occasions that taxpayers cannot escape *fraus legis* by invoking EU law protection, holding that it is not open to reasonable doubt that taxpayers are ineligible to effectively rely on EU law when their tax positions have been assessed by reference to the application of the *fraus legis* doctrine.[88] In addition, to the authors' knowledge, the literature does not record any positions holding that *fraus legis* is not in line with the abuse-of-law concept in EU law.

19.2.1.4. The elements of *fraus legis* further assessed from an EU anti-abuse perspective

The questionnaire asked whether the following elements (tests) are part of the national GAAR (i.e. the *fraus legis* doctrine in the context of Dutch taxation):

(a) a main objective test (the accrual of a tax advantage the grant of which is contrary to the purpose of the legal provision);
(b) the obtaining of a tax advantage as the essential aim of the transactions concerned;
(c) a complementary business purpose test (under international tax law) or the genuine economic activity test (under EU law);
(d) a subjective element, consisting of the intention to obtain a tax advantage; and
(e) the principle of proportionality.

Again, for the *fraus legis* doctrine to be applicable, the case at hand would need to involve a taxpayer, with the predominant aim of avoiding taxation, entering into a transaction or series of transactions which has that

87. Some room may perhaps exist for recognizing a slight difference, i.e. where *fraus legis* perhaps applies in cases of transactions undertaken having a practical meaning in terms of business outcomes sought after that nonetheless make use of legal routings towards such outcomes predominantly for tax avoidance motives. Perhaps such cases constitute genuine activity for EU abuse-of-law purposes, rendering the abuse-of-law concept not applicable (*see*, for example, ECJ, 22 December 2010, C-103/09 (*Weald Leasing*). These remarks should be seen as forwarded quite tentatively, though.

88. *See* Supreme Court, 23 January 2004, BNB 2004/142; and Supreme Court, 1 June 2012, BNB 2012/213.

sought-after effect under the application of the tax legislation under the regular methods of fact finding and interpretation (motive requirement), where such an effect as sought after by the taxpayer contravenes the purpose and intent of the tax legislation involved (norm requirement). The European Union's concept of abuse of law essentially makes reference to the setting-up of a wholly artificial arrangement (objectified intention test) for the purpose of avoiding taxation (subjective test) contrary to the intent of the law (objective test). Indeed, the two concepts seem nearly identical.

Essentially, elements (a) through (e) above are all present in the Dutch concept of *fraus legis*. The norm requirement in *fraus legis* corresponds to (a), the main objective test in EU law, indeed calling for the accrual of a tax advantage the grant of which is contrary to the object or purpose of the applicable legal provision. In addition, *fraus legis* targets tax outcomes that contravene the intent of the law. Moreover, the motive requirement in *fraus legis* neatly aligns with the test in (b), the obtaining of a tax advantage being the essential aim – the predominant aim in *fraus legis* terms – of the transactions engaged into.[89] As previously explained, element (c), the complementary business purposes test (or the EU law equivalent, the genuine economic activity test), may be recognized to be implicitly part of *fraus legis*, since the doctrine effectively applies as an *ultimum remedium* and seems effectively only to apply in scenarios lacking substantive economic activity in support of the legal arrangements set up by the taxpayer involved. Element (d), the subjective test, seems to be included as part of *fraus legis* also. The presence of a predominant intention to obtain a tax advantage is an explicit component of *fraus legis* under the motive test. Both essentially are in search of the same thing, namely the taxpayer's objective of avoiding taxation.

89. In EU VAT, the abuse-of-law concept may be seen to have a somewhat broader scope than its equivalent under the fundamental freedoms in direct tax cases. In EU VAT abuse-of-law case law such as ECJ, 21 February 2006, C-255/02 (*Halifax*) and ECJ, 21 February 2008, C-425/06 (*Part Service*), the Court of Justice noted that the *essential* aim of the transaction may be interpreted as the *principal* aim of the transactions (rather than, for instance, the *sole* aim). In EU VAT, it seems, an arrangement may accordingly constitute abuse even in the presence of economic objectives (or at least objectives other than strictly tax motives). Under the freedoms in EU direct tax law, only a wholly artificial arrangement may constitute an abusive practice. The reference in *fraus legis* to a predominant motive to escape tax and the absence of a test explicitly referring to the artificiality of the arrangement(s) involved leaves open the potential of an outcome similar to that in EU VAT. From that perspective, perhaps, *fraus legis* may be considered to have, as in EU VAT, a somewhat broader scope than the EU abuse-of-law concept has under the application of the fundamental freedoms. This, however, has not been explicated in the Supreme Court's direct tax case law.

It is worth elaborating on the principle of proportionality under the abuse-of-law concept in EU law when it comes to the division of the burden of proof between tax administration and taxpayer. To be justified under EU law, an anti-avoidance rule in the domestic tax system of a Member State needs to be suitable to achieve the objective for which it was adopted and not go beyond what is necessary to achieve that purpose.[90] The Member States, for instance, need to allow taxpayers the ability to provide evidence that the arrangements set up are supported by real economic substance. EU law also allows Member States to provide for a rebuttable presumption in their tax codes, deeming a transaction or arrangement or a series of transactions or arrangements to be tax-induced. Such a reversal of the burden of proof – shifting the burden of providing evidence of the genuineness of the transactions and arrangements undertaken to the taxpayer – is admissible provided that these transactions and arrangements are specified in the applicable legislative act.[91]

The ECJ refers for this purpose to domestic procedural rules of evidence.[92] In tax litigation procedures in the Netherlands, courts are flexible in assigning the responsibility to show evidence to either the taxpayer or the tax authorities – whichever of the parties involved is best placed for that purpose. The courts are called upon to divide the burden of proof in an equitable manner (*redelijke bewijslastverdeling*). This is generally taken to mean that the tax administration will have to provide evidence with regard to any elements that would result in an increase of the tax burden, whereas the taxpayer involved is required to show evidence with regard to any elements that point to the opposite. In *fraus legis* cases, this means that it will be first up to the tax authorities invoking *fraus legis* to show proof of, for instance, the artificiality of the tax structure. The court typically proceeds by requiring the taxpayer involved to subsequently show evidence of the presence of a genuine activity or of having motives other than tax motives for engaging in the transaction or series of transactions, for instance by demonstrating that the transaction would also have been undertaken if the tax effects were absent.[93] The approaches taken in Dutch tax proceedings involving *fraus legis* and burden-of-proof division accordingly adhere to and correspond with EU proportionality requirements (element (d)).

90. ECJ, 12 September 2006, C-196/04 (*Cadbury Schweppes*).
91. ECJ, 17 July 1997, C-28/95 (*Leur-Bloem*), paras. 38 and 39; and ECJ, 5 July 2007, C-321/05 (*Kofoed*), para. 37.
92. ECJ, 14 December 2000, C-110/99 (*Emsland-Stärke*), para. 54.
93. *See* Supreme Court, 8 June 1983, BNB 1983/236; Supreme Court, 4 May 1988, BNB 1988/254; and Supreme Court, 11 October 2000, BNB 2001/121.

19.2.1.5. *Fraus legis* case law leaves international mismatches untouched – A matter for the legislature

19.2.1.5.1. *The intent of the law revealed by reference to the internal consistency of the Dutch tax system*

Fraus legis does not seem eligible to be invoked to address international mismatches. To date, the Supreme Court has rendered non-taxation outcomes that result from international mismatches a matter for the legislature to resolve. This holds for non-taxation due to hybrid entity mismatches, hybrid income mismatches and TP mismatches. The Dutch tax authorities have tried in a number of cases, however they have not been very successful in their attempts to strike down international mismatches on the basis of *fraus legis*. It should be noted here that the tax legislator responded to this by introducing specific anti-hybrid mismatch legislation, which is discussed in some detail in sections 19.3.6., 19.3.7. and 19.3.8.5.

In its case law, the Supreme Court has consistently interpreted the intent of the law by reference to the internal consistency of the Dutch tax system. When it comes to international non-taxation due to the utilization of international mismatch arrangements, the Supreme Court has consistently held such outcomes ineligible to be addressed by invoking the *fraus legis* doctrine. This generally holds regardless of whether it is the Dutch corporate tax base or the foreign tax base that is subject to profit shifting and base erosion. The Supreme Court not only upheld mismatches in cases where the Netherlands was at the recipient end of the mismatch transaction, it did the same in cases involving payments from the Netherlands to abroad. Accordingly, the court does not seem to see much room for applying *fraus legis* to address the disparities and mismatches in the international tax regime and ensuing non-taxation outcomes. That said, however, the Supreme Court did allow the tax authorities some room to successfully invoke *fraus legis* in certain tax base erosion cases involving taxpayers engaging in intra-group financing transactions to artificially create interest expenses with the objective of deducting these from the tax base in the Netherlands. (This "anti-profit drainage case law" is discussed in section 19.2.1.6.; sections 19.2.1.5.2. and 19.2.1.5.3. first examine the Supreme Court's *fraus legis* case law involving mismatch arrangements.)

19.2.1.5.2. *Supreme Court case law on hybrid mismatches*

An example of a case involving a hybrid entity mismatch that the Supreme Court left in place is *Sarakreek*.[94] In *Sarakreek*, the Supreme Court left untouched the so-called Sarakreek tax planning arrangement, basically a hybrid entity mismatch utilization arrangement. The case concerned a Dutch-resident corporate taxpayer parent company that financed its foreign business operations carried on through a permanent establishment operated by its tax-consolidated Dutch subsidiary company with a loan issued to that subsidiary. The foreign operations were exempt from corporate taxation in the Netherlands under the Dutch double tax relief system. Under the Dutch tax consolidation regime laid down in Article 15 of the CITA, the loan was eliminated for tax purposes, as the consolidated subsidiary effectively is treated as tax-transparent for Dutch corporate tax purposes under the application of this regime.[95] The interest payments from the subsidiary to the parent company, however, were tax-deductible in the foreign tax jurisdiction for the purposes of calculating the taxable profit of the permanent establishment, as the subsidiary company was considered non-transparent from that jurisdiction's perspective. The Supreme Court nevertheless upheld the non-recognition of the internal interest receipt, rendering it tax-free in the Netherlands despite its tax-deductibility abroad, leaving the mismatch in place. The court did not resort to *fraus legis* to neutralize the mismatch. The tax legislator responded by formulating a SAAR[96] to address the so-called Sarakreek mismatch (*see* section 19.3.8.5.).

The Supreme Court has upheld the application of the participation exemption in some hybrid income mismatch cases. One such known mismatch case is *Prêt Participatif*.[97] *Prêt Participatif* concerned the tax implications of an interest receipt in the hands of a Dutch corporate recipient on a hybrid loan that qualified as equity under Dutch tax law and would, accordingly, be eligible for exemption under the participation exemption regime. The Supreme Court qualified the hybrid loan as an equity financing arrangement for Dutch corporate tax purposes and left the application of the participation exemption untouched, despite its deductibility for tax base calculation

94. Supreme Court, 4 June 1986, BNB 1986/239. *See also* Supreme Court, 20 December 2002, BNB 2003/286.
95. The question of whether and to what extent notional loans between head offices and permanent establishments may be recognized for Dutch corporate tax purposes upon the 2010 modifications to the OECD Model Tax Convention will be left unassessed. The same holds for any tax implications of the utilization of tax-transparent or hybrid entities in this respect outside those explicitly covered.
96. Article 15ac(4)-(6).
97. Supreme Court, 25 November 2005, BNB 2006/82 (*Prêt Participatif*).

purposes at the level of the foreign debtor entity in which the Dutch creditor held a substantive shareholding.

The Supreme Court did something similar in a recent case known as *Redeemable Preference Shares*.[98] Again, the court did not resort – and even made explicit note of this fact – to *fraus legis* to address an international income qualification mismatch. The case concerned a cross-border issuance of redeemable preference shares, with respect to which the payments were deductible abroad at the payer level, whereas the receipts would be exempt in the Netherlands under the participation exemption in the hands of the Dutch shareholding company. The court upheld the qualification of the shareholding issuance as equity for Dutch corporate tax purposes and applied the participation exemption, despite the deductibility abroad. The court held that the qualification of the redeemable preference shareholding as equity for Dutch tax purposes and the application of the participation exemption did not contradict the intent of the Dutch tax system. It observed that, under Dutch tax law, an equivalent payment from the Netherlands to abroad would qualify as a dividend and would, accordingly, not be tax-deductible in the Netherlands. The non-taxation of the receipts would be consistent with a view of the internal consistency of the Dutch tax system not subjecting dividend distributions to economic double taxation. The qualification of the payment as an exempt dividend receipt therefore did not contradict the spirit of Dutch tax system. The court upheld the application of the participation exemption and, with that, maintained the deduction-and-no-inclusion outcome, essentially by resorting to the internal consistency of the Dutch tax system. As a follow-up to secondary EU law developments involving the PSD, the tax legislator has now responded, recently introducing legislation addressing these types of income qualification mismatches. (This is further discussed in section 19.3.6.)

19.2.1.5.3. *Supreme Court case law on TP mismatches*

The Supreme Court has also left TP mismatches in place. For instance, it left untouched interest deductibility in the Netherlands in such mismatch cases.[99] As early as 1978, in a case known as *Swedish Ultimate Parent*, the Supreme Court upheld the tax-deductibility in the Netherlands of a business-like

98. Supreme Court, 7 February 2014, BNB 2014/79 (*Redeemable Preference Shares*). That same day, the court issued a similar ruling in a comparable case involving a purely domestic situation; *see* Supreme Court, 7 February 2014, BNB 2014/80 (*Banks Syndicate*).
99. Supreme Court, 3 April 1957, BNB 1957/165; Supreme Court, 31 May 1978, BNB 1978/252 (*Swedish Ultimate Parent*); and Supreme Court, 17 December 2004, BNB 2005/169.

interest rate for corporate tax purposes on a contractually interest-free loan taken on from an affiliate entity.[100] The Supreme Court maintained the at arm's length correction in the Netherlands to a business-like interest rate and, with that, the recognition for Dutch tax purposes of a business expense that is in principle tax-deductible – save for the application of a deduction limitation provision – despite the fact that no interest was recognized in the hands the foreign creditor because the loan was contractually interest-free. To substantiate its ruling, the court observed that the reasons underlying the interest-free loan were shareholders motives rather than business reasons; the benefit from the interest-free loan did not originate from the taxpayer's business operations. Under Dutch tax law, a similar correction would materialize in the hands of the recipient, which would be subject to tax on a business-like interest rate regardless of the contract providing for an interest-free loan or a non-arm's length interest rate. In 2004, the Supreme Court delivered an analytically parallel ruling in a similar case in which the loan was taken on to finance a third-party shareholding acquisition. Again, the court upheld tax-deductibility despite the fact that the interest-free loan did not attract taxation in the hands of the foreign creditor;[101] it held *fraus legis* not to apply. Recently, the Supreme Court ruled once again on a similar matter in a case known as *Mauritius*. This time, however, the court was not asked to rule by reference to *fraus legis* but rather under the interest-deduction limitation rules covering these types of scenarios today, which are laid down in Article 10a of the CITA. (Article 10a and *Mauritius* are discussed in section 19.3.7.2.)

As noted, by resorting to internal consistency reasoning, the Supreme Court has consistently upheld the recognition of business-like expenses for tax purposes under an autonomous assessment of the ALS. The court has adopted a consistent approach, regardless of whether the facts of the case involved a domestic or cross-border scenario and regardless of whether the taxpayer in the Netherlands was payer or recipient. Of no relevance was the question of whether the Dutch approach corresponded with TP views abroad at the other end of the transaction. The court does not consider international TP mismatches to contradict the intent of Dutch tax law, for the Dutch approach towards TP is internally consistent. It follows that the court's approach may lead to both international double taxation and non-taxation, depending on whether the interpretation abroad results in a higher or lower transfer price relative to the transfer price as recognized for tax purposes in the Netherlands. From the court's reasoning, it may be inferred that there

100. Supreme Court, 31 May 1978, BNB 1978/252 (*Swedish Ultimate Parent*).
101. Supreme Court, 17 December 2004, BNB 2005/169. *See*, for a comparison, Supreme Court, 27 September 1995, BNB 1996/6.

is room for a strategic utilization of TP mismatches to optimize after-tax business profits. Any resolving of disparities in this area is a matter for the legislature. The tax legislator has responded to this by introducing a SAAR limiting interest deductibility,[102] which is discussed in section 19.3.7.3.

A relatively new body of case law that the Supreme Court has developed is known as the doctrine of the "non-business-like loan" (*onzakelijke lening*).[103] The phenomenon essentially involves the Supreme Court's interpretation of third-party comparability in related-party financing transactions to qualify certain inter-affiliate receivables as non-business-like loans for the purpose of subsequently restricting tax-deductibility of amortization losses realized on such loans and to establish criteria to set business-like interest rates. Under the court's case law, a loan granted to an affiliated party can be qualified as a non-business-motivated loan (or a non-business-like loan) if such a loan is granted under such conditions and circumstances that the debtor carries a risk that an independent third party would not have been willing to take. In the view of the court, such a non-business-like loan exists if the agreed-upon interest rate is not at arm's length and the rate cannot be adjusted to a fixed rate under which a third party would have been willing to extend a similar loan without modifying the nature of the financial instrument, i.e. altering it into a profit-participating loan and requiring a business-like guarantee to be taken into consideration. The Supreme Court held such a loan to be non-business motivated; an impairment loss suffered on such a loan is not tax-deductible.

In the view of the Supreme Court, the arm's length interest rate on such an inter-affiliate, non-business-like loan may be set on the basis of a rule of thumb. The interest rate may be determined by reference to an interest rate that would have been agreed upon by a third-party creditor under an equivalent third-party loan agreement in the presence of a guarantee granted by a group company affiliate of the debtor involved. Accordingly, the interest rate on a non-business-like loan recognized for Dutch tax purposes to a great extent corresponds to an interest rate on a low-risk-bearing bond. It follows that the interest rate agreed upon in the loan agreement is of hardly

102. Article 10b.
103. *See* Supreme Court, 9 May 2008, BNB 2008/191; Supreme Court, 25 November 2011, BNB 2012/37; Supreme Court, 25 November 2011, BNB 2012/38; Supreme Court, 25 November 2011, BNB 2012/78; and, amongst others, Supreme Court, 9 March 2012, BNB 2012/133; Supreme Court, 15 March 2013, BNB 2013/149; and Supreme Court, 20 March 2015, BNB 2015/141.

any relevance. The modification also applies in the presence of agreed-upon non-interest-bearing loans.[104]

The interest rate as modified under the non-business-like loan doctrine seems to be applicable both to the debtor and the creditor. It may be the case that other tax jurisdictions will adopt a different view in cases involving such financing transactions. This may initiate TP mismatches, producing double taxation and non-taxation outcomes. Non-taxation outcomes may arise in cases involving foreign debtor affiliate entities taking on non-business-like loans from Dutch creditor affiliate entities, whereby the debtor deducts the agreed-upon interest rate, whereas only a risk-free rate is taxed in the Netherlands. Such a mismatch does not seem to be eligible to be neutralized on the basis of *fraus legis,* because the non-business-like loan doctrine operates in an internally consistent manner.

19.2.1.6. Countering profit drainage via *fraus legis* – Supreme Court anti-profit drainage case law

Whereas the attempts undertaken by the Dutch tax authorities to address international mismatches via *fraus legis* have not been particularly successful, they have achieved successes in countering artificial Dutch tax base erosion by invoking the *fraus legis* doctrine in tax litigation in an area that has come to be known as profit drainage (*winstdrainage*). The tax authorities have successfully invoked *fraus legis* in the past to put to an end tax base erosion through artificial structuring involving a setting-up of intra-group debt financing arrangements, producing a body of case law known as anti-profit drainage case law (*anti-winstdrainagejurisprudentie*). The case law of the Supreme Court on *fraus legis* in this area – and its subsequent codification and accompanying tightening of interest deductibility possibilities in Article 10a of the CITA – is sizeable (*see*, for an overview, section 19.3.7.2.).

The transactions that the tax authorities targeted by invoking *fraus legis* involved the setting-up of artificial and circular inter-affiliate legal arrangements to erode Dutch tax base by artificially creating interest payments with the purpose of deducting these as interest expenses for corporate tax calculation purposes. These arrangements involved, inter alia, the creation of group interest payments via intra-group debt financing of intra-group dividends, capital contributions, internal shareholding transfers and other types of internal business reorganizations. The Supreme Court held that interest

104. *See* Supreme Court, 15 March 2013, BNB 2013/149.

deductibility under these arrangements contradicts the purpose and intent of Dutch tax law, save for those cases where the interest receipt would be subject to a compensating levy (*compenserende heffing*) that is reasonable according to Dutch tax standards.[105] The court held that such arrangements did not contradict the intent of the law in such cases. The compensating levy escape applied regardless of whether it involved a Dutch tax or a foreign tax levied on the interest payments in the hands of the recipient.[106] The Supreme Court also considered the compensating levy test to be met in cases where the creditor was not effectively taxed because of the application of loss compensation rules, except for those cases – it seems – where the utilization of loss compensation possibilities constituted the predominant motive for the transactions undertaken.[107]

Despite the successes of the Dutch tax authorities in invoking *fraus legis* in these profit drainage scenarios, the Dutch tax legislator considered taxpayers still to have too much leeway in eroding Dutch tax base. Therefore, as per 1 January 1997, the legislator decided to codify the *fraus legis* doctrine in Dutch tax legislation and proceeded to further narrow down room for interest deductibility. The interest deduction limitation regime can be found in Article 10a of the CITA; it is further discussed in section 19.3.7.2.

19.2.1.7. *Fraus legis* has not been replaced and will not be replaced by the EC Recommendation GAAR

The questionnaire further queried whether the national GAAR has been or will be replaced by the GAAR proposed by the European Commission. The answer is no. The *fraus legis* doctrine, as it has been developed since its introduction by the Supreme Court in 1926, forms an integral part of the Netherlands' tax system. Its properties conceptually are nearly identical to

105. *See*, for example, Supreme Court, 17 June 1987, BNB 1987/289; Supreme Court, 10 March 1993, BNB 1993/194; Supreme Court, 10 March 1993, BNB 1993/196; Supreme Court, 23 August 1995, BNB 1996/3; and Supreme Court 20, September 1995, BNB 1996/5.
106. *See*, for example, Supreme Court, 20 September 1995, BNB 1996/5; Supreme Court, 8 February 2002, BNB 2002/118; and Supreme Court, 23 January 2004, BNB 2004/142.
107. *See*, for example, Supreme Court, 10 March 1993, BNB 1993/197; and Supreme Court, 30 June 1999, BNB 1999/323. The Supreme Court differentiated for this purpose between scenarios involving losses that were already present at the time of the legal arrangements concerned and scenarios involving structuring predominantly set up to acquire loss compensation possibilities. *Fraus legis* may effectively be invoked in the latter scenarios.

the European Union's abuse-of-law doctrine. No plans exist at this time to abolish *fraus legis* or to codify it as a GAAR in Dutch tax legislation.

Indeed, *fraus legis* moves away from the GAAR as recommended by the European Commission in terms of not addressing international mismatch arrangements. To date, the Supreme Court has considered this a matter for the legislature to resolve. The tax legislator has responded and has addressed a range of international mismatch risks through SAARs. In a letter to the House of Representatives of 11 January 2013, the Minister of Foreign Affairs announced the position of the Dutch government on the Commission's recommendation to introduce a GAAR into the Dutch tax system.[108] The government noted that Dutch tax practice already aligns with the Commission recommendation at this point by reference to the doctrine of *fraus legis*. Recently, the Dutch State Secretary for Finance voiced the same view.[109] He did not acknowledge the necessity for introducing a GAAR into the Dutch tax system at this time. Referring, inter alia, to the *fraus legis* doctrine and the SAARS, all of which are available to be invoked by the tax administration to target abuse, the State Secretary for Finance stated that he considered the Dutch tax system to be sufficiently robust in addressing tax avoidance.[110]

19.2.1.8. The Netherlands implemented the GAAR in the PSD as per 1 January 2016

Leaving *fraus legis* untouched, the Netherlands has implemented the GAAR in the amended PSD as per 1 January 2016. The GAAR has been implemented in existing SAARs via the corporate income tax regime for non-resident shareholding companies[111] and the dividend withholding tax regime for Dutch-resident cooperatives.[112] Both focus on artificiality and tax-avoidance motives. (These provisions are further discussed in sections 19.3.8.2. and 19.3.8.6.).

108. Parliamentary Papers House of Representatives, 2012-2013, 22 112, No. 1545, at 6.
109. Parliamentary Papers House of Representatives, 2015-2016, 34 306, No. 8.
110. Parliamentary Papers House of Representatives, 2015-2016, 34 306, No. 3.
111. Article 17(3)(b).
112. Article 1(7) DWTA.

19.2.2. EC Recommendation on introduction of subject-to-tax rule

19.2.2.1. EC Recommendation: Proposal for subject-to-tax requirement in national rules and tax treaties

In its Recommendation on aggressive tax planning of 6 December 2012, the European Commission not only suggested that Member States introduce a GAAR into their tax systems, it also recommended that Member States introduce a subject-to-tax rule in both their domestic tax systems and their double tax treaty networks. The purpose of such a subject-to-tax rule is to deal with double non-taxation outcomes. In treaty scenarios, it would 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". The proposed text is derived from the Commentary on the OECD Model Tax Convention. With a view to the provision of double tax relief under national rules, the Recommendation suggests that Member States subject an exemption for foreign income to a subject-to-tax requirement. Pursuant to such a requirement, no relief would be made available if the relevant income is not treated as taxable by the local jurisdiction concerned, for instance by reason of the application of an exemption, a full credit or a zero tax rate.

19.2.2.2. No subject-to-tax gateway requirements in the Netherlands for exempting foreign-source active income; a credit regime applies for passive income

In the Netherlands, foreign-source active income is exempt from corporate tax, regardless of whether it is subject to an effective profit taxation in the source jurisdiction. This holds with regard to both juridical and economic double tax relief, and both in tax treaty scenarios and cases in which no tax treaty applies. The Netherlands' double tax relief system roughly distinguishes between active income (business income) and (low-taxed) passive income (portfolio investment income). An exemption applies with regard to the former, and an ordinary credit applies regarding the latter. Switch-over provisions and a CFC-like regime apply to counter undue tax deferral. In the past, a subject-to-tax requirement applied as a gateway rule for juridical double taxation relief purposes in non-tax treaty scenarios. That requirement, however, was repealed as of 1 January 2012. Notably,

the "compensating levy test", as part of the eligibility criteria for interest deductibility under Article 10a of the CITA, may be considered to form a sort of a subject-to-tax rule as well; *see further* section 19.3.7.2. The same may be considered to hold for Article 13l of the CITA; *see* section 19.3.7.4.

Tax policy considerations for exempting active income from foreign sources are founded on a combination of import neutrality and tax sovereignty arguments. Notions of sovereign prerogatives to tax business income in the investment jurisdiction are well established in the Netherlands. In addition, level playing field considerations, i.e. the view that Dutch enterprises should be able to carry on overseas business affairs under the same tax conditions as their local competitors, are a key aspect of policy. The credit mechanisms for foreign-source passive income in the Dutch international tax system seek to promote export neutrality, i.e. an equal treatment of Dutch portfolio investors in the Netherlands regardless of where the portfolio investment was undertaken geographically, as well as to make sure that passive income is not sheltered abroad in a low-taxing jurisdiction. The switch-over from the exemption method to the credit method in cases involving low-taxed foreign-source portfolio investment income illustrates these underlying anti-avoidance considerations; *see also* section 19.3.5.

19.2.2.3. No plans to introduce a subject-to-tax rule as proposed by the EC Recommendation

The Netherlands is not planning at this time to introduce a subject-to-tax rule as recommended by the Commission. In his letter to the House of Representatives of 11 January 2013, the Minister of Foreign Affairs announced the position of the Dutch government on the Commission's recommendation to introduce such a rule.[113] He noted that the recommendations of the Commission already align with Dutch international tax policies and stated that he considers the recommendations to be supportive of these. With a view to the Commission's recommendation to introduce a provision in the tax treaties to deal with double non-taxation and tax avoidance, the Minister noted that such a provision would encroach upon the competences of the Member States in the area of direct taxation and double tax conventions. Substantively, though, he affirmed that the Commission's recommendations have long formed part of the Netherlands' international tax policies, for they have sought not only to avoid double taxation but also to address double non-taxation outcomes and tax avoidance. Furthermore,

113. Parliamentary Papers House of Representatives, 2012-2013, 22 112, No. 1545, at 3 and 6.

he reiterated that the Netherlands does not conclude tax treaties with countries that do not live up to certain minimum tax standards and noted in this respect that the Commission does not specify exactly which modes of tax avoidance would be countered by the introduction of such a subject-to-tax provision. In the view of the Dutch government, this renders it unclear why the proposal for a subject-to-tax clause would resolve the issues of double deduction and non-taxation identified in the Commission's recommendation. The suggestion was made that the Commission further elaborate on its suggestions and make them more concrete by clearly formulating precisely which types of double deduction and non-taxation would be covered by the recommendation. It was further suggested that the Netherlands could, for this purpose, resort to its knowledge and experience in addressing tax treaty abuse by means of the anti-abuse provisions already included in its tax treaty network (or to be included in those which are currently in the process of being renegotiated).

19.3. TP rules, GAARs, SAARs and linking rules

19.3.1. National TP rules

19.3.1.1. Taxable-profit calculation and the ALS as an integral part thereof

The ALS forms an inherent and integral part of taxable-profit calculation in Dutch business income taxation. The operation of the principle is explicated in the CITA.[114] The mechanism incorporates common TP methodologies and prevents and counters certain tax avoidance possibilities involving transactions and arrangements between related parties. Any advantages or disadvantages that originate from affiliation rather than from business conduct (with the parties to the transaction being aware of that) are considered non-business-like. Any non-business-like elements in (non-)payments or (non-) receipts are excluded from the taxable base. The analysis includes an assessment of whether the inter-affiliate transfers and transfer prices involved originated from shareholder motives (or personal motives if the business enterprise is privately held). The Supreme Court has held, for instance, that expenditures made by a corporate entity lack a business-like character if and to the extent that they are made for the fulfilment of the personal benefits

114. Article 3.8 Dutch PITA; and Article 8. The ALS is explicated in Article 8b.

of its shareholder.[115] Accordingly, the approach taken cancels out from the tax base determination process artificialities arising from inter-affiliation.

In its established case law, the Supreme Court seeks to discover the true nature of the transaction by reference, inter alia, to the underlying motives of the parties engaging in the transaction concerned. The court distinguishes for this purpose between costs and proceeds that arise from business activities and those that do not, i.e. business-like elements on the one hand and non-business-like elements on the other, the latter of which are referred to in Dutch taxation as "constructive dividend distributions" and/or "informal capital distributions". Only those expenditures that are considered to be made with a view to the commercial interests of the business enterprise constitute "costs" for tax purposes and are eligible for deduction (provided that no deduction limitation provision applies; *see* section 19.3.7.). To preserve the internal consistency of the system, only those receipts that arise from business activities as such are considered "proceeds" and hence are eligible to be taxed. Non-business-like (i.e. non-arm's length) payments, both inbound and outbound, are adjusted to an arm's length amount. Non-arm's length outcomes are, accordingly, transformed into business-like outcomes for tax base calculation purposes. Any differences between arm's length prices and contractually agreed-upon prices are considered constructive dividends or informal capital contributions for tax purposes, depending on which of the affiliate entities involved favours the other. Such a labelling as a dividend or capital contribution for tax purposes holds even if the income in question is not considered a dividend or capital contribution for civil law or commercial accounting purposes.

The tax administration may only invoke the non-business-like nature of a transaction or transfer price. Worthy of note is the fact that the tax inspectorate is not authorized to judge whether a particular business decision initiating a loss or profit was wise or sensible (i.e. from a business economics perspective). To the extent that a particular expenditure was made for business-like reasons, such an expenditure is considered a cost for tax purposes and is hence, in principle, deductible. The tax authorities may not disallow a tax deduction for a cost incurred on the grounds that the underlying decision initiating such a cost might be considered imprudent from a business economics perspective. In Dutch taxation, as a general rule, no one other

115. *See*, for example, Supreme Court, 14 June 2002, BNB 2002/290, (*Racehorses*); and Supreme Court, 18 April 2008, BNB *2008/139* (*Fleet of Cars*).

than the entrepreneur may interfere with or judge as to their utility in the business process any business-like decisions.[116]

There is, however, an important exception to this rule. The tax administration does have the authority to conduct a limited judicial review with respect to the amount of the costs under the so-called Cessna costs doctrine, a doctrine developed in case law that applies in the presence of excessive and unreasonable expenses.[117] Established case law of the Supreme Court provides that excessive expenses are non-deductible to the extent that they may objectively be considered unreasonable. Such unreasonableness is interpreted by reference to an objectified sensible entrepreneur accepting a certain expense-to-utility ratio from a business economics perspective. On that basis, costs are non-deductible in so far as there is a discrepancy between the amount of costs and the usefulness thereof for the business to such an extent that a sensible and rational entrepreneur would not maintain that those costs were incurred in consideration of the business-like interests of the business. Only the amount of reasonable costs is tax-deductible in such cases; the excess is not.

19.3.1.2. ALS included in the definition of "profits"

Under the operation of the ALS, associated parties are deemed to interact as if they are unrelated. Approaches taken in the Netherlands to come to a business-like profit calculation in this respect are built on third-party comparability and substance. Any preferential conditions based on the affiliation of the parties to the transaction are adjusted to arrive at a taxable corporate profit that is similar to what independent businesses would derive performing comparable transactions in comparable circumstances. The business-like or non-business-like nature of the transaction or series of transactions is assessed by reference to the functions performed by the parties concerned, the assets used in the business process and the question as to whether economic risks have actually been assumed. Of relevance regarding risk assumption are the questions of whether the persons involved in carrying on the business processes are actually responsible for and capable of

116. *See*, for example, Supreme Court, 18 March 1998, BNB 1998/159, in which the court held that the manner in which a business is conducted, in principle, is determined by the entrepreneur and that it is within its discretion to decide which expenditures will benefit the business.
117. *See* Supreme Court, 9 March 1983, BNB 1983/202 (*Cessna Plane I*); and Supreme Court, 8 March 2002, BNB 2002/210 (*Cessna Plane II*) on the costs of the use and possession of a private plane used to travel to business appointments instead of using scheduled flights.

managing the risks assumed involving with the asset utilization and whether the equity at stake is sufficient to actually bear these risks.[118] A substance-over-form-approach applies.

A number of decrees and resolutions have been issued by the Ministry of Finance to provide guidance on the interpretation and application of the TP legislation in certain specific situations.[119] The Netherlands closely adheres to the OECD's interpretation of the ALS and third-party comparability under the OECD TP Guidelines. The State Secretary for Finance recently noted that current policies and approaches in Dutch taxation correspond to the modified OECD TP Guidelines under the BEPS package (Actions 8-10).[120] The secretary has, for instance, stated that any contractual allocation of risks incurred is recognized for tax purposes only if such a risk assignment is supported by actual business reality. Contractual risk allocation is subject to an assessment of whether the entity (or entities) that contractually bears the risks is actually capable of managing and controlling them. Cash box entities within which no functions are performed may only be remunerated with a risk-free amount – or even less if the cash box concerned lacks any commercial rationality.[121] Synergy benefits are divided among group companies by reference to their functional contributions to these benefits.

19.3.1.3. Codification of ALS and TP documentation requirements

The operation of the ALS in the Dutch tax system has been codified in Article 8b of the CITA as per 1 January 2002. Article 8b was drafted in line with Article 9 of the OECD Model Tax Convention.

In addition to explicating the operation of the ALS in Dutch taxation, Article 8b of the CITA sets forth the basics of TP documentation requirements. Pursuant to Article 8b, corporate taxpayers are required to maintain

118. Supreme Court, 8 August 2008, BNB 2008/256; and Supreme Court, 20 December 2002, BNB 2003/246). *See also* Decree of 21 November 2011, No. DGB 2011/6870M, sec. 4.
119. *See*, for example, TP Decree, *supra* n. 27; Profit Attribution Decree, *supra* n. 27; and Decree of 21 November 2011, No. DGB 2011/6870M, sec. 4.
120. Letter of 5 October 2015, *supra* n. 38.
121. A similar approach may be held to be found in Article 8c. This provision applies to interest and royalty flow-through companies with contractual earnings from intragroup back-to-back debt financing and/or asset licensing arrangements. Such earnings are excluded from the corporate tax base in scenarios where the taxpayer concerned does not bear sufficient economic risks on its debt financing and/or asset licensing arrangements. No credit is available for foreign-source taxes levied in such cases. A handling fee is included in the tax base. Substance requirements apply. The Netherlands may proceed to a spontaneous exchange of information.

"sufficient documentation" with regard to their TP arrangements with associated enterprises. Association is established by reference to "any participating, directly or indirectly, in the management, control or capital of another company". The TP documentation should, at least, consist of a description of the comparability analysis by reference to the comparability factors forwarded by the OECD TP Guidelines, the choice of TP method used and a substantiation of the conditions which have been agreed upon in the associated transactions undertaken.[122] The operation of Article 8b of the CITA shifts the burden of proof regarding the arm's length nature of inter-affiliate transactions to the corporate taxpayer. Taxpayers have the opportunity to obtain certainty on the question of whether the documentation requirements have been complied with.[123]

The Netherlands recently extended TP documentation requirements implementing OECD BEPS outcomes in the area of CbCR (BEPS Action 13).[124] CbCR legislation has been in effect as per 1 January 2016.[125] The new documentation obligations are in line with OECD minimum standards and include the requirement for eligible taxpayers to produce a country-by-country report, a master file and a local file. The new standards for TP documentation serve as a tool for the tax authorities to better analyse potential risks with respect to TP and tax base calculation.

19.3.1.4. No specific TP GAAR

The questionnaire queried whether Dutch tax legislation provides for a "specific GAAR" in the area of TP. Such a provision has not been put in place. Current doctrines and concepts are considered sufficient to address any misuse. The absence of a GAAR in Dutch tax legislation does not mean, however, that the tax administration would not be inclined to counteract any tax-induced and non-business-like profit shifting through a strategic pricing of inter-affiliate transactions. This is the province of the TP Coordination Group – a specialist resource unit within the tax administration devoted to TP, particularly in scenarios involving intangibles, procurement activities and captives.[126] The TP Coordination Group typically seeks to counteract such tax avoidance scenarios in association with other specialist resource units within the tax administration, including the Tax Havens and

122. TP Decree, *supra* n. 27.
123. *See also* the Decision of 11 August 2004, No. DGB2004/1339M, on the establishment of a coordination group TP.
124. Parliamentary Papers, 2015-2016, 34 305, No. 3, at 8 et seq. and 33 et seq.
125. Articles 29b et seq.
126. TP Decree, *supra* n. 27.

Group Financing Coordination Group and the Construction Counteraction Coordination Group.

19.3.2. TP disputes

TP disputes may arise in respect of establishing the business-like nature of transactions undertaken, the methods used for determination of the arm's length conditions and the question as to whether documentation requirements have or have not been met. However, most TP discussions are resolved in practice by the taxpayer and the tax authorities in the (pre-) tax return filing stage. Relationships between taxpayers and the tax administration in the area of TP are generally built on constructive cooperation and transparency. This particularly holds true when it comes to deciding on applicable TP methods, performing comparability assessments, establishing arm's length ranges and prices, and preparing TP documentation. As noted in section 19.1.1.3., the tax administration is willing to conclude unilateral, bilateral and multilateral APAs and/or to proceed to horizontal monitoring. The Netherlands is also generally willing to proceed to making corresponding adjustments in response to TP adjustments abroad to ensure a single taxation of business income at the location of value creation. As noted, the Netherlands considers itself a front-runner in the area of transparency, including in the area of TP. The efficient, professional and constructive tax administration is considered one of the crown jewels of the Dutch tax climate for business and investment.

19.3.3. Case law on TP

Case law on TP is scarce, since most TP discussions are resolved in practice by negotiation rather than through litigation. This particularly holds true when it involves the question of which TP method should be applied in a particular case and whether the agreed-upon transfer price is at arm's length. TP cases that have been brought before the court are quite case-specific.[127] Courts have typically resolved matters in these cases either by reference to establishing whether the burden of proof to establish the arm's length character of the transfer price has or has not been met or by establishing the arm's length price in "good justice". One Dutch TP case that is currently attracting

127. Some examples are Supreme Court, 9 November 2001, BNB 2002/10 (*Costs Bank Guarantee*); Supreme Court, 28 June 2002, BNB 2002/343 (*Car Importer*); and Supreme Court, 23 April 2004, V-N 2004/27.17 (*Procurement Office*).

a great deal of attention concerns not a dispute between the tax administration and the taxpayer but a decision of the European Commission that considers an individual APA concluded between the Dutch tax authorities and a multinational enterprise involving the application of the transactional net margin method to remunerate a Dutch group company performing manufacturing functions to constitute illegal State aid.[128] The Commission considers the pricing not at arm's length, i.e. too low. The Commission considers the Netherlands to have aided the multinational, which is not allowed under EU State aid rules. The Netherlands disagrees with the Commission decision and has appealed.[129] The matter is currently pending.

Some guiding TP case law exists when it comes to establishing whether inter-affiliate conditions and agreed-upon prices are business-like or arise from shareholder relations and to determining whether tax implications abroad should be taken into account for this purpose. (A selection of Supreme Court case law on these matters was presented in section 19.2.1.5.3.) Worth addressing are the lines in the Supreme Court's case law involving, first, a doctrine known as non-business-like profit transfers and profit capacity transfers (*winstgemis*) and, second, the treatment of so-called umbrella credit facilities.

Winstgemis basically involves any non-business-like intra-group transfer of business profit – for instance by contractually transferring profit capacity to an affiliate entity or by contractually shifting profitable transactions or arrangements to that entity – whereby such a transfer rests on shareholders' motives.[130] In such cases, any legal arrangements undertaken for those purposes are de facto disregarded for tax base calculation purposes.

The Supreme Court dealt with the question of whether an arm's length compensation is feasible in the presence of an inter-affiliate arrangement that may only rarely be found between independent entities in a case that

128. European Commission, Press Release, 21 October 2015, IP/15/5880.
129. Letter of 27 November 2015 from the State Secretary for Finance to the House of Representatives, No. AFP/2015/948 M.
130. Supreme Court, 4 January 2013, BNB 2013/77 (*Swiss Paper Trade*); *see also* Supreme Court, 21 March 1962, BNB 1962/139 (Supreme Court, 26 June 1963, BNB 1963/291); Supreme Court, 12 April 1967, BNB 1967/167; Supreme Court, 28 January 1970, BNB 1970/63; Supreme Court, 16 January 1974, BNB 1974/44; Supreme Court, 11 December 1991, BNB 1992/69; Supreme Court, 2 June 1993, BNB 1994/79; Supreme Court, 2 March 1994, BNB 1994/290-291; Supreme Court, 26 March 1997, BNB 1997/219; Supreme Court, 17 August 1998, BNB 1998/385; Supreme Court, 14 April 1999, BNB 1999/326; and Supreme Court, 25 June 1969, BNB 2010/93.

has become known as *Umbrella Guarantee*.[131] The case involved a group of affiliated entities that engaged in an umbrella credit facility. Such a facility basically concerns a cross-guarantee agreement under which a group of affiliated entities jointly accept a liability exceeding that which would have been agreed upon if the capital concerned had been borrowed by those entities independently. The Supreme Court held that no arms' length conditions could be established in such a case, because the underlying reason for the group companies to enter into such an agreement lay in their corporate interrelationships. The court ruled that a loss suffered under such an agreement was, hence, not deductible. The State Secretary for Finance has provided some guidance on the Dutch tax treatment of "guarantee fees" for TP purposes.[132]

19.3.4. Tackling avoidance through anti-abuse clauses in Dutch tax treaties

19.3.4.1. Policy on inclusion of anti-abuse clauses in tax treaties

The Netherlands adheres to the outcome of the BEPS package on Action 6[133] and acknowledges the need to prevent treaty abuse and treaty shopping. The Netherlands is willing to include an LOB clause and/or a PPT in its double tax treaties. The Dutch government considers that room exists for such clauses if treaty abuse risks are present considering the interaction between the national tax systems involved.[134] LOBs focus on the eligibility to treaty benefits of persons, and PPTs focus on eligibility to treaty benefits with respect to certain transactions.

The Netherlands has adopted a wide range of anti-treaty abuse rules in a number of the tax treaties in its network. Provisions adopted include both general anti-abuse provisions and targeted anti-treaty shopping rules such as PPTs and LOB clauses. A general anti-abuse provision can, for instance, be found in the tax treaty with Germany.[135] References to treaties in which PPTs and LOB clauses are included are given in sections 19.3.4.2. and 19.3.4.3. PPTs and LOB clauses apply on top of traditional beneficial

131. Supreme Court, 1 March 2013, BNB 2013/109 (*Umbrella Guarantee*).
132. TP Decree, *supra* n. 27.
133. BEPS Action 6; Letter of 5 October 2015, *supra* n. 38; and Letter of 19 November 2015, *supra* n. 45.
134. The Ministry of Finance has explicitly stated this in its memorandum on Dutch tax treaty policy, *Notitie Fiscaal Verdragsbeleid 2011*.
135. *See*, for example, Article 23(1) Double Tax Convention Netherlands-Germany.

ownership requirements, which are present in virtually all tax treaties in the Netherlands' tax treaty network, as well as in the Dutch domestic tax system. Recently, the Netherlands has entered into tax treaty (re)negotiations with 23 developing countries, concerning, inter alia, the inclusion or enhancing of anti-abuse clauses.[136]

When it comes to the actual design of anti-treaty abuse clauses, the Netherlands takes a tailor-made approach. Provisions and clauses are designed on a treaty-by-treaty basis, with a particular focus on treaty shopping and abuse risks in the relationship with the treaty partner concerned and the mutual interaction of the relevant tax systems. An example of an anti-abuse rule specifically designed to suit the interests of the treaty partner concerned is the remittance clause[137] in the tax treaty between the Netherlands and the United Kingdom. This clause prevents the granting of relief for international double taxation in cases where a taxpayer is only taxed in the other state on a remittance base. In such cases, the Netherlands only grants relief if the income is remitted to or received by the taxpayer concerned in the other state.

19.3.4.2. LOB provisions

LOB clauses have been included in, for instance, the Netherlands' double tax treaties with Japan and the United States.[138] Pursuant to the application of an LOB provision, a resident of a contracting state that derives income from the other contracting state is eligible to be granted tax treaty benefits if such resident is considered a "qualified person". LOB provisions, accordingly, are person-based or entity-based. Eligibility for receiving treaty benefits essentially depends on the nature of the recipient and its activities. The LOB clause in the Netherlands-United States tax treaty limits all treaty benefits to qualifying residents, whereas the scope of application of the LOB clause in the Netherlands-Japan tax treaty is limited to dividend receipts, interest, royalties, capital gains and other items of income. Because of its relatively limited scope, the Netherlands-Japan LOB provision is referred to in practice as "LOB-light".

136. *See* Letter of the State Secretary for Finance, 20 April 2015, No. IZV/2015/292; *see also* Letter of 19 November 2015, *supra* n. 45.

137. Article 22 Double Tax Convention Netherlands-United Kingdom.

138. Article 21 Double Tax Convention Netherlands-Japan; and Article 26 Double Tax Convention Netherlands-United States. The tax treaties with Hong Kong and Panama contain an LOB-like provision in Article 10 (Dividends), which applies in combination with a main purpose test.

LOB clauses are extensive, detailed and technically complex. Broadly put, the LOB clauses in both the treaties with Japan and the United States establish that tax treaty benefits are limited to residents of one of the contracting states deriving income from the other state, provided that the resident involved is an individual, a state (or a political subdivision or local authority thereof) or a company meeting some additional tests. The treaty with Japan also labels the Bank of Japan and the Central Bank of the Netherlands as qualified persons. The additional tests for companies include, amongst others, a "listing and trading on a recognized stock exchange" test and a "share ownership" test. A resident may also be entitled to the benefits of the treaty if the person involved is engaged in the "active conduct of a trade or business" (Netherlands-United States) or "carrying on of business" (Netherlands-Japan) in the other state, provided that some additional criteria are met. Multinational headquarters companies may also be eligible, provided that some additional conditions are met. Under the treaty with Japan, some specific rules apply regarding withholding taxes.[139] For details, reference is made to the relevant treaty texts.

Recently, the European Commission asked the Netherlands to amend the LOB clause in the tax treaty with Japan.[140] According to the Commission, the current phrasing of the clause contradicts EU law to the extent that the Netherlands agreed on an effectively better treatment for shareholders resident in its own territory than for shareholders resident elsewhere in the European Union/European Economic Area. The same holds for the conditions agreed on for companies traded on the Dutch stock exchange and those traded on stock exchanges elsewhere in the European Union/European Economic Area. Such a "reversed most-favoured nation approach" as currently taken by the Commission in this matter bears the potential of having a significant influence on the double tax treaty networks of the EU Member States.

19.3.4.3. PPTs

PPTs can be found, for instance, in the Netherlands' tax treaties with China, Hong Kong, Switzerland, the United Arab Emirates and the United Kingdom. PPTs are essentially transaction-based. Eligibility for receiving treaty benefits with regard to a transaction or series of transactions depends

139. Article 21(4) Double Tax Convention Netherlands-Japan.
140. European Commission, 19 November 2015, Memo 15-6006, Case No. 2014-4233. The Commission refers to ECJ, 15 January 2002, C-55/00 (*Gottardo*); and ECJ, 5 November 2002, C-466/98 (*Open Skies*).

essentially on an objectified intention test. Under the tax treaty with the United Kingdom, no relief is available with respect to dividends, interest, royalties and other income if the main purpose or one of the main purposes of any person concerned is to take advantage of the distributive provisions relating to these types of income.[141] Similar provisions are included in the treaty with China with respect to dividends, interest and royalty payments.[142] Treaty benefits under the tax treaty with China are unavailable if the main purpose or one of the main purposes of any person concerned with the creation or assignment of the shares, debt claim or rights in respect of which the remuneration is paid was to take advantage of the provisions by means of that creation or assignment. Under the tax treaty with Hong Kong, the provided dividend withholding tax exemption for intercorporate dividends does not apply if the establishment, acquisition or maintenance of the recipient company has as its main purpose or one of its main purposes to secure the benefits of the treaty provision on dividends.[143] The Protocol to the tax treaty with Switzerland establishes that the distributive provisions for dividends do not apply if the relation between the company paying the dividends and the receiving company has been established or maintained mainly for the purposes of taking advantage of the treaty benefits concerned.[144]

19.3.5. Provisions in the CITA resembling CFC rules

19.3.5.1. No general CFC regime in the Dutch tax system

The questionnaire queried whether the Dutch tax system contains a general CFC regime. Strictly speaking, the Dutch system does not contain such a provision. However, rules have been adopted in the CITA that show, at least to some extent, a resemblance to internationally widely known approaches to CFCs. Adverse tax deferral is countered in the Netherlands via a mark-to-market valuation rule for passive, low-taxed subsidiaries. The Dutch State Secretary for Finance has acknowledged the importance of addressing undue tax deferral but has characterized a CFC regime as not constructive with a view to maintaining an attractive climate for business and investment, because such a regime may introduce uncertainties for taxpayers regarding

141. Articles 10(3), 11(5), 12(5), and 20(4) Double Tax Convention Netherlands-United Kingdom.
142. Articles 10(5), 11(9) and 12(7) Double Tax Convention Netherlands-China.
143. Article 10(3) Double Tax Convention Netherlands-Hong Kong.
144. Article 10(2) Double Tax Convention Netherlands-Switzerland; and Article VIII of the Protocol thereto.

their tax positions and may increase administration costs.[145] SAARs have been stated to be more efficient in this regard.[146]

19.3.5.2. Double tax relief and addressing undue tax deferral

The Netherlands' double tax relief system roughly distinguishes between active income (business income) and (low-taxed) passive income (portfolio investment income). An exemption applies with regard to the former and an ordinary credit applies regarding the latter. Juridical double tax relief is available in corporate taxation for taxpayers having eligible foreign-source income. Relief is provided in both treaty scenarios and non-treaty scenarios. A mechanism akin to a base exemption applies for foreign-source income derived from carrying on a permanent establishment abroad.[147] A switch-over to a direct tax credit applies in cases involving "low-taxed and passive foreign enterprises", unless the Netherlands is required to grant relief by means of an exemption under the applicable tax treaty.[148] An ordinary credit mechanism applies for foreign-source passive income.[149]

Economic double tax relief in corporate taxation is provided for proceeds from substantial equity investments under the participation exemption regime and the participation credit regime, the latter being an indirect credit mechanism.[150] Eligible for relief are proceeds from an equity investment of 5% or more – a "participation" – in the paid-up capital of the company in which the corporate taxpayer holds its shareholding investment. Exempt from the tax base under the participation exemption are proceeds from actively held participations and proceeds from passively held participations that are subject to a reasonable tax according to Dutch tax standards, which is interpreted as a profit tax at an effective tax rate of at least 10%.[151]

145. Parliamentary Papers House of Representatives, 2005-2006, 30 572, No. 3.
146. Parliamentary Papers House of Representatives, 2009-2010, 32 128, No. 52, at 34.
147. Article 15e. The regime is referred to as "base exemption for foreign business profits". The regime is available for Dutch-resident corporate taxpayers and Dutch fiscal unities that derive profits from foreign sources, e.g. profits attributable to foreign permanent establishments. Under this mechanism, the taxpayer's worldwide earnings are reduced by an amount equal to the sum of the foreign-sourced income items as determined according to Dutch tax standards on a per country basis.
148. Article 15e et seq.; and Article 23d.
149. Article 36 Unilateral Decree for the avoidance of double taxation (Unilateral Decree).
150. These regimes are laid down in Article 13, Article 13aa and Article 23c, respectively.
151. Article 13(11-15). Passively held participations the proceeds from which are eligible for relief under the participation exemption are referred to in Dutch taxation as "qualifying portfolio participations". The participation exemption applies to participations held as a portfolio investment in the event that a subject-to-tax test or the so-called asset test is met. The subject-to-tax test is fulfilled if the company in which the participation is held is

A switch-over to an indirect credit applies with regard to passively held participations which are subject to a profit tax at an effective rate of up to 10%.[152] No relief is available if the passively held participation effectively remains untaxed locally.

Adverse tax deferral, as mentioned in section 19.3.5.1., is addressed by reference to a CFC-like mark-to-market valuation rule that applies to passively held shareholdings of at least 25% in corporate bodies whose assets "exclusively or almost exclusively" consist of low-taxed portfolio investments.[153] The phrase "passively held" is interpreted by reference to the intention of the taxpayer of holding the assets as a portfolio investment. The phrase "low-taxed" refers to the corporate body concerned being subject to an effective corporate tax at a rate of at least 10%. Similarly to CFC rules, the mark-to-market valuation rule prevents taxpayers from obtaining an exemption for income from mobile capital sheltered in a low-taxed entity.[154] Contrary to common CFC rules, however, there is no direct attribution of profits derived by the company concerned to the shareholder/taxpayer. Instead, the regime resorts to the shareholding value and includes any value fluctuations, both increases and decreases, in the taxable base. Since both realized and unrealized profits of the underlying company are reflected in the fair market value of the shares, the income resulting from this may in certain cases be higher than under general CFC rules. Notably, the Dutch personal income tax system also provides for CFC-like regimes, having the objective of countering adverse tax deferral arrangements engaged in by high-net-worth individuals.[155]

subject to a tax on profits which results in a "reasonable taxation according to Dutch tax standards", i.e. an effective tax rate of at least 10%. The asset test is fulfilled if the assets of the company in which the participation is held generally for less than 50% consist of so-called low-taxed free portfolio investments.

152. Articles 13(9), 13aa and 23c. Passively held participations the proceeds from which are ineligible for relief under the participation exemption are referred to in Dutch taxation as "non-qualifying portfolio participations". Benefits connected with such non-qualifying portfolio participations are included in the corporate income tax base and taxed at 25%. However, an indirect tax credit of generally 5% is available as a relief from double economic taxation if the company in which such shareholding is held is subject to an effective tax rate of between 0% and 10%.

153. Article 13a. The legislation refers to a so-called portfolio shareholding of at least 25% in a company which is not subject to an effective tax rate of at least 10% and whose assets consist for at least 90% of low-taxed free portfolio investments. Such a portfolio shareholding must be annually valued at fair market value.

154. Parliamentary Papers House of Representatives, 2009-2010, 32 129, No. 3, at 15-16.

155. Two regimes have been adopted in the personal income tax act for this purpose. First, a SAAR in Article 2.14a PITA counters any tax-induced separation of privately held assets, for example through a trust. The regime provides for an attribution of any assets and

19.3.6. Linking rules relating to hybrid financial instruments – PSD

The Netherlands recognizes the need to implement measures to address hybrid mismatch arrangements, for example by introducing linking rules. However, the Netherlands firmly stresses the importance of an internationally coordinated approach in this area, for instance at EU level.[156] The recommendations in the final BEPS package concerning BEPS Action 2 are considered too non-committal to proceed to unilateral actions. The State Secretary for Finance has called for international consensus on binding rules and a multilateral introduction to ensure a level playing field and to preserve the attractiveness of the Dutch tax climate for business and investment.

As per 1 January 2016, the Netherlands has implemented recent amendments to the PSD involving the adopted anti-mismatch provision[157] by introducing a specific linking rule in the Dutch participation exemption regime.[158] Pursuant to the linking rule, a corporate taxpayer will not be eligible to apply the participation exemption with respect to received profit repatriations to the extent that these are deductible by the subsidiary. This might be the case for certain hybrid financial instruments. Any payments on such instruments are taxed in the hands of the recipient Dutch taxpayer. The linking rule operates mechanically; the aim or intention of the taxpayer is irrelevant. Similarly to some other Member States, the Netherlands has chosen to have its linking rule operate globally (and not only regarding intra-EU payments on financial instruments).

income derived from such a "separated estate" to the contributor (*afgezonderd particulier vermogen*). It accordingly seeks to tackle any creation of "non-taxable and floating" assets (Parliamentary Papers House of Representatives, 2008-2009, 31 930, No. 3, at 50 et seq.). Second, the SAAR found in Articles 4.13 and 4.14 PITA counters any hoarding of portfolio investments in non-taxed or low-taxed entities (Parliamentary Papers House of Representatives, 1998-1999, 26 727, No. 3, at 204). To tackle possibilities to hoard portfolio investment proceeds in a non-taxed or low-taxed entity, a specific rule applies in the substantial shareholder regime. A taxpayer which has a substantial shareholding, i.e. a shareholding of at least 5%, in a Dutch exempt investment fund (Article 6a CITA) or a low-taxed foreign portfolio investment entity, is required to annually include at least a fictitious return of 4% of the fair market value of the shares in its taxable income, which is subsequently subject to the general individual income tax rate for any proceeds from substantial shareholdings of 25% (*forfaitaire rendementsregeling*).

156. Letter of 5 October 2015, *supra* n. 38; and Letter of 19 November 2015, *supra* n. 45.

157. Council Directive 2014/86/EU of 8 July 2014 amending Directive 2011/96/EU on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States.

158. Article 13(17).

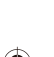
The newly introduced linking rule addresses deduction-and-no-inclusion outcomes in a manner similar to the OECD's specific recommendation on hybrid financial instruments (BEPS Action 2). Both the OECD recommendation and the anti-mismatch provision in the PSD aim to secure a balanced outcome in tax effects in this area. Either the payments are tax deductible and taxed, or they are non-deductible and eligible for double tax relief. Via the PSD, an EU-wide coordination of tax treatments of financial instrument payments is secured, and level playing fields in this area within the European Union are accordingly established.

19.3.7. Limitations on the deduction of interest

19.3.7.1. Objective interest deduction limitation provisions for the preservation of corporate tax base

The Netherlands' corporate tax legislation contains several provisions limiting the deduction of interest expenses. The deduction of business-like interest can be limited in certain situations, either by the application of a legal provision or on the basis of *fraus legis*. The Dutch tax system, as noted in section 19.2.1.1.2., allows for a requalification of debt instruments having equity-like properties into equity for corporate tax purposes. Interest payments on such hybrid financial arrangements qualify as a constructive dividend and hence are not tax-deductible. In cases of excessive non-arm's length interest, the excess qualifies as a constructive dividend also, and is therefore not tax-deductible either. It follows that the deduction limitation provisions in the Dutch tax system apply with regard to an arm's length interest on a debt instrument that qualifies as such for purposes of corporate taxation.

The interest deduction limitations in the Dutch tax system share the objective of protecting Dutch corporate tax base from erosion through financing arrangements. Some provisions focus on specific transactions, and some focus on the financing structures incorporated by the taxpayer concerned. Some interest deduction limitations resort to the motives of the taxpayers concerned, whereas others apply mechanically, i.e. irrespective of whether a taxpayer has a tax-induced reason for engaging in the debt financing arrangement in question. Interest deduction limitation provisions in the Dutch tax system, i.e. Articles 10a, 10b, 13l and 15ad, apply in their order of insertion in the CITA. The same holds for the rollover relief rules for business restructurings.



19.3.7.2. Anti-profit drainage – Article 10a of the CITA

There is a long-standing tradition in the Netherlands of countering tax base erosion strategies utilizing an artificial and tax-induced creation of interest payments under intra-group financing transactions and arrangements. Traditionally, such profit drainage was countered by the tax administration by invoking *fraus legis*, sparking the development of a body of so-called anti-profit drainage case law (*see* section 19.2.1.6.). As noted, the tax authorities have achieved some success in addressing profit drainage via those means. The Dutch tax legislator nevertheless desired to further limit interest deductibility, beyond *fraus legis* scenarios, and proceeded to codify *fraus legis* case law in this area as per 1997 for legal certainty reasons[159] and to further limit the deductibility of group interest payments by broadening the scope of the regime's application. The interest deduction limitation regime was modified into its current form in 2007 and is found in Article 10a of the CITA.

Article 10a of the CITA is essentially a SAAR addressing certain types of tax-induced profit drainage scenarios, i.e. base erosion via certain intra-group financing transactions. Pursuant to Article 10a, any deduction of interest on debts, including expenses and foreign exchange results, that are – either by law or in fact, and either directly or indirectly – owed to "affiliated" parties may be denied in the event that the debts involved relate to the financing of "tainted transactions". Tainted transactions covered by the SAAR include any debt financing that – either by law or in fact, and either directly or indirectly – relates to: (i) a profit distribution or a repayment of capital to an affiliated company or person; (ii) a capital contribution to an affiliated company; or (iii) an acquisition or an extension of a shareholding interest in an affiliated company, including an acquisition from a third party of a shareholding interest in a company that becomes an affiliate of the taxpayer upon its acquisition. Such tainted transactions may either be concluded by the taxpayer or an affiliated party to address some undesired structuring possibilities. Emphasis lies on the substance rather than the form of the transactions undertaken. The provision defines an affiliated party as: (i) a company in which the taxpayer, directly or indirectly, owns an interest of at least one third; (ii) a company that, directly or indirectly, owns an interest of at least one third in the taxpayer; or (iii) a company in which a third party, directly or indirectly, owns an interest of at least one third, while that third party, directly or indirectly, owns an interest of at least one third

159. Parliamentary Papers House of Representatives, 1995-1996, 24 696, No. 3, at 9-12.

in the taxpayer. Corporate entities forming part of a Dutch fiscal unity for corporate tax purposes are also considered affiliated.[160]

To secure a non-effectuation of the deduction limitation under Article 10a of the CITA, the taxpayer is provided an opportunity to demonstrate that there is no intention of misuse. As Article 10a is essentially a codification of pre-existing *fraus legis* case law, the motives of the taxpayer for engaging in the debt financing transactions are of pivotal importance for arriving at any deductibility or non-deductibility of group interest under it. Interest deduction is not limited if the taxpayer demonstrates that both the transaction and the debt financing thereof are predominantly based on sound business-like motives (motive test) or the interest at the level of the recipient is subject to a reasonable taxation according to Dutch tax standards – interpreted as tax payable at an effective tax rate of at least 10% (compensating levy test). If the taxpayer opts to base its arguments on the compensating levy test, the tax authorities have the opportunity to prove that there are no overriding sound business-like motives for the transactions as well as the opportunity to prove that the transactions are set up for the purpose of future loss compensation. Accordingly, matters boil down to the motive of the taxpayer, whereby the burden of proof of the presence of business motives – i.e. motives other than tax motives – rests on the taxpayer if the effective tax rate at the recipient end is lower than 10% and whereby the tax administration bears the burden of proof if the tax rate concerned effectively exceeds 10%. Essentially, the approach taken resorts to a sort of subject-to-tax test as a burden-of-proof distribution tool.

The operation of Article 10a of the CITA and *fraus legis* in this area has given rise to a large body of case law[161] that is perhaps too extensive to be

160. Article 10a(4).
161. Relevant cases include Supreme Court, 9 February 1955, BNB 1955/127; Supreme Court, 27 December 1967, BNB 1968/80; Supreme Court, 17 June 1987, BNB 1987/289; Supreme Court, 26 April 1989, BNB 1989/217; Supreme Court, 7 June 1989, BNB 1990/72; Supreme Court, 10 March 1993, BNB 1993/194; Supreme Court, 10 March 1993, BNB 1993/196; Supreme Court, 10 March 1993, BNB 1993/197; Supreme Court, 23 August 1995, BNB 1996/3; Supreme Court, 6 September 1995, BNB 1996/4; Supreme Court, 20 September 1995, BNB 1996/5; Supreme Court, 27 September 1995, BNB 1996/6; Supreme Court, 17 March 1999, BNB 1999/325; Supreme Court, 18 April 2001, BNB 2001/345; Supreme Court, 13 July 2001, BNB 2001.398; Supreme Court, 10 August 2001, BNB 2001/399; Supreme Court, 8 February 2002, BNB 2002/118; Supreme Court, 7 June 2002, BNB 2002/361; Supreme Court, 6 December 2002, BNB 2003/183; Supreme Court, 23 January 2004, BNB 2004/142; Supreme Court, 9 July 2004, V-N 2004/35.11; Supreme Court, 8 October 2004, BNB 2005/51; Supreme Court, 17 December 2004, BNB 2005/169; Supreme Court, 17 June 2005, BNB 2005/304; Supreme Court, 16 November 2007, V-N 2007/55.23; Supreme Court, 25 November 2005, BNB 2006/86; Supreme Court, 11 July 2008, BNB 2008/266; Supreme Court, 19 March 2010, BNB 2010/215; Opinion

discussed in detail in this chapter. Nevertheless, it is worth addressing a recent case decided by the Supreme Court known as *Mauritius* (*see also* section 19.2.1.5.3.).[162] In *Mauritius*, the court clarified that the motive test under Article 10a also applies with regard to an external acquisition. Taking a group-wide approach, the court stated that the motives of "all parties involved" in the transactions concerned need to be taken into account for the purpose of assessing whether the motive test is fulfilled (rather than the motive of the relevant taxpayer/debtor on a stand-alone basis). Moreover, the court elaborated on what is referred to in Dutch tax practice as a "non-business-like re-routing" (*onzakelijke omleiding*) of capital within the affiliated group (*see also* section 19.1.1.2.). In the presence of such a re-routing of capital, it is not possible to successfully invoke the motive test to shake off a limitation of interest deductibility. Matters must be assessed by taking into account a broad perspective. The court did not answer the question of whether a motive to avoid foreign taxation constitutes a business motive under the motive test for Article 10a purposes.

Furthermore, currently pending before the Supreme Court is *Italian Listed Company*, which potentially may have a significant impact on the interpretation and application of Article 10a of the CITA.[163] This case involves a Swedish multinational that wanted to delist its Italian subsidiary company, a minority shareholding of which was listed on an Italian stock exchange. For acquiring the minority shareholding from the market, the multinational incorporated a Dutch intermediate holding company, funded with intra-group debt, which subsequently made the funds obtained available as a capital contribution into its incorporated subsidiary company, BidCo. BidCo subsequently proceeded to acquire the "floating shares" from the stock exchange. Thus, the structuring left a group debt situated at the level of the Dutch intermediate holding company which sought to deduct the interest paid from its corporate tax base yet was confronted with the interest deduction limitation in Article 10a of the CITA. One of the questions at hand as brought before the Supreme Court is whether and how the motive

Advocate General Wattel, 30 November 2010, V-N 2011/3.19; Supreme Court, 8 April 2011, BNB 2011/156; Supreme Court, 24 February 2012, BNB 2012/229; Supreme Court, 16 March 2012, BNB 2012/149; Supreme Court, 1 June 2012, BNB 2012/213; Supreme Court, 1 March 2013, BNB 2013/137; Supreme Court, 27 February 2015, BNB 2015/125; Opinion Advocate General Wattel, 6 August 2015, V-N 2015/51.12; and Supreme Court, 14 August 2015, BNB 2015/165.

162. Supreme Court, 5 June 2015 and the textually corrected version of 14 August 2015, BNB 2015/165.

163. Case No. 15/00194; *see also* Opinion Advocate General Wattel, 6 August 2015, V-N 2015/51.12.

test should be interpreted and applied in the present case. It is now up to the Supreme Court to decide on the operation of Article 10a in this case.

19.3.7.3. Interest deduction limitation to counter international TP mismatches – Article 10b of the CITA

It was noted in section 19.2.1.5.3. that the tax authorities have not been particularly successful in addressing TP mismatches via *fraus legis*. To counter certain base erosion strategies involving intra-group debt financing, the tax legislator has adopted a SAAR in Article 10b of the CITA. The provision is designed to address international mismatches involving the issuing of long-term debts between associated companies on which no interest is due or with respect to which an interest rate has been agreed upon that is significantly – i.e. at least 30% – lower than the arm's length interest rate. Any debt with no term or with a term of at least 10 years is considered to be long-term within the context of this provision. The term "associated" is interpreted as under Article 8b of the CITA (*see* section 19.3.1.3.). Pursuant to Article 10b, any interest – including both the amount paid and the arm's length amount – is non-deductible for corporate tax base calculation purposes, regardless of the tax treatment of the interest in the hands of the recipient affiliate creditor. The legislator found the economic double taxation risks accordingly initiated justifiable, because it considered the provisions to be aimed at providing a disincentive for associated companies to conclude such long-term debts on non-arm's length conditions.[164] Notably, the State Secretary for Finance has indicated a willingness to resolve any such double taxation in domestic scenarios.[165] EU law compatibility issues are left unassessed.

19.3.7.4. Tax base protection by limiting deduction of interest related to participations – Article 13l of the CITA

A third interest deduction limitation regime (next to Articles 10a and 10b) is Article 13l of the CITA. This SAAR seeks to safeguard corporate tax base by limiting the deduction of interest on debts that are deemed to be related to the financing of both domestic and foreign participations. This provision was introduced as per 1 January 2013 and may be seen as an extended response of the Dutch tax legislator to the widely known ruling of the ECJ

164. Parliamentary Papers House of Representatives, 2005-2006, 30 572, No. 8, at 84.
165. Letter of 14 June 2007 from the State Secretary for Finance, No. BCPP2007-00826. *See also* the pending case No. 15/00707; and Opinion Advocate General Wattel, 14 October 2015.

in *Bosal* in 2003.[166] In *Bosal*, the ECJ held incompatible with EU law a former interest deduction limitation in the Dutch corporate tax legislation that effectively allowed a deduction for interest relating to the financing of domestic participations while denying an equivalent deduction for interest expenses relating to foreign participations. In response to this ruling, Dutch tax law was amended to allow a deduction for all interest expenses relating to participations. As per 1 January 2004, thin-capitalization rules were introduced in Article 10d of the CITA to limit the gap between deductible expenses and exempt profits and to protect the tax base. Article 10d was subsequently abolished as per 1 January 2013 and replaced by Article 13l, which is currently operational.

Article 13l of the CITA aims to limit the gap between deductible expenses and exempt profits related to participations. Interest expenses are not deductible in a taxable year to the extent that the interest is deemed to relate to the financing of participations – referred to in Dutch taxation as "excessive participation interest" – provided such excessive participation interest exceeds EUR 750,000. The amount of excessive participation interest is calculated mathematically and equals the fraction of the annual average "participation debt" and the annual average "total debt" as multiplied by the total sum of interest expenses that year. Temporary changes induced by tax avoidance motives are ignored. The participation debt is determined mathematically. It is calculated as the total cost price of the participations minus the equity for tax bookkeeping purposes – the taxpayer is deemed to have financed its participations with equity first – with a minimum of nil and with a maximum of the amount of the taxpayer's total debt. The total debt includes all debts which are recognized as such for tax law purposes, i.e. both intra-group and external debt, but only to the extent the arm's length interest is deductible, i.e. not otherwise restricted, under Articles 10a and 10b of the CITA. Debts related to so-called intra-group active financing activities and the interest thereon are excluded from the operation of Article 13l.[167] Specific rules make sure that Article 13l and other provisions do not concurrently apply.

Article 13l of the CITA is intended only to apply in improper or non-business-like scenarios. Genuine businesses should not be affected too much by the interest deduction limitation provision. On that basis, the cost price of participations is not taken into account for the calculation of the participation debt if and to the extent that the participation involved qualifies as an "expansion investment", i.e. is interpreted as an expansion of the operational

166. ECJ, 18 September 2003, C-168/01 (*Bosal*).
167. Specific conditions apply as to deciding on whether the group financing activities are considered passive or active.

activities of the group. The exception does not apply, however, in cases of improper use. Again, taxpayer motives are of relevance. An improper use (regardless of the presence of an expansion of operational activities) is considered at hand in three distinct scenarios: (i) if the debt structuring concerned would otherwise produce a double deduction outcome, i.e. a deduction of interest at the level of both the taxpayer and an affiliate, for instance in the case of a hybrid entity arrangement; (ii) if the debt arrangement concerned has been structured as, for instance, a hybrid financial instrument within the group, as a result of which the interest expense would otherwise be deductible, whereas the receivable would not be taxed or be taxed at an effective rate of less than 10%, i.e. if the tax structuring would produce a deduction-and-no-(effective)-inclusion outcome (some sort of subject-to-tax test may be recognized here); and (iii) in the event that the taxpayer would not have engaged in the structuring concerned in the absence of the availability of such an interest deduction. In the event that the interest is taxed in the hands of the creditor, the interest is deductible at the level of the taxpayer/debtor if the taxpayer shows evidence that the structuring has been based predominately on business motives. This may be the case if the taxpayer is engaged in the active and strategic management of the participation concerned. These anti-abuse rules are applied on a continuous basis. No case law on Article 13l of the CITA has yet been produced, due to the provision being relatively new to the Dutch tax system.

19.3.7.5. Tax base protection by limiting deduction of interest on "acquisition debts" – Article 15ad of the CITA

A fourth and final interest deduction limitation is Article 15ad of the CITA. Article 15ad targets the deductibility of interest – including expenses and currency exchange results – on so-called acquisition debts. The provision applies to interest on all debts that – either by law or in fact, and either directly or indirectly – relate to the acquisition or extension of a shareholding interest in a corporate entity– i.e. an acquired company – which subsequently forms part of a Dutch fiscal unity with the taxpayer under the Dutch tax consolidation regime.[168]

To prevent tax base erosion, interest on such acquisition debts may not be offset against the taxable profits of the acquired company within the fiscal unity. A deduction applies in so far as the profits of the fiscal unity – i.e. those outside the profits that have been produced by the acquired

168. Similar rules apply in equivalent cases involving mergers and split-offs, Articles 14a(12) and 14b(9).

company – are insufficient to offset the interest expenses incurred relating to the acquisition debt. The limitation equals the lesser of: (i) the amount of interest that is ineligible to be offset minus a threshold of EUR 1 million; and (ii) the amount of so-called excessive acquisition interest. The excessive acquisition interest equals the amount of interest expenses incurred relating to the so-called excessive acquisition debt, i.e. the acquisition debt to the extent considered excessive. The acquisition debt is considered excessive in so far as it exceeds 60% of the acquisition price in the year of acquisition. This percentage is subsequently reduced by 5% annually to 25% in 7 years. The limitation is calculated annually. Temporary changes induced by tax avoidance motives that may influence the calculated amount of acquisition debt are ignored for the purposes of application of the interest deduction limitation provision. The provision covers all debts which are recognized as such for tax law purposes, i.e. both intra-group and external debt, but only to the extent that the arm's length interest is deductible, i.e. not otherwise restricted. No case law on Article 15ad of the CITA has been produced yet, due to the provision being relatively new to the Dutch tax system. The regime was introduced as per 1 January 2012.

19.3.8. Other SAARs in the Dutch tax system

19.3.8.1. Various additional SAARs in the Dutch tax system

The Dutch tax system includes a broad range of SAARs in addition to the aforementioned regimes and provisions on interest deductibility, including the substantial holding regime, loss offset limitations, anti-deferral rules relating to business restructurings, anti-mismatch rules involving hybrid entities and the anti-avoidance rules in the area of dividend taxation involving Dutch cooperatives and dividend stripping strategies. Worth noting is that a draft legislative bill was proposed in October 2015,[169] bringing the Dutch tax consolidation regime in line with primary EU law in response to the rulings of the ECJ in the joined cases *SCA Group Holding BV*, *X AG* and *MSA International Holdings BV*.[170] The draft legislation contains a number of provisions that seek to secure the internal consistency of the Dutch tax system and to prevent certain forms of potential misuse. This, however, remains unassessed.

169. Parliamentary Papers House of Representatives, 2015-2016, 34 323, Nos. 2 and 3.
170. ECJ 12, June 2014, joined cases C-39/13 (*SCA Group Holding BV*), C-40/13 (*X AG*) and C-41/13 (*MSA International Holdings BV*).

19.3.8.2. The substantial holding regime – Article 17(3)(b) of the CITA; PSD

Pursuant to Article 17(3)(b) of the CITA, an entity resident outside the Netherlands that holds a substantial shareholding, i.e. a shareholding of at least 5%, in a Dutch-resident company will be subject to Dutch corporate income tax if the holding is held with Dutch dividend tax or personal income tax avoidance as its main purpose or one of its main purposes and if the holding has not been put in place for valid commercial reasons which reflect economic reality (substantial holding regime). Non-resident corporate tax liability accordingly arises: (i) if the non-resident taxpayer/shareholding company has been interposed for tax avoidance reasons; and (ii) if the legal structuring is artificial. Both tests need to be met for the regime to apply. The legislator noted that valid commercial reasons may exist if the foreign entity: (i) has sufficient substance; (ii) conducts business activities and the substantial holding is attributable to that business; (iii) is the ultimate holding company; or (iv) is an intermediate holding company linking between the ultimate holding company and the business and, in addition, meets certain substance requirements. The legislator has indicated that, for the purposes of assessing whether the structure is supported by sufficient substance, current substance requirements for intermediate holding companies that wish to seek a Dutch ATR will be taken into account.

Via this regime, as it reads as per 1 January 2016, the Netherlands has implemented the GAAR in the PSD into its corporate income tax legislation. The Netherlands has also amended its dividend tax legislation for this purpose (*see* section 18.3.8.6.). Implementing the adopted GAAR in the PSD according to its literal wording, the phrasing of the substantial holding regime has been slightly altered in comparison to its wording prior to 1 January 2016. The textual alterations, however, are not intended to produce significant substantive changes to the operation of the regime in comparison to existing practice. As to the relationship between the substantial holding regime and the tax treaty obligations of the Netherlands, the State Secretary for Finance has stated that treaty obligations prevail.[171] The Dutch Constitution does not allow domestic law to override any obligations that the Netherlands has shouldered on the basis of an instrument of international public law.[172] Any relationships with EU law obligations are left unassessed.

171. Parliamentary Papers House of Representatives, 2015-2016, 34 306, No. 3, at 5.
172. Article 93-94 Dutch Constitution.

19.3.8.3. Loss offset limitation regimes – Articles 20a and 20(4) of the CITA

Taxpayers have quite liberal loss compensation possibilities under the Dutch tax system. The corporate tax code provides for vertical loss compensation by reference to a carry-back of 1 year and a carry-forward of 9 years.[173] However, the tax code contains two SAARs striking down perceived misuse of loss offset utilization entitlements. These regimes are laid down in Articles 20(4) and 20a of the CITA. In addition to these regimes, a range of extensive and detailed profit-loss offset restriction rules apply in the context of the Dutch tax consolidation regime.[174] These, however, are not discussed in this chapter.

Article 20(4) of the CITA essentially aims to counter any offsetting of operational profits and losses with losses and profits derived from shareholding and group-financing activities. The regime applies for holding and group financing entities, i.e. companies whose activities for at least 90% of the time involve the holding of participations or direct or indirect intra-group financing. Pursuant to Article 20(4), holding and financing losses can only be offset against holding and financing profits.

Article 20a of the CITA seeks to counteract trade in corporate bodies with vertical loss compensation entitlements and limits for this purpose vertical loss compensation possibilities in cases of third-party shareholder ownership transfers. Pursuant to Article 20a, any carry-over of losses is restricted if there is a significant change in ultimate shareholders, i.e. a change of the ultimate share ownership of at least 30%. Subsequent to such a change, any (existing) losses may only be offset against (future) profits arising from the relevant corporate body's original business activities. Accordingly, the provision seeks to prevent any undue inflation of loss compensation possibilities. The loss carry-over is not limited if the losses arose in a year in which the assets of the entity consisted for less than 50% of portfolio investments and the business activities have not been reduced by 70% or more. Accordingly, the provision seeks to allow a loss offset in the event that the shareholding transfer involves a transfer of substantial operational activity. Currently, a case is pending before the Supreme Court concerning the interrelationship between this provision and *fraus legis* (*see* section 19.4.2.).

173. Article 20.

174. Article 15 in conjunction with Articles 15ae, 15af, 15ag, 15ah and accompanying decrees. Provisions involving currency exchange losses on participations (Article 28b) and the so-called compartmentalization approach (Article 28c in conjunction with Articles 34c) are not discussed.

19.3.8.4. Anti-deferral rules relating to business restructurings – Articles 13h-13k and 14-14b of the CITA

The Dutch corporate tax system has implemented the Merger Directive, facilitating corporate business restructurings and reorganizations such as mergers, demergers (i.e. splits and split-offs or divisions and partial divisions), asset deals, transfers of assets and exchanges of shares, by providing rollover relief, i.e. a tax deferral, on accrued hidden reserves, goodwill and tax reserves.[175] Relief is available if no significant liquidities become available in the restructuring process. Tax collection is deferred in such cases until realization. As a general rule, business restructurings give rise to taxation in the Netherlands on any accrued capital gains in the business enterprise. Rollover relief is available as an exception to this general system in both domestic and cross-border scenarios. Relief is granted automatically or upon request, depending on facts and circumstances. Eligibility criteria apply. A request, for instance, is required if the corporate taxpayers involved in the business restructuring have vertical loss offset entitlements. CITA language loosely aligns with Merger Directive terminology. Provisions are nevertheless interpreted in conformity with the Directive.[176]

Rollover relief is unavailable if the restructuring is aimed to "escape tax or unduly defer tax" (*ontgaan of uitstellen van belastingheffing*).[177] A motive test applies, requiring a weighing of business motives and tax motives. The Supreme Court has held that of relevance for such an assessment, inter alia, is whether the business restructuring would have been engaged in absent rollover tax effects.[178] A legal separation of liquidities from the operational business enterprise through a business reorganization for civil liability reasons may suffice for being granted rollover relief.[179] A business restructuring to optimize the legal structure in preparation for sale may be seen as not constituting a main tax motive; this, however, may be different if a

175. Article 13h, 13i, 13j and 13k; Article 14 (asset merger), 14a (legal split) and 14b (legal merger); and Article 3.55 (share merger), 3.56 (legal split) and 3.57 (legal merger) PITA.
176. ECJ case law on the Netherlands' transposition of the Mergers Directive includes ECJ, 17 July 1997, C-28/95 (*Leur-Bloem*); and ECJ, 20 May 2010, C-352/08 (*Zwijnenburg*). Another ECJ ruling on tax avoidance involving the Merger Directive is ECJ, 10 November 2011, C-126/10 (*Foggia*).
177. The Supreme Court has judged that an undue tax deferral also constitutes tax avoidance under the business restructurings legislation implementing the Mergers Directive; Supreme Court, 29 June 2012, BNB 2012/261.
178. Supreme Court, 1 December 1999, BNB 2000/111.
179. Id.

party interested in acquiring the business enterprise has already appeared.[180] Matters should be assessed at the time the legal arrangement to set up the business restructuring is concluded.[181] Furthermore, from parliamentary history in combination with Supreme Court case law, it may be inferred that an undue deferral is at hand if the reorganization transaction is engaged in to defer a somewhat immediate tax liability.[182] Any motives to escape Dutch real estate transfer tax do not interfere with being granted rollover relief for corporate taxation.[183]

As noted in section 19.1.1.2., a rebuttable presumption applies that any business restructuring of any kind is deemed to be based on tax avoidance objectives if it does not take place for valid commercial reasons, such as a restructuring or a rationalization of the active business activities of the parties involved in the restructuring transaction. A rebuttable presumption of the presence of a tax avoidance motive applies in the area of asset deals and demerger transactions. A tax motive is deemed present if the shareholding obtained is disposed of within 3 years after the finalization of the restructuring process. Taxpayers, however, have the opportunity in such cases to show evidence of any present valid commercial reasons to be granted rollover relief regardless of such a disposal within 3 years.

19.3.8.5. SAAR neutralizing "*Sarakreek* mismatches" – Article 15ac(4)-(6) of the CITA

A SAAR applies to neutralize the mismatches that resulted from the "*Sarakreek* tax planning arrangement", which the Supreme Court left untouched in the *Sarakreek* case (*see* section 19.2.5.2.). The regime is laid down in Article 15ac(4)-(6) of the CITA and applies to fiscal unities operating a permanent establishment abroad via a tax-consolidated Dutch subsidiary company. Pursuant to this provision, internal loans granted by the fiscal unity's parent company to finance the permanent establishment's operations are recognized for juridical double tax relief purposes if the financing expenses have been recognized as a tax-deductible item abroad. In consequence, any interest payments on such internal loans are effectively taxed in the Netherlands in such cases. The provision does not apply if the taxpayer demonstrates that these expenses are not tax-deductible abroad. In

180. Supreme Court, 10 October 2008, BNB 2009/28; and Supreme Court, 2 June 2006, BNB 2006/282.
181. Id.
182. Parliamentary Papers House of Representatives, 1998-1999, 26 7272, No. 3, at 115; and Supreme Court, 29 June 2012, BNB 2012/261.
183. Supreme Court, 11 July 2008, BNB 2008/245; and *Zwijnenburg*, *supra* n. 176.

effect, the Netherlands recognizes and taxes such intra-firm interest receipts if the corresponding interests payable are deductible abroad, accordingly neutralizing the *Sarakreek* mismatch.

19.3.8.6. Dividend tax anti-avoidance rules for Dutch cooperatives – Article 1(7) of the DWTA; PSD

Pursuant to Article 1(7) of the DWTA, a cooperative that is resident in the Netherlands is obliged to withhold dividend tax on profit distributions to its members if the cooperative has been put in place with dividend tax or foreign tax avoidance as its main purpose or one of its main purposes and the arrangement is not supported by valid commercial reasons which reflect economic reality. Dividend tax should hence be withheld: (i) if the cooperative has been interposed for tax avoidance reasons; and (ii) if the legal structuring is artificial. Both tests need to be met for the tax to be levied. The legislator has noted that valid commercial reasons may exist if the cooperative has a sound economic relevance. This may be the case in the event that it conducts operational business activities. Valid reasons may also exist if the membership in the cooperative is attributable to the member's business enterprise and when the member operates as an intermediate holding company, provided that certain substance requirements are met.

Via this regime, as it reads as per 1 January 2016, the Netherlands has implemented the GAAR in the PSD into its dividend tax legislation. The Netherlands has also amended its corporate income tax legislation for this purpose (*see* section 19.3.8.2.). Implementing the adopted GAAR in the PSD according to its literal wording, the phrasing of the dividend tax regime has been slightly altered in comparison to its wording prior to 1 January 2016. Like the amendments to the substantial holding regime, the textual alterations are not intended to produce significant substantive changes to the operation of the regime in comparison to existing practice. The State Secretary for Finance noted that the regime's operation cannot override treaty obligations (*see also* section 19.3.8.2.).

19.3.8.7. National beneficial ownership test, dividend stripping – Article 4(7) of the DWTA

Article 4(7) of the DWTA incorporates a national beneficial ownership (*uiteindelijk gerechtigde*) test into the dividend tax legislation to prevent

dividend tax avoidance strategies, including dividend stripping.[184] Dividend stripping typically involves scenarios in which a shareholder engages in a legal arrangement with another party having a more favourable title to dividend withholding tax relief, for instance by means of a lower tariff, a tax credit, an exemption or a dividend tax refund. On the basis of such an arrangement, any legal rights to dividend proceeds are (temporarily) transferred to that other party in return for a consideration, while the original shareholder maintains its beneficial interest in the shares and shareholding proceeds concerned.[185] The legislative act essentially utilizes the above-noted elements in its description of beneficial ownership but does so by means of a negative definition to avoid manipulation, setting forth criteria on the basis of which a dividend recipient is *not* considered the beneficial owner of the profit distributions concerned.

19.4. Application of GAARs, TP rules and SAARs

19.4.1. The interaction of *fraus legis*, TP rules, SAARs and linking rules

The interaction of the *fraus legis* doctrine, the Netherlands' TP approaches and the application of the SAARs in the Dutch tax system may be characterized as somewhat unclear, or at least fiercely complex. All doctrines and regimes simultaneously apply on their individual merits, though they interrelate and mutually interact as well.

The taxable-profit calculation mechanism, of which the ALS forms an integral part, applies independently of the SAARs and linking rules in the Dutch tax system. The determination of taxable profit precedes the application of SAARs and linking rules and is not affected by their operation. A payment that qualifies as an expense for tax base calculation purposes as originating from the taxpayer's business conduct is in principle tax-deductible, save for the application of a deduction limitation. The same holds for a receipt that qualifies as a taxable income item by the same token and consequently is subject to taxation, save for the application of an exemption like the participation exemption. Losses that qualify as such for tax base calculation purposes may be offset against past and future taxable profits under the

184. Article 4(7) DWTA and related provisions. Similar provisions are included in the Unilateral Decree.
185. Parliamentary Papers House of Representatives, 2000-2001, 27 896, No. 3; and Supreme Court, 6 April 1994, BNB 1994/217 (*Marketmaker*).

available loss carry-back and carry-forward rules, save for the application of an anti-loss offset utilization provision.

The same holds for the interaction between profit calculation methodologies and *fraus legis*. Tax base calculation, as noted above, involves the question of whether a certain (non-)payment or (non-)receipt originates from the business operations and should accordingly be recognized as an in principle tax-deductible expense or taxable income item. Of relevance is whether the advantage or disadvantage of the (non-)payment or (non-)receipt is business-like or originated from the shareholding relationship. Any advantages or disadvantages that originate from affiliation, for instance those ensuing from a shareholding relationship, are considered non-business-like and do not affect the profit for tax base determination purposes. The business-like or non-business-like nature of the transaction or series of transactions undertaken is assessed by reference to functions performed, assets used and risks assumed. This property renders the ALS an inherent and integral part of tax base calculation in the Dutch tax system.

Any inclusion or exclusion of non-business-like elements from the taxable base should be seen as a process analytically separate from the application of *fraus legis*. *Fraus legis* involves the substitution or elimination of legal facts to arrive at an application of the law according to its intent in cases involving taxpayers engaging in predominantly tax-motivated legal arrangements contrary to the spirit of the law. Taxable-profit determination, in contrast, is neutral. Any references to tax avoidance motives are alien to taxable-profit calculation methodologies. That holds true regardless of any awareness of non-business-like elements underlying the inter-affiliate transactions arguing for the elimination of these elements from the taxable base.

19.4.2. Interrelationships of applicable rules in terms of hierarchy, coordination or overlapping of measures

No explicit hierarchy exists when it comes to the interrelationships between applicable rules and regimes in the Dutch tax system. That holds true even though there is an order of application and coordination measures have been taken to address issues of concurrent application. In effect, the model boils down to an approach on the basis of which, first, the taxable base of a corporate taxpayer is determined by reference to profit determination approaches and the ALS. Second, the SAARs are applied in their order of insertion in the legislative act and subject to mutual coordination rules. The *fraus legis* doctrine constantly applies on top of that, metaphorically hovering over and

affecting, if necessary, the process of the determination of the Dutch tax implications in a particular set of facts and circumstances.

The SAARs and linking rules in the Dutch corporate tax system explicitly coordinate the modes of their interactive application for those scenarios in which these rules would concurrently apply. The interaction of these rules in concurrent scope-of-application cases – both mutually and in relation to the other tax regimes such as the participation exemption regime, the double tax relief mechanism and the tax consolidation regime – forms the technically most complex part of the Dutch tax system. This particularly holds in cross-border scenarios. The technicalities in these areas are not further discussed in this chapter. The same holds for any EU law compatibility issues.[186]

Fraus legis seems to apply in any case, regardless of applied taxable-profit calculation approaches, TP, or the presence, absence or application of a SAAR or linking rule. Recently, after a long period of uncertainty, the Dutch Supreme Court held that *fraus legis* can effectively be invoked by the tax administration both aside from and simultaneously with the application of a SAAR. The court ruled that the *fraus legis* doctrine, for instance, applied in cases involving the operation of the interest deduction limitation regime in Article 10a of the CITA that codified *fraus legis* in that area and further narrowed down interest deductibility regarding certain intra-group financing arrangements (*see*, on this provision, section 19.3.7.2.).[187] Another example is a recent series of cases in which the Supreme Court held that *fraus legis* was eligible to be invoked by the tax administration alongside a specific anti-deferral provision[188] which targets perceived abuse involving specific tax-induced arrangements set up to defer taxation on hidden reserves realized upon capital asset disposals in cases of third-party shareholder ownership transfers.[189] The cases concerned an arrangement which the anti-

186. The operation of a range of provisions discussed in this chapter may, for instance, effectively be shaken off in domestic scenarios by having the corporate bodies involved join a fiscal unity under the operation of the Dutch tax consolidation regime. As the Dutch tax system does not allow for a cross-border tax consolidation, however, any such shaking off is infeasible in cross-border scenarios. On the basis of the ruling of the Court of Justice in C-386/14 (*Groupe Steria*), it seems that a per-element approach needs to be adopted, rendering a variety of these provisions and regimes potentially subject to EU law compatibility issues.

187. Supreme Court, 11 July 2008, BNB 2008/266; and Supreme Court, 1 June 2012, BNB 2012/213. Room for invoking *fraus legis*, however, seems limited to exceptional scenarios; Parliamentary Papers House of Representatives, 2005-2006, 30 572, No. 8, at 45.

188. Article 12a.

189. Supreme Court, 23 May 2014, BNB 2014/171, BNB 2014/172, BNB 2014/173, BNB 2014/176 and BNB 2014/178.

deferral provision did not explicitly cover – with the tax legislator aware of that in advance – to which the Supreme Court nevertheless held *fraus legis* to apply to annul the tax effects sought after by the parties that entered into the planning arrangement. Notably, the tax legislator has amended the provision in the meanwhile.

Accordingly, any application of SAARs does not, it seems, cancel out *fraus legis*. Currently, a case is pending before the Supreme Court on, amongst others, the question of whether some room exists to effectively invoke *fraus legis* alongside a SAAR, this time the anti-loss offset utilization provision discussed in section 19.3.8.3.[190] This provision targets perceived abuse involving certain specific tax-induced arrangements set up to utilize loss carry-back and loss carry-forward entitlements in cases of third-party shareholder ownership transfers.[191] In the case at hand, the parties involved set up a legal arrangement similar to an arrangement that was targeted under the anti-loss utilization rules concerned but which was not explicitly covered by the provision. The arrangement was set up to avoid the application of the anti-loss utilization measure to ensure an offset of "pre-shareholder transfer profits" with "post-shareholder transfer losses". Similarly to the proceedings on the anti-deferral provision mentioned above, the legislator had been made aware of the fact that the anti-loss utilization rules did not cover these specific types of arrangements beforehand.

One element that makes this case interesting is the fact that the Supreme Court has already interpreted the anti-loss utilization provision in question. The court did so then by reference to a strict textual interpretation.[192] That earlier case concerned a scenario in which the provision operated to the detriment of the taxpayer contrary to the intent of the law. The uncalled-for effective tax burden increase led Advocate General Wattel to resort to a teleological interpretation of the law by reference to its spirit rather than a strict textual interpretation.[193] The Supreme Court, however, resorted to a strict textual interpretation, leaving the burdensome outcome for the taxpayer in place. The case now pending may be seen as an analytical equivalent to that earlier case, with the key difference being that the tax implications under the facts and circumstances of the current case would be detrimental for revenue under such a strictly grammatical interpretation, forming a reason for the tax administration to invoke *fraus legis*. So far, both the Court of First Instance

190. Amsterdam Court of Appeals, 8 October 2015, V-N 2015/53.10. The case was pending before the Supreme Court at the time this chapter was drafted.
191. Article 20a.
192. Supreme Court, 21 November 2008, BNB 2009/42.
193. Opinion Advocate General Wattel, 25 June 2008, BNB 2009/42.

and the Court of Appeals have struck down the arrangement by reference to the *fraus legis* doctrine.

19.4.3. Procedural rules underlying application of the national GAAR, TP rules and SAARs

The questionnaire posed a final question as to whether specific procedural rules exist for the application of *fraus legis*, TP rules and SAARs. No such procedural rules exist, other than those discussed above. General administrative rules and approaches apply. In the Netherlands, the tax authorities assess corporate tax liability; no self-assessment procedure has been put in place. Taxpayers are required to have a properly organized financial administration and TP documentation available.[194] Taxpayers are also required to annually file a corporate tax return, electronically and in good time. In their tax return, taxpayers should state their tax position in a clear and firm manner, without any reservation and taking into account all relevant aspects.[195] Deductions, exemptions and relief, for instance, are claimed by filling in the relevant subject fields in the tax return filing computer program. The return as filed with the tax authorities is subsequently subject to a computerized compliance assessment. The tax assessment is typically formalized accordingly and issued to the taxpayer. In the event that the computer assessment or any findings of a tax administrative officer call for some further inquiry, the tax inspectorate typically proceeds by issuing questionnaires or requests for further information, for instance on the substance supporting the transactions engaged in, the passive or active nature of the income items concerned or the question of whether, in relation to a particular deduction claimed, the corresponding receipt is subject to sufficient taxation. Taxpayers are required to fully cooperate and submit all information relevant to assessing tax liability, save for tax advice.[196] If necessary, the tax authorities may further inquire or proceed to commencing a tax audit. Extremely non-compliant taxpayers may be faced with an estimation of their corporate tax liability. When it comes to a court proceeding in such cases, the burden to provide conclusive evidence in support of positions taken shifts to the taxpayer concerned. The tax authorities may be able to call in additional corporate tax subsequent to the issuance of the tax assessment for a period of 5 to 12 years.[197]

194. Article 52 GLT; and Article 8b (*see* section 19.3.1.3.).
195. Article 8 GLT.
196. Article 47 GLT.
197. Article 16 GLT.

Addendum (1 July 2016) – Anti-Tax Avoidance Directive

On Monday, 20 June 2016, at midnight, the European Council, under the Presidency of the Netherlands, reached political agreement on an Anti-Tax Avoidance Directive. (A preliminary agreement had been reached on 17 June 2016.) The Directive is expected to be formally adopted in a forthcoming Council meeting. The measures taken can be seen as a provisional synthesis of developments in international (G20/OECD) and EU corporate taxation with a view to addressing BEPS concerns. The Directive provides for a set of EU-wide *de minimis* approaches in corporate taxation to interest deductibility, exit taxation, controlled foreign companies, hybrid mismatch arrangements and a general anti-abuse rule. The original Commission proposal of 28 January 2016 also included a switch-over provision. That provision, however, was excluded from the Directive text during political deliberations at Council level. The Directive's provisions have to be transposed into domestic law as per 1 January 2019, except for those involving exit taxation and interest deductibility. The former needs to be transposed into domestic law as per 1 January 2020. EU Member States having interest deduction limitation rules already in place in their corporate tax system that are "equally effective to" the equivalent provision in the Directive may postpone transposition of the Directive provision until 1 January 2024.

As extensively elaborated upon in this chapter, the Netherlands' corporate tax system utilizes a broad range of anti-abuse approaches addressing BEPS concerns, many of which echo those now agreed upon at European Council level. Approaches taken in the Netherlands greatly overlap those adopted in the Anti-Tax Avoidance Directive, although they do not seem completely identical, at least not in technical terms. The Anti-Tax Avoidance Directive provides for a broad EBITDA-based interest deduction limitation provision, whereas the Netherlands' system so far deals with interest deductibility issues by means of targeted measures. The Netherlands' tax system deals with company exits in a manner similar to the equivalent Directive provision. Although the Netherlands' corporate tax system lacks a CFC measure in a strict sense, it does operate a CFC-like mechanism (*see* sections 19.2.2.2. and 19.3.5.). Moreover, with the operation of its TP system, the Netherlands already seems to have an available instrument covering at least some of the issues dealt with under the CFC regime in the Directive text. Hybrid mismatch arrangements are targeted in the Netherlands' corporate tax system via specific means rather than on the basis of a generic approach as provided for in the Directive text. Tax abuse, as discussed in section 19.2.1., is addressed by reference to the *fraus legis* doctrine, which broadly aligns with current approaches in ECJ case law and the PSD. The

general anti-abuse rule now agreed upon within the context of the Anti-Tax Avoidance Directive for its part largely corresponds with these approaches too. It will be interesting to see whether, and if so to what extent, both technically and analytically, the Netherlands transposes the Directive texts into its domestic corporate tax system. An answer to that question lies in the future.

Chapter 20

Norway

Benn Folkvord

20.1. The meaning of avoidance and aggressive tax planning and the BEPS initiative

20.1.1. The meaning of tax avoidance in national legal systems

Norwegian law includes a number of different rules regarding tax avoidance. There are two GAARs: one statutory rule and one case law rule. There are also several SAARs that will be discussed later in this chapter. In practice, Norwegian GAAR case law has had the greatest significance.

Tax avoidance refers to tax-motivated transactions. It is defined somewhat differently in the statutory norm as compared with the case law norm. The Norwegian Supreme Court has defined tax avoidance that is subject to the non-statutory GAAR as follows:

> The Substance Over Form Rule – which has been developed in both case law and theory – consists of a basic premise and an overall assessment. The basic premise is that the primary objective of the disposition must have been to save taxes. This is a necessary, but not a sufficient, condition for applying substance over form. Application of substance over form rules also requires that it, based on an overall assessment of the effects of the disposition (including its intrinsic commercial value), the taxpayer's objective in making the disposition and the circumstances in general, seems adverse to the objective of the tax rules to use the disposition as a basis for taxation.[1]

The threshold for applying the statutory anti-avoidance rule is presumably lower, while the scope is narrower. This statutory anti-avoidance rule is defined as follows in section 14-90 of the Norwegian Income Tax Act:

> This section deals with companies or groups as mentioned in Section 2-2, first and second subsections, and that have tax positions that are not linked to asset or debit items. When such companies, etc. are parties to a reorganisation pursuant to Chapter 11, or if their ownership changes as a consequence of

1. Norsk Rettstidende, *Norwegian Supreme Court Reports*, 2008, p. 1888, *Dyvi* (Norwegian Supreme Court decision).

> such reorganisation or other transaction, and it is likely that exploitation of the general tax position is the predominant motive for the transactions, Position A shall lapse if it represents a tax advantage, or Position B shall be entered as income without the right to offset against deficits if it represents a tax liability.

The anti-avoidance rules are also applied in a fairly comprehensive administrative practice, first and foremost as statements by the (Norwegian) Directorate of Taxes. These are binding advance rulings in specific published cases. In formal terms, such rulings have little or no value as sources of law; however, they may have great significance in practice. In principle, such rulings only apply to one specific case. If the Directorate of Taxes states that it is of the opinion that a transaction is not subject to the anti-avoidance rules, all Norwegian tax authorities will accept this type of transaction without asserting that it contravenes the anti-avoidance rules.

Tax avoidance is one of the areas in which the most decisions have been taken by the Norwegian Supreme Court. Generally, the Court will only hear a few of the cases that are appealed, normally only cases that involve matters of fundamental significance. As the Norwegian anti-avoidance rules are formulated with a very substantial margin of discretion, it is difficult to ascertain exactly where the lines are drawn as to when these rules should be applied. This gives rise to many cases where it is unclear whether or not the tax authorities can apply anti-avoidance. There are also many cases in which various aspects of the rules must be clarified. Not least, the Supreme Court will often adjust the avoidance rules, and there has been considerable variation in how strict the rules have been. The Supreme Court decisions are very important, both as regards application and development of the rules – substantially more important than the legislator's activity.

In spite of a fairly comprehensive catalogue of Supreme Court case law and extensive legal literature on this topic, the scope and content of the anti-avoidance rules are somewhat unclear. This is linked to the discretionary content of the rules, as well as to moderately inconsistent decisions by the Supreme Court, for which has been criticized in the professional literature.

The anti-avoidance rules are applied at all administrative levels. At the first level, the tax authorities must determine whether or not transactions are covered by the rules. This may then be followed by an appeal to a superior administrative body, before the matter is brought before the courts of justice.

International rules have relatively little impact on Norwegian anti-avoidance rules – at least not directly and openly. The Supreme Court very rarely refers

to international sources. It is more unclear whether international law has had a more indirect impact.

So far, the BEPS Project has had little effect on Norwegian anti-avoidance rules, but the more indirect effect is also less than clear. A regulatory commission has proposed that the non-statutory Norwegian GAAR should be signed into law. There are a number of reasons for this: partly because of the fact that the case law rules have been too unclear and partly because the Supreme Court is thought to be too liberal. It is also possible that the BEPS work has had an impact.[2] There is reason to believe that the BEPS Project will gain significance over time. Most likely, it will have limited significance for the general anti-avoidance rules. There is much to indicate that the BEPS Project will have the greatest impact in relation to the special rules (SAARs).

A regulatory commission has proposed introducing Norwegian withholding tax on royalties. The proposal refers to the BEPS work, and must be assumed to have drawn inspiration from this work.[3] There is no authority under Norwegian law for taxing royalties – a fact that has led to major opportunities for adaptation.

When it comes to the use and abuse of hybrid companies, the Norwegian legislator also refers to the BEPS Project. There is more of a wait-and-see attitude here, and it must be assumed that BEPS could also have significance here. The commission that has worked on these rules has clearly stated that one should await the conclusion of the BEPS work.[4]

As regards establishment of a fixed place of business, Item 7.5.5. of NOU 2014:13 (the official Norwegian Report on tax evasion) also concludes that reforms are needed, as the current rules are vulnerable to tax planning. The commission believes that one should await the conclusion of the BEPS Project and follow the recommendations that will be forthcoming. Reference is also made to the BEPS Project as regards exchange of information and it is recommended that the recommendations be followed also in this case.[5]

As illustrated above, it is suggested that the BEPS recommendations should be followed on a number of issues. The extent to which this will actually be

2. NOU, *Norway's Public Reports,* 2014:13, *Scheel*.
3. NOU, 2014:13, Item 7.3.
4. Id., Item 7.5.2.
5. Id., Item 7.6.

carried out has not yet been resolved. Traditionally, the Ministry of Finance has been very slow to introduce SAARs, also in relation to well-known, often used and fairly clear circumventions of the rules. However, it may seem that a shift in practice is underway here, meaning that the Norwegian authorities will become more active.

20.1.2. The meaning of tax planning, abusive tax planning and aggressive tax planning in national legal systems

There are no legal definitions of tax planning, abusive tax planning and aggressive tax planning in Norwegian law. This is due to the fact that the boundary between legal and illegal tax planning is subject to discretionary assessment and that complicates such definitions.

If the requirements for applying the national GAAR are fulfilled, the transaction in question will not be accepted by the tax authorities and the taxpayer will not achieve tax advantages. The decisive factor is thus a clarification of whether or not these requirements have been met. The existence of abusive or aggressive tax planning does not constitute grounds for applying GAAR. However, in practice, aggressive tax planning and abuse are subject to Norwegian GAARs – although this is not a direct or formal requirement.

As mentioned above, the court-made Norwegian GAAR can only be used if two conditions are met. First, only tax-motivated transactions can be affected. An overall assessment of the transaction must also be made. Key elements of this overall assessment will naturally include the degree of abuse and aggressiveness. The Supreme Court does not always state this directly, but one must nevertheless assume that these are key elements – which have no distinct legal clarification.

There is fairly comprehensive administrative practice as regards application of the Norwegian anti-abuse rules. However, this practice also lacks a clear definition of what is meant by tax planning, aggressive tax planning or abusive tax planning. Nevertheless, it is neither natural nor necessary to provide such definitions, as it does not constitute a requirement for applying the rules.

It has not been generally established whether the rules are applied or developed with any notable differences by the administrative bodies or courts of justice. On the other hand, there have been instances where Norwegian courts of justice disregard administrative practice concerning the application

of anti-avoidance rules. For example, it recently became clear that so-called "packaging" is accepted.[6] As a main rule under Norwegian law, shares owned by a company can be sold tax-free. Sale of other items, such as real property, will trigger taxation of capital. It was long assumed that splitting out a piece of real property into a dedicated single-purpose company, and then selling the shares in said company rather than selling the property directly could be subject to the Norwegian GAAR. This was rejected by the Supreme Court, and it is now considered clear that this type of transaction must nearly always be accepted by the Norwegian authorities

There is considerable overlap between the areas of application for the various anti-avoidance concepts in Norwegian law. The two GAAR standards in Norwegian law have the same basic condition for application. Under the court-made rule, an overall assessment of the transaction must also be carried out. However, the statutory norm only applies to certain types of transactions, typically mergers, share sales, etc. One might have expected that the statutory GAAR, which only requires one specific condition for application, would be used in practice. However, the opposite is the case. In the clear case of published cases, the legislator and courts of justice use the non-statutory and, for the taxpayer, more liberal, unpublished GAAR. There may be several reasons for this. One important reason is probably that the statutory rule can essentially only be applied to specific and delimited transactions. The statutory GAAR provides much less leeway than the non-statutory variant, for viewing many transactions – transaction chains – in context.

The rules have been criticized. It has been asserted that there should be a common GAAR with the same requirements for all types of transactions. It is difficult to understand why one should have a stricter statutory GAAR that only applies to certain types of transactions. The legislator's explanation is that a particularly strict GAAR is appropriate for certain transactions because avoidance is more practical in such cases. This reasoning has been criticized. The grounds cited for the criticism are that there are no good reasons for being more lenient when dealing with avoidance that is less common than when dealing with it when it is more common

International sources, including domestic law in other countries, appear to have had little impact on Norwegian case law and administrative practice. Nor does OECD practice appear to have had any significant impact. The indirect significance of these sources is more unclear, but there is little

6. Supreme Court Report, Rt 2014, p. 227.

to indicate that such sources have substantial significance. There may be many reasons for this: Norwegian tax and excise law is comprehensive and complex. It is likely that one has only limited knowledge of international sources. Also, Norwegian legal tradition is such that there is only a limited opportunity to emphasize international sources of law in the clarification of national law.

One exception to the above, however, is the application of anti-avoidance rules in the tax treaties. There, great emphasis is placed on the OECD's comments and practices surrounding them. Tax treaties in Norway require the OECD's insight to be taken into account. These sources are key elements – often quite decisive ones – in the application of international law.

20.2. The reaction to avoidance and aggressive tax planning in the BEPS context

20.2.1. Domestic GAARs

Norway is not a member of the European Union, which means that EC Recommendation C(2012) 8806 of 6 December 2012 is of less significance.

Under the Norwegian GAAR, a fundamental condition is that transactions must be tax-motivated. According to the EU's recommendation of 2012, a GAAR is meant to apply to tax-motivated transactions; however, it is also required for these transactions to be in an artificial arrangement, or a series of artificial arrangements. The requirement concerning artificial arrangements is not present under the Norwegian GAAR, which only requires a discretionary overall assessment of the transaction. A key element here is whether the transaction contravenes the objective of the tax rules.

The degree to which an artificial arrangement is present will be a key element in an overall assessment, also according to Norwegian law. The significance of this element seems to vary somewhat in a not entirely consistently formulated Supreme Court practice.

The effect of the application of both the Norwegian GAAR and the EU's recommended GAAR is relatively minor. In both cases, it is the actual content of the transaction that is used as a basis for the taxation. Exactly what this entails can present challenges in individual cases, but this is an issue that also arises under the EU's recommendation for a GAAR.

In light of the above, it is therefore assumed that there are clear similarities between the Norwegian court-made GAAR and the EU's recommendation of 2012 and that they are not as different as they may seem at first glance, although some differences will naturally emerge at a more detailed level.

The Norwegian GAAR has a type of "main objective test" built into it. A requirement for the application of the Norwegian GAAR is that the transaction is tax-motivated. In reality, this is a type of main objective test. A "business purpose test" is also built into the Norwegian basic requirement that a transaction must be tax-motivated. The degree of tax motivation shall be weighed against the business motivation. The more tax advantages a transaction entails, the greater the business motivation that is required. This is not a traditional business purpose test, although it can still have largely the same function. On the other hand, there is no traditional proportionality assessment built into the Norwegian rule.

The basic requirement in the Norwegian GAAR that a transaction must be tax-motivated shall be evaluated subjectively, according to more recent Supreme Court law. This entails that, if a transaction objectively yields major tax advantages, these must be disregarded if it can be established that the taxpayer was not motivated by these advantages. This subjective assessment has been subject to strong criticism. One well-known example is the *Telenor* case.[7] Shares worth NOK 8.6 billion (approx. EUR 1 billion) were sold, and the sale was undertaken in an artificial manner. The artificial manner of the sale yielded significant advantages. The company asserted that they did not consider tax when they planned the artificial sale (sale via unnecessary intermediary). The company's argument was successful in the Supreme Court. As the company's management had not, purely subjectively, considered tax, the transaction could not be tax-motivated, and the requirement for applying the Norwegian GAAR was not fulfilled.

Critics of the decision point out that it is unlikely that no one considered the tax aspect associated with the sale of assets worth around EUR 1 billion. The result has also been criticized because this yields a GAAR that is not very robust. The taxpayer can claim that he did not consider tax, thus giving rise to difficult questions of proof. If the norm is objective – such that it is sufficient to prove that a transaction will objectively yield advantages – it will be more effective and easier to apply. In light of the above criticism, a committee that suggested a reform of Norwegian tax law has also proposed signing the current non-statutory avoidance norm into law. This committee

7. Supreme Court Report, Rt 2006, p. 1232.

points out, in particular, that the law should require the norm to be objective, not subjective.[8]

It can also be mentioned that the significance of tax advantages in other countries has been controversial in Norwegian law. In the *Hydro* case of 2002, a transaction was carried out in Norway that yielded lower Danish tax.[9] The issue was then whether the basic requirement in the Norwegian GAAR that the transaction must be tax-motivated had been fulfilled. Here, Norwegian tax law concluded, somewhat surprisingly, that only tax advantages in Norwegian law can justify the use of the Norwegian GAAR. The conclusion has been severely criticized in the legal literature. The committee that proposed signing the norm into law in 2014 pointed out that the Supreme Court's solution in the *Hydro* case was something that should be examined in connection with making the norm a proper statute.

There are instances where the courts of justice do not accept the tax authorities' application of substance over form. This is natural. The main challenge associated with the Norwegian GAAR is its very discretionary design. This feature is the weakness of the Norwegian GAAR, as well as its strength – as the rule can be applied to all types of avoidance. The discretionary character of the rule entails that its boundaries are diffuse. There will be grey areas that require clarification. This also means that the tax authorities' decisions are not upheld by the courts in all cases where a substance-over-form approach is applied.

20.2.2. EC Recommendation C(2012) 8806 of 6 December 2012 and subject-to-tax rule

Norway is not an EU Member State; however, there is reason to believe that the EC recommendation of 2012 may have significance. An expert committee that has proposed signing the Norwegian GAAR into law refers to the EC's recommended GAAR as a background for its recommendation. Professor Zimmer from the University of Oslo has been assigned the task of making a more detailed assessment of the content and formulation of a statutory GAAR. This proposal is was disclosed in early 2016 and is currently under debate. To date, there are no known plans to implement a subject-to-tax rule as proposed by the European Union.

8. NOU, 2014:3, Item 7.5.3.
9. Supreme Court Report, Rt 2002, p. 456.

20.3. TP rules, GAARs, SAARs and linking rules

The Norwegian GAAR is largely supplemented by special rules that target avoidance more indirectly (SAARs). The Norwegian transfer pricing rule is probably the most practical of these. If a community of interest exists between two parties, the price must be arm's length/commercial. The Norwegian rules are closely linked to the OECD's Model Convention, etc. Section 13-1 of the Norwegian Taxation Act states inter alia that the Norwegian transfer pricing rule shall be applied in accordance with the OECD's Guidelines.

When the TP rules are used, it is normally done to prevent avoidance. Norway is a country with relatively high tax rates and the typical TP cases relate to sale of goods or services to companies in countries with lower tax rates. There are also cases relating to sale to countries without higher tax rates. In these cases, it is actually more a matter of distributing tax revenues between countries.

The TP rules come to a head in the courts in certain cases. A number of transfer pricing cases were heard in both the Supreme Court and in lower courts. This should not be surprising as these evaluations often entail difficult, discretionary assessments that may require clarification in the court system. The Norwegian TP rules are based on statutory, and not traditional case law.

Section 10-60 et seq. of the Norwegian Taxation Act contains rules regarding CFC rules. These are rules pertaining to current taxation of participants in Norwegian-controlled foreign limited companies and equivalent companies or federations, etc. that are domiciled in low-tax countries. The main purpose of the rules is to counteract tax-motivated flight of capital to low-tax countries. In an effort to prevent capital flight, the rules are targeted so that they ensure equal treatment of Norwegian taxpayers' investments in Norway and in low-tax countries or tax havens (capital export neutrality). As a main rule, Norwegian control of foreign companies must be regarded as being present when at least half of the company's assets or capital are directly or indirectly controlled by Norwegian taxpayers. Tax havens or low-tax countries are countries where the general income tax on the company's overall profit amounts to less than two thirds of the tax that would have been levied in Norway.

There is no CFC taxation of Norwegian owners in companies domiciled in countries with which Norway has tax treaties, unless the company's income

is mainly passive. Following a statutory amendment in 2007, the CFC rules do not apply if the company is genuinely established and carries out genuine financial activity in a low-tax country in the EEA. At the same time, a requirement was established regarding documentation and verification of this. The rule change was implemented after the CJEU's decision in *Cadbury Schweppes* (Case C-196/04).

Rules that directly govern hybrid entities such as BEPS Action 2 are not addressed. However, the topic has been discussed by the committee that has a mandate to examine measures to prevent moving profits out of Norway. The committee proposes measures targeting hybrids, for example that dividend to hybrid entities is not normally tax-free.[10]

Effective from income tax year 2014, rules have been introduced to limit interest deductions in connection with loans between close associates.[11] The rule entails that deductions for interest costs that exceed 30% of a specifically set profit shall be excluded. Only deductions for interest paid to close associates (internal interest) are potentially limited. Interest paid to independent third parties (external interest) is not subject to exclusion, but may supersede deductions for internal interest.

The rules are intended to reduce the incentives for multinational groups to place a high percentage of the group's debt in group companies domiciled in Norway, while interest income, etc. is channelled to group companies domiciled in countries with low taxation.

Mergers and demergers can be implemented tax-free under Norwegian law – in certain circumstances. There is no requirement that activity be transferred in such transactions. The rules entail that one can transfer more or less completely empty companies, or companies with limited assets, through a merger or demerger. Such shell companies can often be used in connection with tax planning. This type of requirement regarding transfer of activity appears to be fairly common internationally. In a consultation memo from 18 January 2010, the Ministry of Finance proposed introduction of a requirement for business continuity, also in connection with mergers and demergers. The proposal encountered significant opposition and was not adopted. The opponents argued that such a requirement would impede socio-economically beneficial and desirable transactions.

10. NOU, 2014:13, Item 1.4.4.3.
11. Sec. 6-41 Norwegian Taxation Act.

Under Norwegian law, there is considerable leeway to change company structures. Changing company structures is natural and useful. The scope and character of a business will change, and what was once a favourable company structure may no longer be expedient. Therefore, it is desirable that company structures can be changed without this being precluded by tax rules. One requirement for restructuring a company is that activity is transferred. There is thus a requirement for business continuity when company structure is changed. This requirement is not a traditional SAAR, but it could still have the same function – preventing avoidance.

The special Norwegian legality requirement can also be mentioned as an example of a SAAR. The requirement entails that a number of different transactions (such as dividend, etc.) must be carried out in accordance with rules of company and accounting law. If a transaction violates company or accounting rules, it cannot be implemented tax-free. This legality requirement has been subject to strong criticism in the Norwegian legal literature. Critics point out that the legality requirement is highly inaccurate, and that it is not suitable as a SAAR. Avoidance is rarely the cause of violating company or accounting rules of law. Such violations should be subject to sanctions via company or accounting legislation, not via tax legislation.

20.4. Application of GAARs, TP rules and SAARs

As a point of departure, the TP rules, Norwegian GAAR and the various SAARs are self-contained and independent rules that stand on their own. In practice, there is considerable overlap between the rules. In many cases, several rules could be applied.

In more complex cases, such as cases involving cross-border transactions, it may present a challenge to obtain a complete overview of the facts. Issues of evidence often arise that make it difficult to apply the national GAAR. Therefore, it is often not used, even though the requirements may be fulfilled. In many cases, the TP rules are used even though other rules might also be relevant.

It is not uncommon that multiple rules are used in the same case; often such that an assertion is first made regarding application of one set of rules. If these rules do not apply, the Norwegian tax authorities assert that a different set of rules should apply.

There is no hierarchy for the various sets of rules. The one that fits best shall be used, but multiple rules that yield the same result cannot be used at the same time. If, for example, a SAAR regarding business continuity is applicable, it can be used to show that a transaction triggers a tax obligation. It could be envisaged that the national GAAR will also yield the same result. In such a case, one must determine which means is more suitable and use that one. If one does not succeed in the legal system with the argument one believed was most suitable, one can assert that another legal basis applies instead.

There are no special procedural rules that apply to the Norwegian GAAR. However, it is worth mentioning that taxpayers who are uncertain whether a transaction may be affected by a GAAR, before the transaction is implemented, can ask the tax authorities to determine this via a binding advance statement. Such statements are issued prior to a transaction.

If a taxpayer disagrees with the result of a binding advance statement, he cannot challenge it in an appeal to or review by the courts of justice. The fact that binding advance statements cannot be reviewed by the courts of justice has been criticized in legal literature. In principle, a taxpayer can implement a transaction where the tax authorities have concluded that it is subject to the Norwegian GAAR. Then the taxpayer can bring the decision that is subsequently made in the case, before the courts of justice. In practice, no taxpayer will implement a transaction which he already knows the tax authorities believe is subject to the national GAAR. This opportunity to indirectly review a decision regarding the national GAAR is thus a theoretical possibility.

Chapter 21

Poland

Agnieszka Olesińska* and Joanna Witkowska

21.1. The meaning of avoidance and aggressive tax planning and the BEPS initiative

21.1.1. The meaning of tax avoidance in national legal systems

Tax avoidance is defined as an action (arrangement) that has been put into place primarily in order to obtain a tax benefit, which under the circumstances defeats the object and purpose of the provision of the tax act if the manner in which the action was carried out was artificial. The Polish GAAR is based on this definition.[1]

Administrative regulations do not clarify the meaning of tax avoidance. Tax rulings that are present in the Polish system do not seem to have an impact on avoidance. There is no settled meaning of "tax avoidance" in Polish case law. However, this is not surprising since the Polish GAAR entered into force recently on 15 July 2016 and before that the term "tax avoidance" was not present in Polish legislation.

In the past, in the absence of a statutory general anti-avoidance provision, the judiciary tried to combat tax avoidance. Polish courts employed a similar method to the judicial doctrine tackling tax avoidance employed by the courts in some common law countries.[2] The Polish administrative courts took the position that the taxpayer is not allowed to "avoid tax law" in order to obtain a tax benefit. This approach was based on the concept of "avoidance of the law", rooted in civil law principles.[3] According to this concept,

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1. Art. 119a General Tax Law (GTL), *Ustawa z dnia 29 sierpnia 1997 r. – Ordynacja podatkowa* (Tax Ordinance 1997), Journal of Laws of 2015, item 613, as amended.
2. *See* H. Filipczyk and A. Olesińska, *Poland [in] GAARs – A Key Element of Tax Systems in the Post-BEPS World*, (IBFD 2016), pp. 486-488.
3. According to art. 58(1) Polish Civil Code (1964), a legal act contrary to the law or aiming to circumvent the statute is invalid. *Ustawa z dnia 23 kwietnia 1964 r. kodeks cywilny*, Journal of Laws of 2014, item 121.

"tax avoidance" (a term that is not used in Polish legislation or courts' decisions) seemed to be similar to "avoidance of tax law". It could have been seen as a judiciary GAAR. But this judiciary approach was almost completely abandoned in the mid-2000s.[4]

In some decisions, the courts stated that a civil law contract that has been undertaken only to circumvent the tax law is not invalid, but tax authorities may disregard its tax consequences.[5] The court referred to the sole purpose of the transaction, not the "main" or "essential" one. Artificiality was mentioned. In some cases, the courts referred to tax avoidance, considering it as "circumventing" or "avoiding" the rule, but in fact the transaction was recognized as a sham transaction.[6] In some decisions, the courts mentioned this judicial concept ("avoiding of law") seemingly with no relation to the case being decided.[7]

It may be concluded that until 2016 (with the establishment of a new GAAR), the judiciary had not defined (or even used) the term "tax avoidance". The BEPS project does not seem to have an impact on the meaning of tax avoidance in our legal system.

21.1.2. The meaning of tax planning, abusive tax planning and aggressive tax planning in national legal systems

There is no legal definition of tax planning, abusive tax planning nor aggressive tax planning in the Polish legal system. Administrative regulations do not clarify their meaning either. Tax rulings have no impact in that respect.

4. For more about this judicial concept, *see* B. Brzeziński, *Narodziny i upadek orzeczniczej doktryny obejścia prawa podatkowego*, Przegląd Orzecznictwa Podatkowego 1 (2004), pp. 7-13. *See also* H. Filipczyk and A. Olesińska, *supra* n. 2, at sec. I.1, pp. 486-488. It is disputable whether, in the absence of a GAAR, a judicial interpretation, especially a purposive interpretation, could be seen as a method to combat tax avoidance, but some authors present such a view, *see* J. Niedojadło, *Interpretation of law as an alternative to the normative method against the tax avoidance,* (Toruński Rocznik Podatkowy 2014), pp. 216-225, http://www.trp.umk.pl/download/trp2014/Interpretation_of_law_as_an_alternative_to_the_normative_method.pdf (accessed 14 Nov. 2015)
5. PL: NSA, 18 Oct. 2006, II FSK 1299/05 (Polish Supreme Administrative Court – *Naczelny Sąd Administracyjny*). All the Polish administrative courts' decisions are available at http://orzeczenia.nsa.gov.pl.
6. PL: NSA, 7 Feb. 2014, II FSK 362/12.
7. PL: NSA, 2 July 2009, I FSK 839/08.

The principle of prohibition of abuse of law developed by the CJEU is effectively implemented by the Polish courts to VAT issues.[8] Many cases applying the concept of abuse of law to VAT have been decided by the courts.[9] The principle of abuse has not yet been applied beyond VAT and has not influenced the judicial approach to direct tax issues.

According to the VAT case law,[10] abuse of law means an act (behaviour) whose essential purpose was to obtain a tax benefit violating the socio-economic purpose of the right to input tax deduction. Polish courts do not focus on artificiality. An act (transaction) constituting abuse of law does not necessarily constitute an artificial arrangement.

Recently, the definition of abuse of law compatible with CJEU case law was added in article 5 of the VAT Act 2004. The amendment has been made by the same act that introduced the GAAR in Poland (*see* section 21.2.1.).

21.2. The reaction to avoidance and aggressive tax planning in the BEPS context

21.2.1. Domestic GAARs

The Polish GAAR is part of the Tax Ordinance Act (*Ordynacja podatkowa 1997*).[11] It came into force on 15 July 2016.[12] However, the idea of introducing a GAAR in Polish tax system is not new.

The statutory GAAR (the old version) was a part of the Polish tax system in the past, but it remained in force for a very short period of time (2003-2004)

8. H. Filipczyk and A. Olesińska, *supra* n. 2, at sec. I.1, pp. 486-488; D. Dominik-Ogińska, *Zasada zakazu nadużycia prawa unijnego w zakresie VAT*, [w:] M. Militz, D. Dominik-Ogińska, M. Bącal, T. Siennicki, *Zasady prawa unijnego w VAT*, (Wolters Kluwer, Warszawa 2013), pp. 121-122; and A. Mudrecki, *Wykładnia gospodarcza w orzecznictwie Naczelnego Sądu Administracyjnego,* in *Stanowienie i stosowanie prawa podatkowego w Polsce. Optymalizacja podatkowa a obejście prawa podatkowego,* (M. Münnich, A. Zdunek eds., Wydawnictwo KUL, Lublin 2012), pp. 143-144.
9. PL: WSA, 4 Dec. 2014, I SA/Wr 1906/14.
10. PL: NSA, 25 Feb. 2015, I FSK 93/14; WSA, 23 July 2013, I SA/Bd 378/13.
11. *Ustawa z dnia 29 sierpnia 1997 r. – Ordynacja podatkowa* (Tax Ordinance 1997), Journal of Laws of 2017, item 201, as amended.
12. *See* H. Filipczyk, *New Anti-Avoidance Provisions in Poland – A Change of Scenery*, 5 European Taxation, 2016 (volume 56).

and was not being applied in practice. Article 24b of the Tax Ordinance Act (1997)[13] containing an old GAAR stated:

> § 1 When deciding tax matters tax authorities shall disregard the tax effects of legal acts if they prove that no significant benefits could have been obtained from the performance of such acts other than the benefits arising from the reduction of the tax liability, the increasing of the loss, the increasing of the overpayment or tax refund.
>
> § 2 If the parties performing the legal act referred to in § 1 achieved the intended commercial result for which other legal act or legal acts are more appropriate, then the tax effects shall be derived from such other legal act or legal acts.[14]

This provision (the old Polish GAAR) was criticized from the very beginning because of its unconstitutionality. Actually, the regulation became partially ineffective (§1) as a result of its being pronounced unconstitutional by the Polish Constitutional Tribunal (*Trybunał Konstytucyjny*) on the grounds that the rule was too vague for a taxpayer to be able to predict its scope and manner of application.[15] The remaining part of the rule (§ 2), which obviously could not be applied separately, was repealed by the Polish parliament (the *Sejm*).[16] As a consequence, from 2004 until 2016, Poland had no GAAR.[17]

Recently, in 2016, Poland introduced a new GAAR. It covers all taxes except for VAT.[18] Generally, the rule follows the EC Recommendation of

13. *Supra* n. 11.
14. Translation of A. Olesińska, *The General Anti-Avoidance Rule Consultative Committees*, 16 Comparative Law Review (2013), p. 70.
15. PL: TK, 11 May 2004, K 4/03 (*Trybunał Konstytucyjny*, Constitutional Tribunal).
16. The history of the Polish GAAR was presented by B. Brzeziński and K. Lasiński-Sulecki in *Poland*, in *A Comparative Look at Regulation of Corporate Tax Avoidance,* (K.B. Brown ed., Dordrecht, New York: Springer 2012), pp. 269-273 and (including a recent draft proposal) H. Filipczyk and A. Olesińska, *supra* n. 2, at sec. I.1, pp. 485-495; *see also* A. Olesińska, *Klauzula ogólna przeciwko unikaniu opodatkowania,* (Toruń, 2013), pp. 245-291.
17. Although the Constitutional Tribunal has not excluded the possibility of introducing a GAAR in Polish tax law, some authors emphasized the negative effect of the Constitutional Tribunal's judgment (FN 15) on Polish legislation. The GAAR removed from the Polish tax system as a result of this decision could have improved the effectiveness of the Polish tax system. *See* D. Mączyński, *Wpływ orzecznictwa Trybunału Konstytucyjnego na trwałość instytucji materialnego prawa podatkowego (Influence of the Constitutional Court decisions in tax matters on the stability of institutions of substantial tax law),* Ruch Prawniczy Ekonomiczny i Socjologiczny, No. 3 (2014), pp. 23-36.
18. It was concluded that a GAAR is not needed in VAT because the abuse of law concept has been effectively applied by the Polish courts in VAT cases. A British example has been taken into account as well. Some authors, however, argue that some tax avoidance issues in VAT cannot be solved by an adoption of an abuse of law concept and because of that the GAAR should be applicable also in VAT cases. *See* K. Lasiński-Sulecki, *Czy*

6 December 2012 or is at least equivalent to the wording of a GAAR proposed in that Recommendation. It is compatible with the ECJ concept of abuse of rights as well.

Contrary to the old Polish GAAR, which was as concise as the German or Austrian GAARs, the recently introduced Polish GAAR is quite extensive.

Tax avoidance is defined as an action (arrangement)[19] that has been put into place primarily in order to obtain a tax benefit, which under the circumstances defeats the object and purpose of the provision of the tax act if the manner in which the action was carried out was artificial.[20] The tax administration is empowered to disregard the tax benefit arising from such an arrangement, which constitutes tax avoidance, if the tax benefit obtained or intended to be obtained by a taxpayer exceeds PLN 100,000 (circa EUR 25,000).

There are three key elements of the definition of tax avoidance: (1) an action was undertaken "primarily in order to obtain a tax benefit"; (2) the artificiality of the means used to obtain the tax benefit; and (3) the assumption that tax benefit defeats the object and purpose of the provision of the tax act. The rule is based on an objective test and the subjective elements are not present.

The requirements of the first element are met if an action has been undertaken primarily in order to obtain a tax benefit if the non-tax purposes of the action indicated by a taxpayer are considered to be insignificant (article 119d of the Tax Ordinance Act).

The second element (artificiality) is clarified in section 119c of the Tax Ordinance Act, which states that the manner in which the action was carried out is deemed to be artificial if, under the circumstances, it must be concluded that an entity would not have been acting in that way if it had acted reasonably, guided by lawful purposes other than obtaining a tax benefit contrary to the subject and purpose of the tax law. The provision

przeciwdziałanie nadużyciu prawa w VAT wymaga podstawy prawnej w przepisach krajowych, in *Międzynarodowe unikanie opodatkowania. Wybrane zagadnienia,* (D. Gajewski ed., Warszawa 2015), pp. 69-77. Finally, the GAAR has not been introduced into Polish VAT legislation, but a definition of "abuse of the law" has been added in art. 5 of the VAT Act 2004 (art. 3 sec. 5 of the law amending the GTL and some other Acts – *Ustawa z dnia 13 maja 2016 r. o zmianie ustawy – Ordynacja podatkowa oraz niektórych innych ustaw Dz.U. 2016 poz. 846*; this Act introduced the GAAR as well). It created a statutory basis or at least confirmed the legal grounds for adoption of the abuse of law concept in VAT cases.

19. Including set of actions.
20. *Supra* n. 1.

lists a few examples of factors which should be taken into account when assessing whether a taxpayer acted in an artificial manner. These factors are, for example, unjustified division of operations; involvement of intermediate entities without economic justification; elements that have the effect of offsetting or cancelling each other; and economic risk exceeding expected non-tax benefits to such a degree that it must be concluded that a person acting reasonably would not have chosen such a course of action.

The legislator has not clarified the meaning of a tax benefit that "defeats the object and purpose of the act" (the third key element of the definition of tax avoidance). In this respect, the Polish GAAR seems to reflect and follow (more or less) section 4.5 of the EC Recommendation of 6 December 2012 on aggressive tax planning:[21]

> …the purpose of an arrangement or series of arrangements consists in avoiding taxation where, regardless of any subjective intentions of the taxpayer, *it defeats the object, spirit and purpose of the tax provisions* that would otherwise apply.

The authority exclusively entitled to apply the GAAR is the Head of the National Treasury Administration *(Szef Krajowej Administracji Skarbowej)*. While a tax assessment proceeding is pending in tax avoidance cases, at the request of a taxpayer or of the Head of the National Treasury Administration, an opinion could be issued by the specially appointed consultative council semi-independently of the tax administration (similar to the GAAR consultative committee or advisory panel in some other countries).[22] This council will issue a non-binding opinion on whether the GAAR is applicable in a given case.

The Head of the National Treasury Administration issues a decision (an assessment), which can be subject to a court appeal. Importantly, the Polish GAAR can be "self-executing" because before a decision has been announced a taxpayer is entitled to amend his self-assessment of the tax due.

According to article 119w of the Tax Ordinance Act, the taxpayer may seek an opinion on whether a certain action is tax avoidance. Such an opinion is issued under a special payable procedure (a kind of tax ruling known as *opinia zabezpieczająca*, i.e. protective opinion).[23] The taxpayer requesting such an opinion should provide the Head of the National

21. 2012/772/EU, OJ L 338/41-43.
22. *Rada do Spraw Unikania Opodatkowania* (The Council for Tax Avoidance Proceedings).
23. The entity applying for an opinion disallowing the application of the GAAR will have to pay a fee of PLN 20,000 (circa EUR 5,000). In tax avoidance cases (i.e. if the GAAR is applied) or when abuse of law is identified in a VAT case, the new law provides

Treasury Administration with all relevant information that is necessary to evaluate whether an action planned (or an arrangement which has been put into place) constitutes tax avoidance. GAAR is not applicable if the Head of the National Treasury Administration issued an opinion stating that an action does not constitute tax avoidance (section 119b § 1 pkt 3 of the Tax Ordinance Act).[24] Moreover, if the Head of the National Treasury Administration does not reply within 6 months, the GAAR would not be applicable (section 119b § 1 pkt 3 of the Tax Ordinance Act).

There are no special financial sanctions for tax avoidance (however, a taxpayer may be obliged to pay default interest charged for late payment of tax owed).

Attention should be paid to the fact that the recently introduced GAAR is applicable to tax benefits obtained after the date of entry into force of the Act (15 July 2016), even if the tax benefit is the result of activities performed before this date.[25] It is expected that this rule would lead to numerous disputes on constitutional grounds. The key issue is the distinction between retroactive and retrospective effects of the Act.[26]

Since the GAAR came into force on 15 July 2016, there is no relevant case law yet.

that in the "ordinary" tax rulings (for a fee of less than EUR 10) the rule whereby a taxpayer acting in compliance with a tax ruling may not suffer harm or may benefit from increased protection will no longer apply.

24. However, an opinion that has already been issued may be amended ex officio, if it is found to be inconsistent with rulings issued by the Polish Constitutional Tribunal or the Court of Justice of the European Union.

25. Despite the draft proposal previously stating the GAAR to be applicable only to actions taken after the new law came into force.

26. The application of the Polish GAAR in the intertemporal aspect was discussed by H. Filipczyk, *Reguła intertemporalna klauzuli ogólnej przeciwko unikaniu opodatkowania w świetle standardów konstytucyjnych*, 9 Przegląd Podatkowy (2016), pp. 7-20 and K. Turzyński, M. Kolibski, *Reguła intertemporalna klauzuli ogólnej przeciwko unikaniu opodatkowania w świetle standardów konstytucyjnych – polemika*, 12 Przegląd Podatkowy (2016), pp. 21-25.

21.2.2. EC Recommendation C(2012) 8806 of 6 December 2012 and subject-to-tax rule

21.2.2.1. Has your Member State introduced a subject-to-tax rule as proposed by the EC in its DTCs?

Taking into account the international context, and the fact that Poland is a Member State of the European Union, some action to combat tax avoidance is justified. Poland has followed the instructions of the European Commission (EC Recommendation C(2012) 8806 of 6 December 2012) as well as OECD recommendations formulated within the framework of the Action Plan on BEPS. Both the preamble to the Recommendations as well as the content of the Action Plan stated that aggressive tax planning using cross-border structures as well as differences in national tax jurisdictions is particularly harmful and demands action at the legislative level.[27] The main aim of this legislation is to combat sophisticated optimization structures using aspects of international tax planning.

In the case of double non-taxation, it should be pointed out that if contracting states in a double taxation agreement would like to prevent income from being taxed in any of the two contracting states, they can use subject-to-tax or switch-over clauses.[28] If income is not taxed in the state where it was created and is also tax-free, or taxed to a small degree in the state of residence of the taxpayer, the subject-to-tax clause enables a state to impose a tax of appropriate proportions. The switch-over clause is used when income is not taxed either in the first state or in the state of residence, and the state of residence may apply the tax credit method instead of the method of

27. OECD/G20, *Base Erosion and Profit Shifting – Developing a Multilateral Instrument to Modify Bilateral Tax Treaties* (2014), http://dx.doi.org/10.1787/9789264219250-en (accessed 14 Nov. 2015); M. Rudnicki and Ł. Blak, *Wewnątrzkrajowe środki walki z unikaniem opodatkowania – zarys problemu*, Monitor Podatkowy, No. 8 (2007), p. 21. The problem of abuse of double taxation agreement is presented in S. Kudert and M. Jamroży, *Optymalizacja opodatkowania przedsiębiorców*, (Warszawa 2007), pp. 211-214; J. Grzywacz, *Pranie pieniędzy. Metody. Raje podatkowe. Zwalczanie,* (Warszawa 2011), pp. 91-92; M. Duda, M. Münnich, A. Zdunek, *Stanowienie i stosowanie prawa podatkowego w Polsce,* (Lublin 2011), pp. 217-230; M. Żyniewicz and D. Załupka, *Luki podatkowe 2000*, (Wrocław 2000), p. 28; J. Głuchowski, *Oazy podatkowe,* (Warszawa 1996), p. 108; and A. Jamroży, *Spółka osobowa prawa handlowego. Aspekty prawno-podatkowe, optymalizacja podatkowa*, Lex No. 141216 (accessed 14 Nov. 2015).

28. M. Uss, *Cele umów o unikaniu podwójnego opodatkowania*, Kwartalnik Prawa Podatkowego, Nos. 3-4 (2008), pp. 121-122.

exemption.[29] The effect of using these two clauses is similar. Poland favours the switch-over clause.

According to the EC Recommendation, Poland seeks to improve bilateral agreements on double taxation with respect to taxes on income and on capital. The new regulations have already been introduced in agreements with inter alia, Cyprus (March 2012),[30] Iceland (May 2012),[31] Norway (July 2012)[32] and Slovakia (August 2013).

The main aim of the changes is to exclude the possibility of some kind of income not being taxed in the other state at all and Poland had to apply in this case the tax exemption method (usually with progression). Consequently, the taxpayer was not required to pay tax in either state.[33] This changed when the tax exemption method[34] was replaced in some cases by the tax credit method[35] (the proportional tax credit method). The tax credit method, in contrast to the exemption method, does not exclude certain income from

29. D. Koreń, *Kształtowanie obciążeń podatkowych w stosunkach międzynarodowych*, Monitor Podatkowy, No. 8 (2014), p. 15.
30. Protocol of 22 Mar. 2012 between the Government of the Republic of Poland and the Government of the Republic of Cyprus amending the Agreement between the Government of the Republic of Poland and the Government of Cyprus for the Avoidance of Double Taxation with Respect to Taxes on Income and on Capital of 4 June 1992 (original spelling); http://www.finanse.mf.gov.pl/c/document_library/get_file?uuid=df7339dc-e78e-442e-b0be-e416f4ed6f2c&groupId=766655 (accessed 14 Nov. 2015).
31. Protocol of 16 May 2012 between the Government of the Republic of Poland and the Government of the Republic of Iceland amending the Agreement between the Government of the Republic of Poland and the Government of the Republic of Iceland for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income and on Capital of 19 June 1998; http://www.finanse.mf.gov.pl/c/document_library/get_file?uuid=1583dc3c-a3eb-4939-9bab-a97952b25358&groupId=766655 (accessed 14 Nov. 2015).
32. Protocol of 5 July 2012 between the Republic of Poland and the Kingdom of Norway amending the Convention between the Republic of Poland and the Kingdom of Norway for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income of 9 Sept. 2009 (original spelling); http://www.finanse.mf.gov.pl/c/document_library/get_file?uuid=f73639d2-428f-4d90-8750-a24d67a8c24c&groupId=766655 (accessed 14 Nov. 2015).
33. Post-audit statement of the Chairman of the Supreme Audit Office (NIK); KBF-4101-004-01/2014, P/14/013; http://ey-ftp.pl/ftp/TP-Actions/MF_NIK.pdf (accessed 14 Nov. 2015).
34. In the case of the tax exemption method, the income earned abroad is exempt from tax in the state of tax residence and is only taken into account when the tax rate is calculated, according to which the taxpayer will be obliged to settle the tax on the income earned in the state of tax residence.
35. In the case of the proportional tax credit method, tax paid on income earned abroad shall be included on account of tax paid in the state of tax residence, calculated on all income in the same proportion as the income from foreign sources is in relation to the total income of the taxpayer.

taxation in Poland. In the case of not deriving from the taxpayer income from other sources in Poland, this exclusion could lead to double non-taxation of certain income. The tax credit method effectively protects taxpayers from double taxation of the same income but significantly reduces the possibility of abuse of provisions of double taxation agreements aimed at tax avoidance. Bearing in mind the above, in some double taxation agreements, Poland decided to change the method of double taxation avoidance from the exemption method to the tax credit method when the former method would cause income to not be taxed anywhere or taxed at a reduced rate.[36]

One example of this is the Convention between the Republic of Poland and the United States for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income signed on 13 February 2013[37] (which will replace the Convention between the Government of the Polish People's Republic and the Government of the United States for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income of 8 October 1974[38]). According to the new convention for the avoidance of double taxation, Poland will apply – as the basis – the exemption with progression method . However, in the case of income from dividends, interest, royalties, gains from the transfer of ownership of assets and other income not covered by the provisions of the Convention, the proportional credit method will be applied. This may help to cope with the problem of double non-taxation.

Another example is the Protocol between the Republic of Poland and the Grand Duchy of Luxembourg amending The Convention between the Republic of Poland and the Grand Duchy of Luxembourg for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income and on capital, drawn up in Luxembourg on 14 June 1995, and signed in Luxembourg on 7 June 2012[39] (which amended the Convention

36. The opinion of the Act ratifying the Protocol of 11 Dec. 2013 between the Government of the Republic of Poland and the Government of the United Arab Emirates amending the Agreement between the Government of the Republic of Poland and the Government of the United Arab Emirates for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income and capital signed at Abu Dhabi on 31 Jan. 1993 and the Protocol signed at Abu Dhabi on 31 Jan. 1993 (print No. 674).
37. http://www.finanse.mf.gov.pl/c/document_library/get_file?uuid=3b36f0b3-ea40-4536-aefc-6a5ef8fadfc7&groupId=766655 (accessed 14 Nov. 2015).
38. Journal of Laws 1976 No. 31, item 178 as amended; http://www.finanse.mf.gov.pl/c/document_library/get_file?uuid=7a51389e-32c0-45b2-82dd-8411474bd94d&groupId=766655 (accessed 14 Nov. 2015).
39. Journal of Laws 2012 item 1303, as amended; http://www.finanse.mf.gov.pl/c/document_library/get_file?uuid=afa46795-9931-4fc5-b701-8354dd49fb78&groupId=766655 (accessed 14 Nov. 2015).

between the Republic of Poland and the Grand Duchy of Luxembourg for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income and on capital, drawn up on 14 July 1995[40]). In this case, the method of double taxation avoidance in Poland in the field of so-called active income (from work as well as economic activity) remains the exemption with progression method. However, for certain categories of income – for example, dividends, interest and royalties received by Polish residents in Luxembourg – the proportional tax credit method will be applied.

Worth mentioning also is the Protocol of 1 August 2013 between the Republic of Poland and the Slovak Republic amending the Agreement between the Republic of Poland and the Slovak Republic for the avoidance of double taxation with respect to taxes on income and on capital of 18 August 1994[41] (which amended the Agreement between the Republic of Poland and the Slovak Republic for the avoidance of double taxation with respect to taxes on income and on capital of 18 August 1994[42]). In the current version of the double taxation agreement with Slovakia, the primary method of avoiding double taxation was the exemption with progression method. This means that if some income could be taxed only in Slovakia, Poland was obliged to exempt such income from taxation, regardless of whether it was subjected to any tax in the state in which it was created. The benefits for taxpayers appeared when Slovakia exempted certain categories of income from taxation. This led to double non-taxation. This kind of situation occurred in respect of dividend income earned by the entity led in Slovakia by Polish residents. Domestic Slovak law exempts dividends from taxation and, unlike Polish legislation, enables them to be linked to economic activity. When the Polish resident became a partner in a limited partnership, profits from participation in this entity were treated as profits from economic activity carried out in Slovakia.

Consequently, their taxation was possible only in Slovakia, where in respect of dividends, they were not subject to taxation. The main change is that under exemption with progression, as a basic principle of avoiding double

40. Journal of Laws 1996 No. 110, item 527, as amended; http://www.finanse.mf.gov.pl/c/document_library/get_file?uuid=91c081b8-c1e1-42c5-95a9-4893386c465d&groupId=766655 (accessed 14 Nov. 2015).
41. Journal of Laws 2014 item 1046, as amended; http://www.finanse.mf.gov.pl/c/document_library/get_file?uuid=33ad79ec-8d62-420d-9b76-1782df2a82cb&groupId=766655 (accessed 14 Nov. 2015).
42. Journal of Laws 1996 No. 30, item 131, as amended; http://www.finanse.mf.gov.pl/c/document_library/get_file?uuid=4d5bc9d9-bac8-498c-8795-a9742115087f&groupId=766655 (accessed 14 Nov. 2015).

taxation, a number of exceptions will be introduced. They will include inter alia profits of enterprises, profits from the sale of assets, earnings from professional activity and remuneration of directors. In all these cases, the tax credit method will be used. This means that the tax that would be paid in Poland may by reduced only by the amount of tax paid in Slovakia. Apart from this, in relation to other revenue, the state will not be able to apply the exemption if the same category of income is exempt from taxation in the state where it was created. This regulation will protect the taxation of income in the future, if one of the states introduces further tax exemptions.

Current changes aimed at combating aggressive tax planning in the areas of double taxation agreements were introduced to resolve the problem with double non-taxation. According to EC Recommendation C(2012) 8806 of 6 December 2012, in general, as part of the analysis, the following risks and areas associated with optimization and tax avoidance were identified:[43]

> a) the possibility to use for aggressive tax planning contained in some of the Polish double taxation agreements the so-called tax sparing clause; therefore it is planned to remove the tax sparing clause from all agreements; in the last five years in this field Poland renegotiated agreements with Cyprus, the Czech Republic, India, Malaysia, Malta, Singapore, Slovakia and the United Arab Emirates; soon it is planned to start talks with other partners, in which cases there are tax sparing clauses;
> b) there is a lack of the so-called real estate clause in Polish double taxation agreements; this is a provision preventing avoidance of income from the sale of real estate in the state of its location; therefore, when negotiating new agreements or renegotiating those that do not contain such a clause, inclusion is always suggested on the Polish side; with the recently negotiated contracts, the real estate clause was included in agreements with India, Luxembourg, Malta, Singapore, Slovakia and the United Arab Emirates.[44]

21.2.2.2. If the answer to 21.2.2.1. is no, is your Member State planning to introduce a subject-to-tax rule as proposed by the EC?

It should be pointed out that the Ministry of Finance conducts the current analysis of double taxation agreements and takes action to remove other mechanisms for tax evasion and aggressive tax planning as well as the problem of double non-taxation. However, it is still clear that the

43. Answer to interpellation No. 33386; http://orka2.sejm.gov.pl/INT7.nsf/klucz/088552EF/%24FILE/i33386-o1.pdf (accessed 14 Nov. 2015).
44. Answer to interpellation No. 33627; http://orka2.sejm.gov.pl/INT7.nsf/klucz/088552EF/%24FILE/i33627-o1.pdf (accessed 14 Nov. 2015).

subject-to-tax rule aimed to deal with double non-taxation was not introduced in Polish double taxation agreements. Instead, the Polish legislator decided to introduce a switch-over clause that has the same effects.[45]

21.2.2.3. Does your domestic GAAR correspond to the proposed GAAR?

The GAAR introduced in Polish tax law is compatible with the EC proposal for a general anti-abuse rule. In this respect, tax avoidance is an action undertaken to obtain a tax benefit that, under the circumstances, defeats the object and purpose of the provision of the tax act if the manner in which the action was carried out was artificial. In this case, the tax effects are derived from the state of affairs that would arise if the taxpayer carried out proper action (reclassification of undertaken action). But if the taxpayer carried out an action only in order to avoid taxes, the whole operation will be treated as non-existent (i.e. ignored). In such a situation, the tax effects shall be determined on the basis of such a state of affairs that would arise if the taxpayer did not undertake any action. This construction of the Polish GAAR corresponds to article 7 of the EC proposal according to which non-genuine arrangements, or a series thereof, carried out for the essential purpose of obtaining a tax advantage that defeats the object or purpose of the otherwise applicable tax provisions shall be ignored for the purposes of calculating the corporate tax liability.

21.2.2.4. Will your SAARs have to be redrafted/amended according to the rules in the ATAD proposal?

Primarily, it should be emphasized that the Polish government has a positive attitude towards the adoption of the EU's Anti-Avoidance Tax Directive (ATAD) and supports the solutions proposed in this document.[46] However, for the full implementation of the ATAD, it will be necessary to change some provisions (primarily in terms of their adjustment and specification)

45. Post-audit statement of the Chairman of The Supreme Audit Office (*Prezes Najwyższej Izby Kontroli*), KBF-4101-004-01/2014, P/14/013; http://ey-ftp.pl/ftp/TP-Actions/MF_NIK.pdf (accessed 14 Nov. 2015).
46. Complete course record meeting, Commission for the European Union (No. 38) of 17 Mar. 2016 http://orka.sejm.gov.pl/zapisy8.nsf/0/029D8A85C62930E5C1257F8100272706/%24File/0042608.pdf (accessed 3 July 2016); and Complete course record meeting, Commission for the European Union (No. 55) of 19 May 2016 http://orka.sejm.gov.pl/zapisy8.nsf/0/C6F9F7DF70688449C1257FC300452B41/%24File/0065408.pdf (accessed 3 July 2016).

and to introduce some new regulations. Necessary changes in the Polish SAARs' regulations include:

- changes in regulations on thin capitalization (according to the ATAD's interest limitation rule); as mentioned, provisions concerning thin capitalization were changed on 1 January 2015; however, this amendment to the corporate income tax (CIT) did not change the essence of so-called thin capitalization, and only modified, to a varying extent, its particular elements; according to the rules of ATAD, these provisions should be amended and a new interest limitation rule should be created in the case of deductible expenses at the grounds of CIT;
- a regulation should be adopted to prevent taxpayers from trying to reduce their tax burden by moving their tax residence and/or assets to a low-tax jurisdiction (exit tax); however, it should be emphasized that the Polish government stated that the Minister of Finance would work on this point in the near future;
- renegotiation of agreements on the avoidance of double taxation concluded with other countries in order to introduce the switch-over clause; and
- changes in terms of Polish controlled foreign company (CFC) regulation.

21.3. TP rules, GAARs, SAARs and linking rules

21.3.1. Are your national TP rules often used to prevent or combat avoidance?

So far, Polish transfer pricing rules have not been used often to prevent as well as combat tax avoidance. Over the last 2 years there have been many changes and amendments to transfer pricing rules.[47] At that time, significant changes were introduced related to transfer pricing. These changes resulted from the fact that, in recent years, the effectiveness of the Polish tax authorities in detecting tax avoidance in the area of CIT has been lagging behind that of the tax authorities of other countries in Central and Eastern Europe.[48]

47. PL: *Ustawa z dnia 29 sierpnia 2014 roku o zmianie ustawy o podatku dochodowym od osób prawnych, ustawy o podatku dochodowym od osób fizycznych oraz niektórych innych ustaw* (Act of 29 Aug. 2014 amending the CIT, PIT and certain other Acts); Journal of Laws 2014, item. 1329, as amended.

48. The answer for the post-audit statement KBF-4101-004-01/2014; http://ey-ftp.pl/ftp/TP-Actions/Odpowiedz_MF_na%20zalecenia_NIK.pdf. The opinion No. 7/2025 of the Consultative Council on Tax Law of 2 June 2015 on a draft of an Act amending the CIT Act and PIT Act and several other Acts of 27 Apr. 2015 (accessed 14 Nov. 2015).

In 2014, changes were initiated and implemented in the organization of entities subject to the Minister of Finance in order to increase the efficiency of control of affiliated entities.[49] The Minister of Finance has appointed a Control Committee of Affiliated Entities aimed at supporting tasks to ensure effective cooperation between tax authorities and tax inspection authorities on tax income control of affiliated entities and to maximize effectiveness in the exchange of information between these authorities and the Ministry of Finance. The tasks of the Committee are to develop rules of analysis and risk assessment, set the strategic direction of control, develop a system for collecting and analysing information, identify the necessary tools and information sources, in particular databases, develop principles of cooperation and coordination between the tax authorities and the tax inspection authorities and the Ministry of Finance, analyse the results of control for the application of transfer pricing rules, risk areas and determine the direction of legislative changes, identify the needs for training and strengthening of human resources and to create a coordinated system for the exchange of experience. The Committee's work in 2014 focused on choosing areas of control in the field of transfer pricing, developing a tutorial for good practices for the control of affiliated entities, preparing ideas on transfer pricing issues most frequently used by international groups to shift income among various jurisdictions, deciding the directions of legislative amendments and identifying the necessary tools and information sources, including databases.

In addition, particular areas of concern for the tax authorities were identified that were connected with high risk including areas in the field of transfer pricing, such as repeated transactions with affiliated entities, transactions with affiliated entities from states with low tax rates, creation within a group of marketing companies and shopping centres located outside the state's market or in states where production is done as well as transactions that result in excessive debt or interest expenses, or concerning the restructuring of business activity.

Transfer pricing has not been particularly controlled by the tax authorities. However, in the context of amendments of provisions and changes of approach by the tax authorities and tax inspection authorities, the number of fiscal controls has recently increased. Transactions between affiliated entities have been given special attention during the audits by the tax authorities. Moreover, all these changes and amendments will probably lead

49. Post-audit statement of the Chairman of the Supreme Audit Office, KBF-4101-004-01/2014, P/14/013; http://ey-ftp.pl/ftp/TP-Actions/MF_NIK.pdf (accessed 14 Nov. 2015).

to Polish transfer pricing rules being used much more often to combat and prevent tax avoidance. At the same time, their significance in this field will become greater.

Considering the overall scope of changes, it should be emphasized that they are intended to enhance the quality and adequacy of the information contained in transfer pricing documentation in order to better assess the market nature of settlements.

21.3.2. Do your TP rules often raise litigation?

As outlined above, so far, controls on transfer pricing were neither intense nor frequent. Similar conclusions were presented by the Supreme Audit Office, which in 2014 examined the effectiveness of tax audits related to transfer pricing in the Ministry of Finance. The conclusions were simple: the number of completed control proceedings was very small.[50] A small amount of tax auditing in this regard meant that transfer pricing disputes before the administrative courts were not very significant. However, there were cases initiated before the administrative court that even led to judgments by the Supreme Administrative Court. In terms of litigation of transfer pricing rules, there is a positive side. Administrative courts clearly expect that the tax authorities conduct a thorough and professional analysis of the case from the perspective of transfer pricing. However, the basic problem is the issue of long-term proceedings. Although court rulings are positive, such proceedings are very time consuming and expensive.

21.3.3. If the answer to the above is yes, is there case law on the application of your TP rules?

To explain the case law on the application of transfer pricing rules in Poland, it is necessary to analyse a few of the most significant court judgments.

There are three trends in court judgments that are extremely positive: (i) the courts require the tax authorities to conduct a professional and thorough analysis of all the facts from the perspective of transfer pricing rules, for example, using detailed comparative analyses; (ii) the courts must obey the

50. Post-audit statement of the Chairman of the Supreme Audit Office, KBF-4101-004-01/2014, P/14/013; http://ey-ftp.pl/ftp/TP-Actions/MF_NIK.pdf (accessed 14 Nov. 2015).

law and require the same from the tax authorities; and (iii) the trust in the judicial system in the case of transfer pricing should be strengthened.

Transaction and the documentary obligation. The Supreme Administrative Court in its judgment of 10 May 2012[51] decided that the obligation to create documentation arises if the value of all benefits of the some kind in respect of the transaction with the affiliated entity exceeded the amount indicated in article 9a paragraph 2 point 2 of the CIT Act.[52] If the taxpayer conducts several transactions with the same affiliated entity but they are connected with different benefits that are assigned different prices, the value of each benefit is not subject to summation.[53] This judgment should be considered appropriate. The transaction should be differentiated based on its individual character and its different type resulting in inter alia a separate mechanism for the calculation of prices. For such a differentiated transaction, the existence of a documentary obligation must then be confirmed by reference to the value of a statutory threshold.[54]

The documentation of transfer pricing. There is a lack of strict criteria when tax documentation is incorrect. This raises doubts about the correct interpretation of particular provisions. The Provincial Administrative Court in Wrocław in its judgment I SA/Wr 678/10 (of 16 August 2010)[55] pointed out the effects of these ambiguities. The court noted that the CIT Act does not regulate the situation in which the taxpayer presents transfer pricing documentation that is incomplete. It can be therefore concluded that the taxpayer had performed his formal duty, albeit improperly, or that this obligation was not fulfilled because he presented only part of the tax documentation required by law to the tax authorities, resulting in the application of sanctions with article 19 paragraph 4 of the CIT Act. It can not be excluded that the tax authorities will adopt a conservative approach. This approach was followed, for example, by the Supreme Administrative Court in judgment II FSK 1319/10 (of 10 January 2012).[56] The Court considered that it is wrong to think that every documentation will protect a taxpayer against

51. PL: NSA, 10 May 2012, II FSK 1894/10.
52. PL: *Ustawa z dnia 15 lutego 1992 roku o podatku dochodowym od osób prawnych* (CIT Act), Journal of Laws 2015, item 1348, as amended.
53. P. Małecki and M. Mazurkiewicz, *Commentary on Art. 9a Corporate Income Tax Act*, Lex 2015 No. 10122, (accessed 14 Nov. 2015).
54. The same approach was presented in the judgment of the Supreme Administrative Court (PL: *Naczelny Sąd Administracyjny*, NSA) of 15 Jan. 2013, II FSK 1052/11 and in the judgment of the Provincial Administrative Court in Warszawa (PL: *Wojewódzki Sąd Administracyjny w Warszawie*, WSA) of 9 Feb. 2012, III SA/Wa 1506/11.
55. PL: WSA, 16 Aug. 2010, I SA/Wr 678/10.
56. PL: NSA, 10 Jan. 2012, II FSK 1319/10.

a tax rate sanction. This documentation needs to be appropriate and appropriate documentation means one that describes the key aspects of the transaction in a comprehensive and detailed way. The Supreme Administrative Court in judgment II FSK 1402/09 (of 14 December 2010)[57] challenged the taxpayer's documentation because it described various points only in a general and descriptive way without any analysis of the economic impact of the transactions and without calculating the future financial effects resulting from cooperation with affiliated entities.

Guarantee function of tax documentation. The importance of tax documentation was emphasized by the Supreme Administrative Court in judgment II FSK 1924/09 (of 1 March 2011).[58] It was noted that tax documentation is, by the will of the legislator, the primary source of evidence containing information to permit an analysis of the nature of the economic activities and to assess whether the remuneration in the transaction between affiliated entities is set at market level, which is not different from that which would otherwise arise between independent entities. The information in this documentation has to prove to the tax authorities whether or not the transaction was concluded in accordance with market conditions and allow them to determine whether the main aim of the transaction was to transfer income to entities that are in a more favourable tax situation. It was appropriate therefore that the Supreme Administrative Court (and following that Court, also the tax authorities) stated, for example, in judgment II FSK 1319/10 (10 Jan. 2012)[59] that documentation has a guarantee function. The submission and presentation of proper documentation makes it possible to assess transactions as meeting the conditions of market transactions.

The issue of market price. As already mentioned, proper tax documentation makes it possible to assess whether the transaction price is the market price. However, the Supreme Administrative Court noted that if the price used by the taxpayer can be contested, it is the tax authorities rather than the taxpayer that must prove that independent entities would not have an audited transaction under similar conditions. On this subject, the Supreme Administrative Court stated in judgment II FSK 1924/09 (of 1 March 2011)[60] that the lack of documentation does not allow one to assume without any evidence that relations with affiliated and independent entities were carried out on a different basis. To demonstrate this, tax authorities must rely on other available means and sources of evidence in the procedure

57. PL: NSA, 14 Dec. 2010, II FSK 1402/09.
58. PL: NSA, 1 Mar. 2011, II FSK 1924/09.
59. PL: NSA, 10 Jan. 2012, II FSK 1319/10.
60. PL: NSA, 1 Mar. 2011, II FSK 1924/09.

than those that should be included in the documentation. Similarly, the Provincial Administrative Court in Wrocław in judgment I SA/Wr 678/10 (of 16 August 2010)[61] pointed out that the burden of proof that a price or expense differs from the market price or expense incurred on behalf of an national entity rests on the national tax authorities. The obligation to create documentation did not result in shifting this burden of proof onto the taxpayer.

Basic principles for the estimation. As regards estimations, the tax authorities must prove fulfilment of three conditions: connection, the effect of the relation on the price and the effect of transfer income. The estimation of income by tax authorities comes at a time when there are certain conditions from article 11 of the CIT Act. The Supreme Administrative Court pointed out in judgment II FSK 385/11 (of 11 October 2012)[62] what are the conditions when a tax authority determines the income of a taxpayer and taxes him without taking into account the conditions resulting from existing relation. This occurs if the taxpayer:

– is connected by the capital to another entity;
– due to this relation, the entity enjoys benefits on favourable terms, different from the terms generally applied at the time and place of performance of benefit; and
– as a result of these connections and benefits under more favourable terms, the taxpayer does not have any income or has income lower than that which would be expected if the terms for such benefits do not differ from those arising from that relation; failure to fulfil this requirement makes it impossible to conduct an estimation; this was emphasized by the Supreme Administrative Court in judgment II FSK 1777/09 (of 30 March 2011);[63] correctly therefore, the Supreme Administrative Court emphasized that it is not enough for the conditions laid down by the affiliated entities to be non-market conditions, but it is necessary that they resulted from the relation between those entities (both conditions must be met); it means that the occurrence of another relation between entities than that mentioned in the CIT Act cannot justify the consideration that these entities are not independent and the conditions made between them just for this reason are not marketable.

The process of preparing tax documentation. It is possible that tax documentation prepared some time after completion of a transaction and made in a hurry may prove to be incomplete and incorrect. Facts and documents

61. PL: WSA, 16 Aug. 2010, I SA/Wr 678/10.
62. PL: NSA, 11 Oct. 2012, II FSK 385/11.
63. PL: NSA, 30 Mar. 2011, II FSK 1777/09.

proving the legitimacy and market-base of transactions as well as transfer pricing practice of the entity as a whole will no longer be so well reflected, particularly if the entity's staff changes. Therefore, the courts rightly encourage taxpayers to keep tax documents up to date. The Provincial Administrative Court in Gdańsk stated in judgment I Sa/Gd 1222/12 (of 29 January 2013)[64] that the process of preparing tax documentation, depending on the subject and nature of the transaction as well as the available data, can be a long and time-consuming process. Therefore, tax documentation should be drawn up by taxpayers on a regular basis (i.e. kept up to date), and not only before an inspection by the tax authorities.

Estimation of income. The final selection of the estimation method is affected by the characteristics/specificity of the transaction – the comparable uncontrolled price method is used, unless another method determines prices in transaction at a closer level to the market value of the subject of the transaction and determines the income of the taxpayer more accurately.[65] The main aim of the estimation is to find a price as close as possible to the market price. Either method is acceptable and the tax authorities may choose between using internal and external price comparison methods. However, the freedom of the tax authorities in this area is not unlimited. The estimation should lead to the income that could be achieved by the parties if the relation did not exist.[66]

21.3.4. Do your DTCs include LOB rules?

In some Polish double taxation agreements, limitations of benefit (LOB) rules were introduced. In these agreements, provisions were added according to which benefits connected with making a contract are not admitted in cases where the main purpose, or one of the main purposes, of the transaction was to obtain such benefits, the achievement of which would not be possible otherwise. This clause will refer to entities that do not conduct actual business activity. It means that the tax authorities will be able to challenge the structure created in another state by Polish tax residents if it has been proved that they had been created only for the tax optimization or it had been a type of aggressive tax planning.

On this basis, a special LOB rule was created, for example, in Protocol of 11 December 2011 between the Government of the Republic of Poland

64. PL: WSA, 29 Jan. 2013, I Sa/Gd 1222/12, Legalis No. 667488 (accessed 14 Nov. 2015).
65. PL: NSA, 11 Jan. 2012, II FSK 385/11.
66. PL: NSA, 30 Mar. 2011, II FSK 1777/09.

and the Government of the United Arab Emirates amending the agreement between the Government of the Republic of Poland and the Government of the United Arab Emirates for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income and capital of 31 January 1993.[67] This clause created a rule that states that benefits from this double taxation agreement cannot be obtained in cases where the main aim of making a transaction was to obtain benefits that could not be achieved in any other way. LOB clauses were also introduced in the Convention between the Republic of Poland and the United States for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income of 13 February 2013. This clause defines in a very casuistic and complex way how a group of entities are entitled to the benefits of the contract. There is also a requirement concerning the real beneficiary in the case of interest payments, dividends and royalties.

Moreover, in the Protocol of 1 August 2013 between the Republic of Poland and the Slovak Republic amending the Agreement between the Republic of Poland and the Slovak Republic for the avoidance of double taxation with respect to taxes on income and on capital of 18 August1994, a LOB rule was introduced. According to this double taxation agreement, it is possible that the tax authorities of a particular state would make recognition a substantial part of the transaction. The benefits of this agreement will not be applied to the income received or derived in connection with a sham structure. These provisions have the character of a general anti-avoidance rule.

67. The opinion of the Act ratifying Protocol from 11 Dec. 2013 between the Government of the Republic of Poland and the Government of the United Arab Emirates amending the Agreement between the Government of the Republic of Poland and the Government of the United Arab Emirates for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income and capital signed at Abu Dhabi on 31 Jan. 1993 and the Protocol signed at Abu Dhabi on 31 Jan. 1993 (print No. 674); Journal of Laws 2015, item 312 as amended; http://www.finanse.mf.gov.pl/c/document_library/get_file?uuid=87e52d6e-cc0a-430a-b54e-d521b7911556&groupId=766655 (accessed 14 Nov. 2015).

In double taxation agreements with Canada,[68] Israel[69] and Sweden,[70] and as mentioned with the United States,[71] there are clauses limiting the benefits of contract (LOB) with respect to companies and entities other than the natural person. In general, under certain conditions, these clauses exclude the use of double taxation agreements entirely or partly for companies.[72]

21.3.5. Does your tax legislation include CFC rules?

Polish CFC rules have similar goals and structure to the CFC rules that have been in force in other states for many years.[73] The main purpose of Polish CFC rules is to combat tax avoidance. They are brand new and have never been applied in the Polish system of tax law, being implemented on 1 January 2015. These provisions were introduced by the Act of 29 August 2014[74] by adding article 30f of the PIT Act of 26 July 1991 and article 24a of the CIT Act of 15 February 1992. Polish CFC rules will therefore potentially apply to all entities, both individuals and legal entities

68. Art. 26 of the Convention between the Republic of Poland and Canada for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income of 14 May 2012; Journal of Laws 2013, item 1371 as amended; http://www.finanse.mf.gov.pl/c/document_library/get_file?uuid=edffb34a-ed0f-4231-8d16-5c9cb0d19ad8&groupId=766655 (accessed 14 Nov. 2015).
69. Art. 25 of the Agreement between the Government of the Republic of Poland and the Government of the State of Israel for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income of 22 May 1991; Journal of Laws 1992 No. 28, item 124 as amended; http://www.finanse.mf.gov.pl/c/document_library/get_file?uuid=db22be0d-6116-499c-a7f5-83fd827bdcca&groupId=766655 (accessed 14 Nov. 2015).
70. Art. 27 of the Convention between the Republic of Poland and the Government of the Kingdom of Sweden for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income of 19 Nov. 2004; Journal of Laws 2006 No. 26, item 193 as amended; http://www.finanse.mf.gov.pl/c/document_library/get_file?uuid=633dc50b-db18-429b-9bde-3437eb775f33&groupId=766655 (accessed 14 Nov. 2015).
71. Art. 22 of the Convention between the Republic of Poland and the United States for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income from 13 Feb. 2013.
72. The exclusion of the double taxation agreement entirely is in the agreement with Canada and exclusion in part is in the agreement with Sweden and the United States.
73. B. Kuźniacki, *Polskie CFC rules w świetle międzynarodowego prawa podatkowego. Zagraniczna i polska praktyka legislacyjna w zakresie relacji między CFC rules a umowami o UPO*, Lex No. 248856 (accessed 14 Nov. 2015); M. Dahlberg and B. Wiman, *General Report: The taxation of foreign passive income for groups of companies,* Cahiers de droit fiscal international, Vol. 98a, Kongres IFA w Kopenhadze, 2013, p. 19.
74. *See* art. 1, point 22 and art. 2, point 24 of the Act from 29 Aug. 2014 amending CIT Act, PIT Act and certain other Acts.

that are Polish tax residents.[75] The main elements of Polish CFC rules will be described on the grounds of the CIT Act.

The tax on the income of a CFC generated by the taxable person shall amount to 19% of the taxable base. The following terms should be clarified: *foreign company* shall mean a legal person, limited company in organization, organizational unit without legal personality other than company without legal personality, company without legal personality and without a registered office or management board in the Republic of Poland, in which the taxable person holds a share, has the right to vote in supervisory or management bodies, or the right to participate in profit; *derivatives* shall mean the financial instruments referred to in article 2 of the Act of 29 July 2005 on Trading in Financial Instruments;[76] and *subsidiary* shall mean an entity, or a foreign company not meeting the conditions in which the taxable person holds, directly or indirectly, at least 25% of the shares in the capital or 25% of voting rights in supervisory or management bodies, or 25% of the shares related to the right of participation in profits.

Based on Polish CFC rules, controlled foreign companies shall include any foreign company with a registered office or management board within a territory or in a state listed in the regulation issued on the basis of a specific regulation or any foreign company with a registered office or management board in another state than indicated above, with which the Republic of Poland has not concluded an international agreement, and in particular a double taxation convention, or with which the European Union has not concluded an international agreement – constituting the basis for obtaining tax information from tax authorities of this state, or any foreign entity meeting all of the following conditions:

– a company in which the taxable person holds, for a period no shorter than 30 days, directly or indirectly, at least 25% of the shares in the capital or 25% of the voting rights in supervisory or management bodies, or 25% of the shares related to the right of participation in profits;
– at least 50% of the revenue of the company generated in the fiscal year referred to in paragraph 6 originate from dividends and other revenues from sharing in the profits of legal persons, revenues from disposal of the shares, receivables, interests and benefits on loans, sureties, and

75. B. Kuźniacki, *Polskie CFC rules w świetle międzynarodowego prawa podatkowego. Wybrane aspekty wystąpienia ryzyka niezgodności CFC rules z umowami o unikaniu podwójnego opodatkowania,* cz. 1, Lex No. 215962 (accessed 14 Nov. 2015).

76. PL: *Ustawa z dnia 29 lipca 2005 r. o obrocie instrumentami finansowymi* (Act of 29 July 2005 on Trading in Financial Instruments), Journal of Laws 2015, item 1348, as amended.

guarantees of any type, and also the revenues from copyrights, industrial property rights – also due to disposal of such rights, and also disposal and exercise of rights related to financial instruments; and

– at least one revenue type referred to above is generated by the company, is subject to taxation in the country of its registered office or management board in accordance with the income tax rate applicable in that country which is lower by at least 25% than the rate referred to in article 19 paragraph of the CIT Act, or to exemption or exclusion from income taxation in that country, unless the revenues are eligible for tax exemption in the country of the registered office or the management board of the company receiving them on the basis of the provisions of Council Directive 2011/96/EU of 30 November 2011 on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States.

The taxable base is constituted by the income of the CFC for the period in which the condition indicated above was met, or for the period referred to in paragraph 8 or 9 of article 24a of the CIT Act, in the part corresponding to the shares owned and related to the right of participation in profits of the company, after deducting the dividends received by the taxable person from the CFC; the amounts from paid disposal, by the taxable person, of the shares in the CFC. The amounts not deducted pursuant to the abovementioned principle in a given fiscal year shall be deducted in the next 5 consecutive fiscal years. This income is constituted by the excess, generated in the fiscal year, of the sum revenues over tax-deductible expenses related to them, defined pursuant to the provisions of the Act, whatever the revenue source type, and determined as of the last day of the fiscal year of the CFC. If a CFC does not apply to a specified fiscal year or if such a year exceeds the period of consecutive 12 months, it shall be assumed that the fiscal year of the CFC is the same as that of the taxable person. The income of a CFC shall not be decreased by losses incurred in prior years.

If it is impossible to determine a taxable person's share related to the right of participation in profits of a CFC, or the right has been excluded or limited, the share related to the right of participation in profits of a CFC shall be determined on the basis of the highest share of the taxable person in the capital, voting rights in supervisory or management bodies of the company, expressed as a percentage.

In the case of a CFC, in order to determine the share related to the right of participation in profits of the CFC, it shall be assumed that the taxable person(s) referred to had all the rights to participate in the profits of the

company throughout the fiscal year. If there is no evidence to the contrary, it is assumed that the shares of the taxable persons, related to the right of participation in profits, are equal. This principle shall be applied accordingly to determine the share related to the right of participation in profits of a CFC referred to unless the taxable person proves that his actual share in the CFC or the period in which that share was applicable was different. In the case of a CFC, the provision shall not apply if the taxable person proves that at least one of the conditions defined in the paragraph above is not met.

The taxable person's share in the CFC shall be decreased by the share of their subsidiary related to the right of participation in profits of this CFC, applicable in the same period, if the following conditions are jointly met:

– the subsidiary owns, directly or indirectly, at least 25% of the shares related to the right of participation in profits in the CFC;
– the subsidiary includes in its taxable base the income of the CFC on the basis of regulations relating to the CFC and applicable in the country where it is subject to taxation on its whole income; and
– the subsidiary is a taxable person or there is a legal basis resulting from a double taxation convention, another ratified international agreement to which the Republic of Poland is a party, or another international agreement to which the European Union is a party, for a tax authority or a tax inspection authority to obtain tax information from the tax authority of the country in which the subsidiary being a foreign company is subject to taxation on its whole income.

Taxable persons are obliged to keep a registry of foreign companies, and after the end of the fiscal year before the expiry of the timeframe for submitting the tax return relating to the income generated by the CFC in the fiscal year, they are obliged to record the developments in the CFC in records separate from the accounting records indicated in specific provisions, in a manner ensuring determination of the amount of income, taxable base, and output tax amount for the fiscal year, and also to include information necessary to determine the amounts of depreciation and amortization write-offs in the fixed and intangible assets register.

The provision of CFC rules shall not be applied if the income of the CFC does not exceed in the fiscal year the amount corresponding to EUR 250,000, converted into Polish currency at the average currency exchange rate announced by the National Bank of Poland and applicable on the last day of the fiscal year preceding the fiscal year, or the CFC conducts actual economic activities in a state other than a Member State of the European Union or a member state of the European Economic Area, where it is subject

to taxation on its whole income, and its income does not exceed 10% of revenues generated due to the actual economic activity conducted in that state – provided that there is a legal basis resulting from a double taxation convention, another ratified international agreement to which the Republic of Poland is a party, or another international agreement to which the European Union is a party, to obtain tax information from the tax authority of the state in which the CFC is subject to taxation on its whole income.

In assessing whether a CFC conducts actual economic activities, it is taken into account, in particular, whether:

- the registration of the CFC is connected with the existence of an enterprise as part of which the company pursues actual operations constituting its economic activities, and in particular whether the company has premises, skilled staff and equipment used in the economic activities conducted;
- the CFC is not a structure operating in a manner that does not reflect economic reality;
- the scope of activities conducted by the CFC and the premises, staff and equipment actually possessed by the company correspond adequately;
- the agreements concluded reflect economic reality, have an economic rationale and are not manifestly contrary to the general economic interests of the company; and
- the CFC carries out basic economic operations on its own, using its own resources, including management being present.

In practice, Polish CFC rules will be mostly applied to taxpayers who are majority shareholders of foreign companies that generate at least 50% passive income and are located in jurisdictions that are favourable with regard to Polish taxation of a foreign company, from a tax year that began after 31 December 2014 or from a tax year of a Polish taxpayer who controls the foreign company, starting after 31 December 2014.[77] Polish CFC rules may be also applied to foreign permanent establishments of Polish taxpayers if their income is not subject to tax in Poland.[78] The income of the foreign permanent establishment shall not be subject to tax in Poland only if this is due to the mandatory application of the method of exclusion from taxa-

77. *See* art. 1 Act of 21 Oct. 2014 amending CIT Act, PIT Act and certain other Acts (PL: *Ustawa z dnia 21 października 2014 r. zmieniająca ustawę o zmianie ustawy o podatku dochodowym od osób prawnych, ustawy o podatku dochodowym od osób fizycznych oraz niektórych innych ustaw*), Journal of Laws 2014, item 1478, as amended.
78. *See* art. 24, para. 19 CIT Act (PL: *Ustawa o podatku dochodowym od osób prawnych*) and art. 30f para. 21 PIT Act (PL: *Ustawa o podatku dochodowym od osób fizycznych*), Journal of Laws 2014, item 1328, as amended.

tion of that income in accordance with the provision of a particular double taxation agreement. Otherwise, the income of a foreign permanent establishment can be assigned to the Polish taxpayer who shares the profits of a permanent establishment and is taxed in Poland according to the method of tax credit from the double taxation agreement or when the double taxation agreement is not applied – according to the method of tax credit resulting from the national provisions.[79]

21.3.6. Did your country introduce linking rules as recommended in OECD/BEPS Action 2?

In the Polish tax legal system, efforts are being made to neutralize the effects of hybrid instruments/structures under CFC rules. In BEPS Action 2, there is a recommendation for a system providing for the linking rules between the tax settlement of a hybrid entity (structure) or hybrid contract in one of the states and the tax settlement in the other party's state. The use of Polish CFC rules may also significantly complicate the problem of hybrid structures used by taxpayers to avoid taxation due to the varying assessments of the tax status of companies (or other taxable entities) and/or different assessments of the type of income by various states (residence and source).[80]

21.3.7. Does your tax legislation include limits on the deduction of interest?

On 1 January 2015, legislation[81] entered into force introducing significant changes in the tax accounting for interest of broadly defined loans. These changes consist of modification of existing provisions on thin capitalization and an introduction of an alternative to the provisions of thin capitalization regulations defining the method of recognizing in the tax cost of the interest

79. *See* art. 20, para. 1 CIT Act and art. 27, para. 9a as well as art. 30c, paras. 4 and 5 PIT Act. Explanation of the Ministry of Finance regarding the use of Polish CFC rules (Rules for taxation of income earned by a controlled foreign company - CFC) p. 3; online access: http://www.mf.gov.pl/documents/766655/6725129/CFC-wyjasnienia-2015.pdf (accessed 14 Nov. 2015).
80. M. Kane, *The Role of Controlled Foreign Company Legislation in the OECD Base Erosion and Profit Shifting Project*, 68 Bulletin for International Taxation 6/7 (2014), Journals IBFD, pp. 321-326.
81. PL: *Ustawa z dnia 29 sierpnia 2014 r. o zmianie ustawy o podatku dochodowym od osób prawnych, ustawy o podatku dochodowym od osób fizycznych oraz niektórych innych ustaw* (Act of 29 Aug. 2014 amending CIT Act, PIT Act and several other Acts). Journal of Laws 2014, item 1328, as amended.

on loans. This amendment to the CIT Act did not change the essence of the regulation concerning thin capitalization and only modified some particular elements.

According to provisions that concerned thin capitalization,[82] expenses that are not tax deductible are interests on loans granted to a company by an entity holding, directly or indirectly, no less than 25% of the company's shares, or granted jointly by entities holding jointly, directly or indirectly, no less than 25% of the company's shares, if the total value of the company's debt owed to the entities holding, directly or indirectly, at least 25% of its shares, including also the debt under loans, exceeds in total the amount of the company's equity. This is in the proportion in which the amount of debt exceeding the amount of the company's equity remains relative to the total amount of the said debt to these entities, determined as of the last day of the month preceding the month of payment of the interest on loans. The provisions shall be accordingly applied to a cooperative society, members of the cooperative society and the equity of such a cooperative society.

Other not tax-deductible expenses include interest on loans granted to a company by another company, if in both companies one and the same entity holds, directly or indirectly, no less than 25% of the shares, and the amount of debt of the company receiving the loan to the company granting the loan and to the entities holding jointly, directly or indirectly, no less than 25% of the borrowing company's shares, including also the debt under loans, exceeds in total the amount of the company's equity. This is in the proportion in which the amount of debt exceeding the amount of the company's equity remains relative to the total amount of the said debt, determined as of the last day of the month preceding the month of payment of the interest on loans. The provisions shall be accordingly applied to a cooperative society, members of the cooperative society and the equity of such a cooperative society. Similar rules were applied in relation to the cooperative, members of cooperatives and to the cooperative share fund.

The changes that were introduced concerned the scope of loans covered by this regulation by expanding the concept of qualified shareholders (members) to entities associated with the company (cooperative) indirectly. Under the new rules, there is a limit to the classification of the interests to tax-deductible expenses that will be applied not only to interests on loans received by the company (cooperative) from its direct shareholders (members) and the company (cooperative) in which those shareholders (members)

82. *See* art. 16, para. 1, points 60 and 61 CIT Act.

also have a certain number of shares (stocks) but also to the interests on loans granted to the company (cooperative) by entities that have an indirect share of at least 25% in it. In determining the amount of indirect share that a company has in the capital of another entity, a rule will be applied according to which if one entity holds a share in the capital of another entity and the other entity has the same share in the capital of another entity, the first entity will be deemed to have participated indirectly in the capital of another entity in the same amount. If the values are different, the value of the indirect share is always lower. In other cases, the method of calculating the percentage rate of shares (stocks) held in a company (cooperative) remains the same.

21.3.8. Do you have any other SAARs?

In Polish tax law, there are many provisions that may be treated like specific anti-avoidance rules (except for the regulations mentioned above with regard to thin capitalization, transfer pricing regulations and Polish CFC rules).

The first regulation is connected with the issue of mergers and divisions of companies.[83] Income (revenue) from sharing in the profits of legal persons is the actual income (revenue) earned from that sharing. It also includes:

– income from redemption of shares, revenue from withdrawal of a shareholder from the company, the value of property gained as a result of the liquidation of a legal person, company, the income of a company allocated to increase the share capital, and in the case of cooperatives;
– income allocated to increase the share fund and income equivalent to the amounts transferred to the share capital (fund) from the other capital (funds) of that company, partnership or cooperative, in the case of mergers or demergers of companies;
– additional cash payments received by the shareholders of the overtaken, merged companies or demerged companies, if, in the case of a division of companies, the property is acquired as a result of a division, or in the case of division by spin-off;
– the property acquired as a result of the division or the property that remains in the company is not an organized part of an enterprise;
– the surplus of the nominal value of shares in the acquiring company or in the new company over the costs of the acquisition or takeover of shares in the divided company, if a company is divided by separation, tax-deductible expenses represent the value or amount of expenses

83. *See* art. 10, para. 4 CIT Act.

incurred by a shareholder in order to take over or acquire shares in the divided company, calculated proportionally to the ratio of the nominal value of that shareholder's shares in the divided company to the nominal value of shares before division, the value of undistributed profits in a company and the value of profit transferred to other capitals than the share capital of the transformed company; and

- in the case of the transformation thereof into a company without legal personality, the revenue shall be determined as of the day of transformation and interest on shares paid to a shareholder by the company.

Following mergers or demergers of companies, the surplus of the value of the acquired or divided company's profit received by the acquiring company or the new company over the nominal value of shares allocated to the shareholders of the acquired or divided company does not constitute income of the acquiring company or the new company, as referred to above. In the case of mergers or demergers of companies, it is the revenue of a shareholder of the acquired or demerged company representing the nominal value of shares allocated by the acquiring or new company. However, this regulation[84] does not apply if the mergers or divisions of companies are not substantiated by economic reasons, and the main or one of the main purposes of such an operation instead is to avoid taxation.

Another regulation is connected with the exclusion of the right to the dividend exemption, if the dividends were subject to deduction in the company. According to the adopted solution, this exemption will not be applied in Poland to the received dividends if the values of these dividends were subject to the tax-deductible expense in the company (which paid dividends), or deduction from income, taxation base or tax. In line with the Polish tax system, the obligation to calculate personally to verify this condition, as well as other conditions for the tax exemption on dividends received from abroad, rests on the taxpayer.

Income (revenue) earned by taxpayers on dividends and other revenue from sharing in the profits of legal persons who have their registered office or management outside the territory of the Republic of Poland is exempt from income tax, if all the following conditions are satisfied: the payer of dividends and other revenue from shares in the profits of legal persons is a company whose entire income, irrespective of where it is earned, is subject to income tax in a Member State of the European Union or another Member State of the European Economic Area other than the Republic of Poland; the

84. *See* art. 10, para. 2(1) and art. 12, para. 4(12) CIT Act.

recipient of income (revenue) from dividends and other revenue from shares in the profits of legal persons, is a company that is an income taxpayer and has its registered office or management in the territory of the Republic of Poland; a company directly holds no less than 10% of shares in the equity of a company; a company does not enjoy exemption from income tax on its entire income, irrespective of the sources from which the income is earned. However this regulation shall not be applied to dividends and other income (revenues) derived from sharing in the profit of legal persons, to the extent in which in the state of the company the amounts paid due to that are subject to any form of inclusion in tax-deductible expenses, deduction from income, taxable base, or tax of the company paying them.[85]

Furthermore, a specific anti-avoidance rule of Polish tax legislation is the regulation of article 199a of the Tax Ordinance Act. According to this regulation, when determining the content of an Act in law, a tax authority takes into account the joint intention of a party and the purpose of the Act, rather than only the exact wording of the declarations of intent made by the parties. If, under the pretence of one Act in law, another Act in law is performed, the legal consequences are derived from the concealed Act in law. If evidence collected in the course of proceedings, and in particular the party's testimony, unless the party refuses to testify, gives rise to doubts as to whether a legal relationship existed or not that is associated with tax consequences, a tax authority requests a general court to determine whether or not that legal relationship or law exists.

Moreover, from 1 January 2014,[86] limited joint-stock partnership is taxed by the CIT. Before this new regulation came into force, the structures of limited joint-stock partnerships were very often used as part of an aggressive tax optimization.

Last but not least, it should be noted that in the PIT Act, there are regulations concerning the taxation of revenue not covered in the revealed sources or arising from sources that are not revealed. The amount of revenue not covered in the revealed sources or arising from the sources that are not revealed shall be determined on the basis of expenses incurred by a taxpayer in a tax year and the value of property summed up in a given year if the expenses and the assets cannot be covered by the assets determined before incurring

85. *See* art. 20, para. 16 CIT Act.
86. PL: *Ustawa z dnia 8 listopada 2013 roku o zmianie ustawy o podatku dochodowym od osób prawnych, ustawy o podatku dochodowym od osób fizycznych oraz ustawy o podatku tonażowym* (Act of 8 Nov. 2013 amending the CIT Act and PIT Act and Tonnage Tax Act); Journal of Laws 2014, item 1387, as amended.

the expenses or determining the property arising from the revenue previously taxed or exempt from taxation. This means that the tax authority is entitled to compare the amount of expenses that the taxpayer incurred during the tax year to the value of property determined in a given year if the expenses and the assets cannot be covered by the assets determined before incurring the expenses or determining the property arising from the revenue previously taxed or exempt from taxation. The main aim of this construction is to tax income from hidden sources and combat the so-called grey zone and it is undoubtedly a tax method for combating this phenomenon.[87]

21.4. Application of GAARs, TP rules and SAARs

21.4.1. How do GAARs, TP rules, SAARs and linking rules interact in your national legal system?

All the above-mentioned regulations have a great influence on the Polish tax legal system. In the past few years, many laws and regulations have been amended in this area. Moreover, changes as a result of introduced regulations attract much social interest because they are connected with the business activity. It should be also emphasized that analysis for detection practices in the field of international tax evasion, tax avoidance and aggressive tax planning is still on-going. First of all, a binding treaty base of agreements on the avoidance of double taxation and prevention of tax evasion is being analysed by identifying those provisions that can be used in aggressive tax planning.

However, the analysis involves not only the provisions of national law. In addition, harmful regulations have been identified that are created in other tax systems elsewhere in the world that could potentially support the creation of structures aimed at tax avoidance or evasion. This insight is then reflected in negotiated or amended double taxation agreements through removing tax sparing clause, the introduction of the real estate clause and the use in double taxation agreements of terms such as principal purpose tests or limitations of benefits clauses.

Furthermore, national tax provisions have been amended and new tax regulation created that is aimed at creating specific anti-avoidance regulations or whose main purpose is to combat tax avoidance as well as aggressive tax

87. *See* art. 20, para. 3 PIT Act.

planning (these regulations are also aimed at eliminating sham structures that were created only for tax avoidance or tax evasion).

21.4.2. Is there a hierarchy, coordination or overlapping of measures?

As a general rule, there should be coordination between all the measures taken[88] because some of them overlap in Poland. There is a lack of hierarchy in these measures but in the last few years progress has been made on the general anti-avoidance clause, which has become the most important and significant development with respect to combating tax avoidance and aggressive tax planning.[89]

The Supreme Audit Office (in Poland) notes that, from 2014, the work on improving the Polish tax system and creating an appropriate approach to entities is subject to the Minister of Finance and the control on persons transferring income has been tightened. The Minister of Finance has identified all the risks related to tax income settlement by entities with foreign capital and prepared legislative changes that are aimed at eliminating the mechanisms for aggressive tax planning. All changes to stop the reduction of the tax base for income tax and income transfer beyond the Polish tax system were in conformity with the recommendations of the European Union and OECD. Legislative changes introduced or initiated by the Minister of Finance aimed at improving the whole tax system and preventing tax avoidance were related to inter alia:

– taxation of foreign company income controlled by Polish taxpayers (amendments came into force on 1 January 2015);
– introduction into double taxation agreements of clauses preventing abuse of contractual provisions or reduction of their use by the creation of sham structures as well as conduction of transaction whose primary purpose is to benefit from the preferences granted in these agreements; and

88. A. Ladziński, *Prawne granice optymalizacji podatkowej*, Przegląd Podatkowy, No. 6 (2008), pp. 18-19.
89. *See* P. Karwat, *Klauzula ogólna a przepisy szczególne przeciwdziałające unikaniu opodatkowania,* 12 Przegląd Podatkowy (2016), pp. 12-20. The Author analyses the relationship between the new Polish GAAR and other provisions whose function is to combat tax avoidance. *See also* J. Niedojadło, *Economic and legal causes of tax evasion*, Przegląd Prawa Publicznego, No. 5 (2015), pp. 89-98; J. Niedojadło, *Legal and economic consequences of tax evasion*, Studia Prawnicze i Administracyjne No. 2 (2014), pp. 33-37; and P. Karwat, *Obejście prawa podatkowego*, (Warszawa 2003), p. 10.

– inclusion of limited joint-stock partnership in the subjective scope of the CIT Act (amendments came into force on 1 January 2014).[90]

21.4.3. Are there procedural rules underlying application of your national GAAR, TP rules and/or SAARs?

There are no specific procedural rules underlying TP rules and/or SAARs in Polish legislation. However, there are general procedures in which these rules can be used, such as tax procedures, tax audits or audit activities as well as other tax procedures (for example, APAs, issuing of certificates, mediation and estimating the tax base).

90. https://www.nik.gov.pl/aktualnosci/nik-o-kontroli-firm-z-udzialem-kapitalu-zagranicznego.html (accessed 14 Nov. 2015).

Chapter 22

Portugal

Gustavo Lopes Courinha

22.1. The meaning of avoidance and aggressive tax planning and the BEPS initiative

22.1.1. Tax avoidance

22.1.1.1. In the Portuguese tax system

In the Portuguese tax system, no explicit definition of "tax avoidance" can be found. Tax avoidance is defined, by most Portuguese scholars, only as a concept encompassing cases where the legislator, through the use of general, sectorial or special anti-abuse rules, set boundaries to legitimate tax planning. Accordingly, the notion of tax planning is negative: the structures set up by taxpayers to achieve tax advantages not countered or targeted by law.

Through the use of administrative regulations, the tax administration has provided some examples of situations likely to be subject to the application of general or sectorial anti-abuse rules, thus tax avoidance cases. In fact, Decree-Law 29/2008 of 25 February, enabled the approval of a list of "abusive schemes" by the tax administration, where the general anti-avoidance rule (GAAR), the anti-abuse rule regarding the Merger Directive, the anti-abuse rule regarding the Interest-Royalties Directive, or the anti-abuse rule regarding the Parent-Subsidiary Directive (sectorial anti-abuse rules) was deemed applicable.[1] However, a definition of the phenomenon is still clearly lacking, and no clear guidance on the reasoning behind such a list was put forward.

As far as tax rulings are concerned, the Portuguese tax system specifies that if a taxpayer is not given an answer within 150 days after requesting a ruling, the GAAR becomes non-applicable.[2]

1. Available at http://info.portaldasfinancas.gov.pt/NR/rdonlyres/BC481FC3-FD05-4960-BB58-D7D2D96790DC/0/DivulgacaoDL_2908PFA.pdf.
2. PT: Lei Geral Tributária [General Tax Law – GTL] 1998, Art. 63(8), available at http://info.portaldasfinancas.gov.pt/pt/informacao_fiscal/codigos_tributarios/lgt/index_lgt.

22.1.1.2. In the Portuguese judicial and arbitral jurisprudence

Case law has abundantly discussed the limits of tax planning and the scope of tax avoidance in application of the GAAR, particularly in the arbitration tax court (*Centro de Arbitragem Administrativa* – CAAD) cases.[3] The decisions, however, have been deeply contradictory, with the aggravating factor that no appeal is possible in any of the cases.

In general, the decisions can be divided into two different groups: the first (and prevalent) group supports the notion that tax avoidance can exist (and the GAAR be applied) only in *fraus legis* cases (where the intention/purpose of the legislator or the tax system were clearly defeated); the second (minority) group supports the idea that any abnormal structure achieving tax advantages is immediately “abusive”, even in cases where the legislator may have left an obvious loophole or even endorsed the structure.

These different approaches are very clear in cases where the legal form of a commercial company is changed from *Sociedades por Quotas* (limited liability company) into *Sociedades Anónimas* (joint-stock company) and where a tax exemption is used for capital gains deriving from the subsequent sale of shares (equity participations in *Sociedades Anónimas*) held for more than one year as laid down in (the now-revoked) article 10(2) of the Personal Income Tax (PIT) Code. Even if, in most of the decisions, the arbitrators opposed the application of the GAAR, in a few cases (without any peculiar facts) they decided for its application on mere tax motivation grounds, not considering the normative-systematic (*fraus legis*) condition/element: the obvious fact that the legislator clearly promoted (or, at the very least, was indulgent towards) such structures.

In the judicial or arbitral decisions concerning the GAAR, only seldom have Court of Justice of the European Union (CJEU) decisions, foreign tax jurisprudence or OECD soft law been considered.

htm.

3. The following decisions concerning the application of the GAAR were issued by PT: CAAD: 2013, cases 123/2012, 124/2012, 138/2012, 34/2013, 43/2013, 46/2013, 47/2013, 70/2013, 124/2013 and 139/2013; 2014, cases 196/2013, 224/2013, 234/2013, 258/2013, 51/2014, 62/2014, 131/2014, 142/2014, 143/2014, 200/2014, 208/2014, 234/2014, 264/2014, 284/2014, 299/2014, 320/2014 and 379/2014; and 2015, cases 61/2014, 180/2014, 283/2014, 377/2014, 381/2014, 666/2014 and 420/2015, all available at www.caad.org. Judicial courts have, so far, only dealt with the GAAR and the limits of tax planning in two cases with identical results held by the PT: Tribunal Central Administrativo – Sul, 2011, 4255/10 and PT: Tribunal Central Administrativo – Sul, 2012, 5104/11. On these decisions, *see* www.dgsi.pt.

In one of the few cases related to a leveraged buyout with a reverse merger, decided by the CAAD, one of the arbitrators took into account equivalent decisions held by the French *Conseil d'Etat*[4] to support its view that the GAAR – and not article 23 of the CIT Code, as suggested by the Tax Administration – should have been applied.

In another case – the inaugural decision on the application of the GAAR – the *Tribunal Central Administrativo Sul* actually mentioned CJEU jurisprudence (namely, the *Cadbury Schweppes* decision, Case C-196/04) to suggest the European law endorsement of the use of GAARs as anti-avoidance instruments.[5]

22.1.1.3. BEPS influence

Because the Portuguese tax system already held a significant number of rules, tax regulations and jurisprudence concerning tax avoidance, the BEPS Reports and Action Plan have not had a noticeable impact. In fact, some of the Actions suggested by the Action Plan have long been adopted in Portugal.

For example, regarding transfer pricing rules (Actions 8 to 10) the following can be seen. Portugal has, since the tax reform of 2000, adopted modern transfer pricing rules, with special and extensive regulations on "cost sharing agreements" and "Intra-group services agreements", for instance, which are favourite mechanisms of income transfer. The same can be said about the available transfer pricing methods. A wide range of accepted methods, sufficiently flexible to regulate different kinds of transactions and items, is one of the main features of the applicable Portuguese regulation.

Further, regarding Action 6 (prevention of abuse in DTCs), the Portuguese tax system has for the past decade adopted a significant number of conventional anti-abuse rules, even if they are highly confusing in most instances (beneficial owner clauses for passive income, special and general subject-to-tax clauses, recapture clauses for pensions, LOB clauses, safeguard of the compatibility of domestic anti-abuse rules, GAAR in DTCs, etc.).

These are just a few of the many examples regarding different BEPS proposed actions that could be given.

4. PT: CAAD, 2013, case 14/2011-T. The arbitrator was Ana Paula Dourado. *See* www.caad.org.
5. PT: Tribunal Central Administrativo – Sul, 2011, 4255/10. *See www.dgsi.pt*.

22.1.2. Aggressive tax planning

Before any further remarks, we want to make clear that, in our opinion, "aggressive tax planning" is not a juridical concept *proprio sensu*.[6]

Instead, the idea of aggressive tax planning merely groups a number of situations together that are, from an ethical or moral point of view, considered dishonest and/or unfair.[7] Taken together, these cases clearly lack the substance of which a proper juridical concept is made: a group of essential characteristics that forms its nucleus and aggregates multiple facts or situations of life.[8]

Thus, unlike tax avoidance, aggressive tax planning is not determined by the abuse of legal forms or by fraud of tax law and it is very hard to ascertain any truly legal feature that can be considered common to all its forms. In fact, the structures considered "aggressive" in many cases were deliberately sponsored by the tax legislator to attract foreign investment; also, the tax advantages they provide are very easy to achieve without the use of any particular abusive legal form.

22.1.2.1. In the Portuguese tax system

Although the BEPS Report has influenced Portuguese tax legislation, previously the Portuguese legislator had already anticipated and prevented many of the practices now called aggressive.

In fact, Decree-Law 29/2008 of 25 February anticipated Action 12 of the BEPS Action Plan by more than 5 years, particularly at a time when there were not many OECD tax systems that had similar regimes. Accordingly,

6. Apparently against, *see* Ana Paula Dourado, *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*, 43 Intertax 1 (2015), pp. 48-49.
7. The preamble of Decree-Law 29/2008, of 25 Feb. – setting the disclosure regime on aggressive tax planning – provides clear evidence on this. On one occasion, one can read: "The phenomenon of aggressive tax planning erodes the justice and integrity of the system...". At another point, one can read "The exercise of tax consultancy is, at the moment, not regulated at all... In fact, many players in the field of tax consultancy conceive their mission... as the mere exploration without bounds or moral considerations of the tax loopholes of the system. All the tax consultants want is to protect their unsound practice and know-how, regardless of their very serious economic and social repercussions...".
8. On juridical concepts, among many others, *see* Arthur Kaufman, *Filosofia do Direito*, Fundação Calouste Gulbenkian (2007), pp. 142 et seq. and Karl Engisch, *Introdução ao Pensamento Jurídico*, Fundação Calouste Gulbenkian (1988), pp. 205 et seq.

both "abusive" and "aggressive" structures have been, since 15 May 2008, subject to very strong disclosure obligations (provided certain characteristics are involved) that, if not fulfilled, may lead to the application of severe fines.[9]

Regarding the abolition of preferential regimes (Action 5), only one regime could be deemed to qualify as a "preferential regime": the Madeira Free Zone (MFZ). But this regime is practically defunct due to the changes introduced in the 2012 Budget Law, particularly article 33 of the Tax Benefits Statute (TBS), and it is uncertain whether it will re-emerge.

Also in the recent corporate income tax reform of 2014 – based solely on the BEPS Report but not the Action Plan, by then not yet made public – some rules concerning the BEPS phenomenon were introduced.

As far as Action 4 is concerned (the need to restrict excessive interest deductions), the Portuguese tax system has also adopted some of the OECD recommendations, namely, a *per company* legal limit of EUR 3 million or 30% of the earnings before interest, deductions, taxation or amortization (EBIDTA) results (article 67 of the CIT Code) – with a transitional period of 4 years (until 2016), along with a general prohibition of the deduction of any sort of direct or indirect interest payments to offshore territories (unless strict and difficult to demonstrate conditions are met), under article 23-A(1)(r) and (7) of the CIT Code.

Especially regarding the Participation Exemption and Credit for Double Economic Taxation regimes, some rules clearly reflect the BEPS Report concerns.

First, working as a common rule to both regimes, dividends from offshore companies do not qualify for the exemption, under any circumstances;[10] neither do capital gains from participations in real estate companies.[11]

Furthermore, dividends from tax-exempt affiliate companies cannot benefit from the participation exemption,[12] whereas dividends from low-tax jurisdictions (inferior to 60% of the normal CIT tax rate) can only qualify if

9. Which may go as high as EUR 100,000, according to Art. 17 of this Decree-Law, a very considerable amount according to Portuguese standards.
10. Arts. 51 (1) (e) and 91-A (4) of the CIT Code.
11. Art. 51-C (4) of the CIT Code.
12. Art. 51 (10) (b) of the CIT Code.

deriving from non-passive activities (agriculture, industry, commerce, etc.);[13] if such conditions are not met, only the credit method for double economic taxation is available. And, finally, if the dividends were deducted in the state of the affiliate company, the participation exemption is not available either.[14]

Identical BEPS motivations explain many of the features of the recent Portuguese patent box regime, introduced by the corporate income tax reform of 2014.

This regime – which submits to taxation merely 50% of the gross amount of royalties paid to Portuguese resident companies[15] – is not restricted exclusively to royalties deriving from contracts concerning the use of, or the right to use, patents, designs or industrial models (thus, excluding any other intangible assets from such favourable treatment),[16] but it does not encompass ancillary income from services eventually included in such contracts.[17]

In addition, this regime imposes a rule that the R&D activities leading to the creation of these specific assets must be performed (or, at least, contracted) by the company,[18] therefore preventing the merely tax-motivated acquisition of these assets.

Two important restrictions to the regime – directly stemming from the BEPS initiative[19] – can be found in article 50-A(3) of the CIT Code. The first restriction is that the advantages of the regime do not apply if the use of these assets takes the form of goods or services ultimately acquired by the company;[20] it is a clear obstacle to circular transactions. The second condition prevents the payer from being resident in any tax haven.[21]

As far as the use of tax havens is concerned, tax legislation has been amended gradually through the years, so that it has become almost impossible to make use of a tax-saving option such as this.

13. Art. 51 (2) of the CIT Code.
14. Art. 51 (10) (a) of the CIT Code.
15. Art. 50-A (1) of the CIT Code.
16. Art. 50-A (1) (a) and (b) of the CIT Code.
17. Art. 50-A (1) of the CIT Code.
18. Art. 50-A (3) (a) of the CIT Code.
19. By then, it should be noted that only the general BEPS Report was available for the members of the Corporate Tax Reform Commission to consider.
20. Art. 50-A (3) (c) of the CIT Code.
21. Art. 50-A (3) (d) of the CIT Code.

In the first place, both direct and indirect payments to offshore companies are non-deductible for CIT purposes[22] – even if subject to a rebuttable presumption, according to which the taxpayer should demonstrate the real and non-abnormal (or expensive) nature of the underlying transaction.[23]

Second, while receiving income, these offshore companies are subject to a special (heavier) tax rate on the amount of the expenditure itself, of 55%;[24] in most cases, however, the rate is 35%.[25-26] On the other hand, while paying income to individuals, this income is subject to a special tax rate of 35% (as opposed to the normal tax rate for foreign passive income of 28%).[27]

Additionally, regardless of whether such expenditures are deductible by the resident undertakings, any transactions involving offshore companies are necessarily subject to transfer pricing rules.[28]

Third, even if income may be attributed to offshore companies, Portuguese CFC legislation ensures that it will not remain there if more than 25% of the equity participations/voting rights/rights on income are owned by a Portuguese resident company. In such cases, the profits are immediately attributed to the Portuguese company, regardless of its effective distribution.[29]

Many more examples could be provided that show how deep the influence of the BEPS phenomenon is on tax legislation.

22.1.2.2. In the Portuguese judicial and arbitral jurisprudence

The topic of aggressive tax planning has not, thus far, been scrutinized by Portuguese courts.

22. Art. 23-A (1) (r) and 23-A (7) of the CIT Code.
23. Which the case law application shows to be impossible to counter. *See*, for all, PT: Tribunal Central Administrativo Sul, 5/11/2015, case 7022/13.
24. Art. 88 (8) of the CIT Code.
25. Art. 88 (8) of the CIT Code and Art. 71(12) of the PIT Code.
26. Also, any real estate bought by offshore companies is subject to a heavier municipal tax on real estate transmission of 10% (as opposed to the normal rate of 6.5%) and, if held by such companies, also subject to a very heavy municipal property tax (known as IMI) of 7.5% (as opposed to the normal rate of 0.3%-0.5%), rendered the use of such companies as special purpose vehicles for real estate investments impossible.
27. Art. 72 (12) (a), (b) and (c) of the PIT Code.
28. Art. 63 (4) (h) of the CIT Code.
29. Art. 66 of the CIT Code.

This is not, however, surprising: also with regard to tax avoidance the Portuguese courts took many years, even after the approval of a GAAR, to address this topic directly. As a consequence, one should not expect any decisions in the near future.

22.1.2.3. BEPS influence

Although the topic of aggressive tax planning is not, as seen above, absolutely new in Portugal, it has clearly become increasingly important since the OECD discussions on BEPS.

Before 2013, aggressive tax planning was described in Portuguese tax legislation – namely Decree-Law 29/2008 of 25 February (on the disclosure of aggressive tax schemes) – as "any tax planning scheme" where "offshore companies", "exempt or non-liable to tax company", "use of tax losses" or "financial or insurance instruments leading to the requalification of income" are involved.[30]

Since then, no explicit legal definition was adopted for that phenomenon, but the above-mentioned changes in the tax legislation suggest that the scope of what is considered aggressive tax planning has clearly been amplified, in accordance with the BEPS Report analysis, and specially concerning international transactions.

22.2. The reaction to avoidance and aggressive tax planning

22.2.1. GAAR

Adopted in late 1998, the Portuguese GAAR, laid down since 2001 in article 38(2) of the General Tax Law,[31] reads as follows:

> Any wholly or mainly tax-motivated acts or contracts entered into by a taxpayer, by way of artificial or fraudulent means and with abuse of legal forms, designed to reduce, eliminate or postpone taxes which would be due as a result

30. Arts. 2 and 3.
31. The GAAR was adopted by Law 87-B/98, of 31 Dec. (1999 State Budget Law), which changed the Tax Procedure Code. Subsequently, the GAAR was transferred to the new GTL (by Law 100/99, of 26 July) and, finally, redrafted by Law 30-G/2000, of 29 Dec. In all, these various legal changes meant that all Portuguese political parties seated in the parliament at some moment, actually did approve the GAAR.

> of economic equivalent acts or contracts or that would not have been achieved without such means shall be ineffective for tax purposes, and taxation shall proceed in accordance with the rules that would apply in their absence and the tax advantages shall not arise.[32]

Though approved 14 years before EC Recommendation C-(2012) 8806 of 6 December 2012, the GAAR has many similarities with the proposed draft for a GAAR contained in the Recommendation. However, there is a big difference: the Portuguese GAAR, as interpreted by most scholars, requires a *fraus legis* condition, which is clearly absent from the Recommendation draft.

In fact, it is curious to notice that the Recommendation draft is, in some aspects, more similar to the earlier version of the Portuguese GAAR, which was in force between January 1999 and December 2000 (though never applied) and read: "Any wholly or mainly tax-motivated acts or contracts entered into by a taxpayer, designed to reduce or eliminate taxes which would be due as a result of economic equivalent acts or contracts shall be ineffective and the latter acts or contracts shall be taxed accordingly". Such a version was, however, abundantly criticized by Lisbon, Coimbra and Porto scholars on the grounds that it did not adopt the Germanic *Missbrauch von Formen* doctrine as the criterion for *avoidance*, but instead merely submitting "economically equivalent acts and contracts" (that is, any sort of tax planning) to the same tax effects.[33]

According to most Portuguese scholars, the GAAR, in its present version, is influenced by the *fraus legis* doctrine (of Roman law origin) and the *Mißbrauch von Formen* doctrine (of German tax law origin).[34] And, while the first of these doctrines is widely accepted as an essential piece of the general theory of private law,[35] the *Mißbrauch von Formen* does not have

32. Our translation.
33. On such criticism, *see* J. L. Saldanha Sanches, *Os Limites do Planeamento Fiscal*, Coimbra Editora (2006), pp. 169-175; J. Casalta Nabais, *Direito Fiscal*, Almedina (2012), p. 215; and R. Duarte Morais, *Imputação de Lucros de Sociedades Não Residentes*, Publicações Universidade Católica (2005), pp. 213-218.
34. On this, *see* J. L. Saldanha Sanches, *supra* n. 33, at sec. II.A., pp. 169-172; J. Casalta Nabais, *supra* n. 33, at sec. II.A., p. 215; G. Lopes Courinha, *A Cláusula Geral Anti-Abuso no Direito Tributário*, Almedina (2009), pp. 131-161; and M. C. Cavali, *Cláusula Gerais Antielusivas: Reflexões acerca da sua conformidade constitucional em Portugal e no Brasil*, Almedina (2006), pp. 242-245.
35. Just to mention certain University of Lisbon School of Law scholars, *see* J. Oliveira Ascensão, *Teoria Geral do Direito Civil – III* (1992), pp. 358-359, or João de Castro Mendes, *Direito Civil – Teoria Geral III*, AAFDL (1979), pp. 268-274.

any obvious equivalent in any other field of law and is an absolute novelty in the Portuguese legal system.[36]

Its elements, as generally applied by the Court,[37] are the:
(a) *result* element – both an advantageous tax situation when compared with the non-use of the arrangements and an economically equivalent result;
(b) *means* element – the arrangements put into action should be of an artificial nature (indirect, atypical, useless or very unusual arrangements);
(c) *intellectual* element – only wholly or mainly tax-motivated arrangements can be affected by the GAAR, even if merely objective evidence for the demonstration of such a motivation is admissible; and
(d) *normative-systematic* element – the accrual of the tax advantage is based on the circumvention of tax rules and contrary to its spirit or the purpose of the legislator or the tax system.

No changes on the GAAR are expected to occur in the near future, as its present draft is already the result of an evolution to ensure the GAAR is in conformance with the constitution. Particularly the *normative-systematic* element – which seems to be absent in the proposed EU Recommendation draft – is considered by many to be the centrepiece of any admissible rule intended to counter tax avoidance and, at the same time, compatible with the *separation of powers* and *private property* fundamental principles.[38]

36. On the Germanic doctrine influence on the drafting of the Portuguese GAAR, *see* G. Lopes Courinha, *supra* n. 34, at sec. II.A., pp. 149 et seq.
37. On this, *see* A. P. Dourado, *Direito Fiscal*, Almedina (2015), pp. 279-285.
38. On these grounds, *see* G. Avelãs Nunes, *A Cláusula Geral Anti-Abuso de Direito em Sede Fiscal – Art. 38º, n.º 2 da Lei Geral Tributária – à luz dos Princípios Constitucionais do Direito Fiscal*, Fiscalidade 3 (2000), pp. 56-58; J. L. Saldanha Sanches, *O Abuso de Direito em Matéria Fiscal: natureza, alcance e limites*, Ciência e Técnica Fiscal 398 (2000), pp. 20-21; G. Lopes Courinha, *supra* n. 34, at sec. II.A., pp. 190-197; or M. C. Cavali, *supra* n. 34, at sec. II.A., p. 250; R. Palma Borges, *A Zona Franca da Madeira entre a Isenção e a Elisão: um contributo para o estudo do direito tributário internacional português*, available at the library of the Faculty of Law of the University of Lisbon (2003), pp. 383-384; A. Lima Guerreiro, *Lei Geral Tributária Anotada*, Rei dos Livros (2001), p. 187; or A. Fernandes de Oliveira, *A Legitimidade do Planeamento Fiscal, As Cláusulas Gerais Anti-Abuso e os Conflitos de Interesses*, Coimbra Editora (2009), p. 174

Moreover, when considering the formula of the proposed GAAR in the ATAD Proposal of 28 January 2016,[39] one can conclude that the conditions referred to are almost identical to those found in the Portuguese GAAR.[40]

Even though the wording is different, one can still identify the four abovementioned elements in the EU proposal; with some *grano salis*, it is possible to extract such a conclusion from the reading of article 7 of the ATAD.[41]

Therefore, the "obtaining (of) a tax advantage" is an obvious equivalent to the *result* element, whereas "non-genuine arrangements" is just a different wording for the artificiality to which the *means* element refers to. "Carried out for the essential purpose" clearly indicates the relevance of a tax motivation on the taxpayer's conduct (*intellectual* element) and, finally, "defeats the object or purpose of the otherwise applicable tax provisions" implies the clear adoption of the *fraus legis* theory.

Again, no important differences can be perceived; and that is a good thing as these similarities will prevent the more than likely hermeneutical problems deriving from article 3 (Minimum level of protection) rule that would, otherwise, arise.[42]

The application of the GAAR in Portugal has occurred on three different groups of cases – one of which has already been described above and which is frequently unsuccessful.

The first case, however, had to do with the use of the MFZ and the exemption mechanism for the elimination of double economic taxation. By creating a company (Y) in the MFZ, the parent company (X), resident in continental Portugal, would fund Y using supplementary payments of capital that would later be used to finance intra-group companies worldwide via the Netherlands and the Channel Islands. The interest derived therefrom

39. On the initial EC Recommendation on Aggressive Tax Planning concerning the GAAR's proposal and the CJEU jurisprudence, *see* A. P. Dourado, *supra* n. 6, at sec. I.B., pp. 52-54.
40. Apparently, such a conclusion is upheld by other scholars and even Courts. On a very recent Spanish Supreme Court decision concerning the application of the GAAR, and expressly influenced by (and quoting) the BEPS, *see* A. P. Dourado, *May You Live In Interesting Times*, 44 Intertax 1 (2016), pp. 3-4.
41. It reads as follows: "Non-genuine arrangements or a series thereof carried out for the essential purpose of obtaining a tax advantage that defeats the object or purpose of the otherwise applicable tax provisions shall be ignored for the purposes of calculating the corporate tax liability. An arrangement may comprise more than one step or part."
42. On the *de minimis* rule of the ATAD and its effects, *see* A. P. Dourado, *The EU Anti Tax Avoidance Package: Moving Ahead of BEPS?,* 44 Intertax 6 (2016), pp. 442-443.

would be tax exempt in the MFZ and, then, paid back to X as dividends, using the equivalent domestic regime to the Parent-Subsidiary Directive. The GAAR was considered applicable and the perceived dividends were requalified as interest.[43]

The most recent group of cases concerning the application of the GAAR has to do with the use of a shareholders' loan by holding Company A to buy the shares of Company B, held by the same shareholders. The shareholders of Company B would rely on the tax exemption for capital gains deriving from the sale of shares held for more than one year.[44] In order to pay out its shareholders, Company A would hold a debt that would be paid by way of dividends distributed by Company B. The tax administration suggests that the payment of the debt by Company A is, in substance, no more than a mere distribution of dividends.

The decisions concerning this case have, thus far, been somewhat divided (even if considerably more in favour of the taxpayer), with some decisions suggesting that the legislator created a disruption in the system (by exempting such capital gains) and that such a loophole cannot be repaired by the tax administration with the assistance of a GAAR.[45] Some cases lost by the tax administration frequently have more to do with procedural than substantial reasons, e.g. the levy of tax to Company A, instead of its shareholders.

22.2.2. EC Recommendation C-(2012) 8806 of 6 December 2012 and subject-to-tax rule

Portugal's use of the subject-to-tax rule in its own DTCs dates back to its first DTC with the United Kingdom. Ten other DTCs hold similar rules – Estonia, Finland, France, Germany, Ireland, Israel, Latvia, Lithuania, the Netherlands and Norway.

Its use was considered the most obvious answer to the limits of "liable to tax" rules of article 4(1) of the Model Conventions in preventing treaty

43. PT: Tribunal Central Administrativo – Sul, 2011, 4255/10 and PT: Tribunal Central Administrativo – Sul, 2012, 5104/11. Both available at www.dgsi.pt.
44. According to (the now revoked) Art. 10 (2) of the PIT Code.
45. On this case, and with a very critical opinion on the minority decisions, *see* A. P. Dourado, *supra* n. 37, at sec. II.A., pp. 283-285; and G. Lopes Courinha, *A Cláusula Geral Anti-Abuso no CAAD: a insustentabilidade de uma Jurisprudência Contraditória*, VII Revista de Finanças Públicas e Direito Fiscal 4 (2015), pp. 179 et seq.

shopping, and thus focused primarily on the legal status of the income instead of the taxpayer.[46]

However, an obvious substitution of such rules in favour of the beneficial owner rules – following the 1977 OECD Model Convention – took place in the early 80s;[47] in the 90s, again, subject-to-tax rules were considered less adequate in fighting treaty shopping and, subsequently, lost preference to LOB rules.

An important and extensive discussion on these three different approaches to international subjective tax avoidance (subject-to-tax, beneficial owner and LOB rules) was held in the Commission for the Reform of Portuguese International Fiscal Law, in 1998;[48] the resulting conclusions clearly favoured the beneficial owner clause and the LOB rules to the detriment of subject-to-tax rules.[49]

22.3. Transfer pricing, GAARs, SAARS and linking rules

22.3.1. Transfer pricing rules

Although not specifically targeted to anti-avoidance purposes, TP rules have gradually also been used as an interesting anti-avoidance mechanism, even if keeping in mind the original reason behind them – the correct allocation of cost and profits between related companies.[50]

46. On this, *see* G. Lopes Courinha, *A Residência no Direito Internacional Fiscal – do Abuso Subjectivo de Convenções*, Almedina (2015), pp. 318-321.
47. On this evolution, *see* G. Lopes Courinha, *supra* n. 46, at sec. II.B., pp. 322 et seq. *See also* the table with the anti-treaty shopping provisions on Portuguese DTCs, at pages 511-512: by contrast with subject-to-tax rules, beneficial owner rules are now widespread in Portuguese DTCs.
48. Presided by Alberto Xavier – Comissão de Reforma da Fiscalidade Internacional Portuguesa, *Relatório*, Ciência e Técnica Fiscal 395 (1999).
49. The private sector members of this commission tended to favour the beneficial owner rule, while the tax administration members clearly favoured LOB rules.
50. One of the clear obvious reasons supporting this conclusion has to do with the fact that, even if leading to a mere arithmetic correction (without further tax receipts, that is), the application of fines whenever market prices are disrespected is, nonetheless, mandatory – *see* Art. 130 (4) of the CIT Code and Art. 113 of the General Tax Infringements (GTI) Code. Thus, the anti-avoidance nature of this rule is clearly not predominant and such rules should always be applicable.

In Portuguese court decisions, the application of TP rules generally had to do with the existence (or not) of "special relations",[51] namely, whether the parties in a contract have particular ties that might lead them to manipulate transaction prices between them.

More recently, new court decisions – particularly CAAD decisions – have focused more on the determination of the most adequate arm's length price method, according to article 63(2) of the CIT Code.

22.3.2. LOB rules

As explained above, there is growing sympathy for LOB rules from the tax administration,[52] probably due to its automatic (even if more extensive) and more simplified application in international cases.[53] Partly because of this, Portugal now has LOB rules in 11 DTCs.[54]

Because these rules are relatively new and without precedence in Portugal, a common element is not exactly easy to find. While the DTCs with Mexico, Spain, Ukraine and the United States have a more traditional structure – the predominant (but not exclusive) element is capital holding[55] – many of the remaining DTCs are a mix of several elements.

While some DTCs refer to a general beneficial owner clause to all categories of income,[56] others simply prescribe the application of domestic GAARs and SAARs at the international treaties level,[57] others hinder taxpayers entitled to special or general tax benefits (including the MFZ),[58] others provide

51. Under Art. 63 (4) of the CIT Code.
52. That became clear in the already mentioned Comissão de Reforma da Fiscalidade Internacional Portuguesa, *supra* n. 48, at sec. II.B, p. 143, footnote 18 and pp. 172-173.
53. For critics of this position, *see* G. Lopes Courinha, *supra* n. 46, at sec. II.B., pp. 425 et seq.
54. DTCs with Barbados, Belgium, Malta, Mexico, Panama, Republic of Moldova, Sweden, Ukraine, the Netherlands, Spain and the United States. *See* the table with the anti-treaty shopping provisions on Portuguese DTCs, in G. Lopes Courinha, *supra* n. 46, at sec. II.B., at pp. 511-512.
55. When more than 50% of the capital is held by third-country companies, the company does not qualify for the application of the convention, unless a substantial business activity can be shown to exist.
56. For instance, the DTCs with Barbados, Republic of Moldova and Panama.
57. For instance, the DTCs with Barbados, Republic of Moldova and Panama.
58. For instance, the DTCs with Barbados, Malta, the United States, the Netherlands and Sweden.

a tax motivation test,[59] and some, finally, aggregate (entirely or partly) these different perspectives.[60]

22.3.3. Linking rules

The most notorious linking rule in the Portuguese domestic system is inserted in the participation exemption and states that, if the dividends were previously deducted in the state of the affiliate company, the exemption by the parent company is not available, since no double economic taxation is possible to occur.[61]

At the DTC level, linking rules can be found regarding the taxation of pensions in the Portuguese DTCs with the Netherlands and Denmark: if the residence state refrains from taxing such income, the taxation rights return to the source state.

22.4. Application of GAARs, TP rules and SAARs

While it is arguable that GAARs, SAARs and linking rules might overlap, even at an international level, the topic has been debated neither by scholars nor by the Courts.

By contrast, at a domestic level, these potential overlaps are normally solved, according to scholars, by hermeneutical rules governing relations between general and special rules, according to whether the scope of a particular SAAR intended to negatively limit or, inversely, strengthen the importance of the economic substance behind the legal rule. In the first case, the GAAR is not applicable; in the second, such a general rule can be applied.[62]

With some adaptations – particularly considering the different hierarchical level of the rules involved, when DTCs are at stake – the reasonings may be also applicable internationally.

59. For instance, the DTC with Barbados, Republic of Moldova and Panama.
60. For instance, the DTC with Barbados, Republic of Moldova and Panama.
61. Art. 51 (10) (a) of the CIT Code.
62. G. Lopes Courinha*, supra* n. 34, at sec. II.A., pp. 106-110.

Chapter 23

Russia[1]

Evgeniy Pustovalov, Eugeniy Zakharov and Andrey Savitsky

23.1. The meaning of avoidance and aggressive tax planning and the BEPS initiative

Currently, legal concepts such as tax avoidance, tax planning or aggressive tax planning are not defined in the Russian tax legislation. In general, these terms refer to the phenomenon that in Russian legal reality has been called “tax optimization”, meaning actions that reduce the tax burden of a particular person who is subject to taxation and that are not formally prohibited by the law.

There is a clear distinction between tax evasion, which is a criminal offence, in Russian legislation,[2] and the legitimate fulfilment of tax obligations. Russian tax legislation does not contain a legal definition of “tax avoidance”, although it is noted in Russian judicial doctrine and such actions of taxpayers are labeled as “non-bona fide”, which means that, formally, they are within the scope of the legal field, but entail non-payment of tax or payment of tax in a smaller size. The Tax Code of the Russian Federation contains two principles that correspond to this idea. They are principles of guiltlessness[3] and good faith (bona fide)[4] of the taxpayer. According to the ruling of the Constitutional Court of the Russian Federation, the responsibility for non-payment of taxes cannot be established in cases when a taxpayer uses legal ways to reduce the amount of tax payments.[5]

Situations of tax avoidance in Russian case law are connected with tax incentives that the taxpayer can receive. Since 2006, such tax avoidance

1. Issues of aggressive tax planning and circumvention of tax laws are highly relevant for the Russian Federation. This is confirmed by the large number of tax disputes in which these issues are raised as well as by the active work on the development of GAAR and the introduction of SAARs.
2. *See* arts. 198 and 199 Criminal Code of the Russian Federation.
3. *See* art. 108 para. 6 Tax Code of the Russian Federation.
4. *See* art. 3 para. 7 Tax Code of the Russian Federation.
5. *See* RU: Constitutional Court of the Russian Federation, 27 May 2003, No. 9-П in the case concerning the review of the constitutionality of the provision of art. 199 Criminal Code of the Russian Federation in connection with complaints of P.N. Beletsky, G.A. Nikova, R.V. Rukavishnikov, V.L. Sokolovsky and N.I. Talanov.

behaviour by a taxpayer, when tax avoidance is covered by formally legal behaviour, has been labeled as "obtaining of 'unjustified tax benefit'". The following list shows exact situations that indicate the unjustified use of tax benefits:

- reduction of the tax base;
- obtaining a tax deduction;
- obtaining of tax benefits;
- use of a lower tax rate; and
- obtaining the right to return (offset) or a tax refund from the budget.

The Higher Arbitration Tribunal of the Russian Federation in its Resolution of the Plenum described terms when all above-mentioned tax benefits should be treated as mala fide.[6] The burden of proof that the taxpayer has acted in bad faith lies on the tax authorities. Each particular fact of an unjustified use of tax benefits is individual and tax authorities must corroborate it in the course of a tax audit by providing appropriate evidence. Tax authorities regularly issue clarifications about the methods of identification and detection of the use of unjustified tax benefit.[7] Furthermore, it can be noted that currently the development of out-of-court and pre-court methods is a stable practice that involves taxpayers and tax authorities. A pre-court procedure is a requirement for resolving tax disputes, so many of them do not even make it to the courts at all – the number of court hearings decreases by 17% each year.[8] However, decisions in such pre-court procedures also do not provide definitions of tax avoidance – the tax authorities use adjudgements ruled in similar cases to prove their position, and they have no opportunity to interpret them. Decisions are published through an e-service.[9]

Disputes on obtaining unjustified tax benefit can be divided into four categories:

(1) Creation of a scheme aimed at increasing the value of goods to make artificially high amounts of tax deductions of value added tax (VAT) and the increase in expenses, deductible for corporate income tax purposes, in situations with real economic and financial transactions related to the acquisition of goods.

6. Resolution of the Plenum of the Higher Arbitration Tribunal, 12 Oct. 2006, No. 53.
7. *See* Letter of the Federal Tax Service of the Russian Federation, 24 May 2011, No. CA-4-9/8250; Order of the Federal Tax Service of the Russian Federation, 30 May 2007, No. MM-3-06/333@ (edition of 10.05.2012); and Letter of the Federal Tax Service of the Russian Federation, 28 Dec. 2012, No. AC-4-2/22619@.
8. https://www.nalog.ru/rn78/news/activities_fts/4706578/.
9. https://www.nalog.ru/rn77/service/complaint_decision/.

(2) Use of organizations (in some cases, directly or indirectly controlled by the taxpayer) that do not perform real financial and/or economic activities but whose aim is to overrate the amounts of tax deductions of VAT and the increase in expenses, deductible for corporate income tax by signing agreements with such organizations.

(3) "Splitting" of business aimed at the opportunity to apply preferential tax treatment.

(4) Carrying on business activities that formally are within the scope of tax legislation, but which actually do not have a business purpose, except unjustified tax benefit itself.[10]

Aggressive tax planning in Russia has the same meaning as that announced by the OECD – strategies that exploit gaps in the architecture of the international tax system to artificially shift profits to places where there is little or no economic activity or taxation.[11] As pointed out above, there is no special legislation or case law in Russia that would clarify the meaning of tax planning or aggressive tax planning. Since Russia, as a member of G20, was one of the active participants of the BEPS initiative and does not have its own precise rulings on tax avoidance and tax planning or aggressive tax planning, it is necessary to prepare and implement such rulings. The "deoffshorization" campaign, which was announced in 2012, contains several instruments that will conduce Russian tax legislation in accordance with international standards. According to this campaign, in January 2015, the Russian Tax Code was amended with controlled foreign corporation (CFC) rules and rules about tax residence in Russia of foreign companies, which will be discussed further in section 23.3. These national measures for tax control are also supported by strengthening the work of the Federal Tax Service in the exchange of information for tax purposes.

According to the "Main directions of tax policy for 2016 and the planning period of 2017 and 2018"[12] (the "Main directions"), the actions by taxpayers to obtain unjustified tax benefits are defined as "the abuse of rules of tax legislation in order to minimize taxes" and one of the goals of the tax policy is to deal with such abusive actions. According to Main directions, an important task of tax policy is to work on tightening measures aimed at

10. *See* Letter of the Federal Tax Service of the Russian Federation, 31 Oct. 2013, No. CA-4-9/19592.
11. http://www.oecd.org/tax/aggressive/.
12. http://www.minfin.ru/common/upload/library/2015/07/main/ONNP_2016-2018.pdf (in Russian).

countering the creation and use of abusive schemes aimed at tax evasion and illegal tax refunds from the budget. One of the measures to counter abusive schemes in taxation is a clear legal consolidation of mechanisms that restricts the use of "fly-by-night" or shelf companies and tax schemes involving offshore companies. The Main directions indicate that there is a need to develop Tax Code amendments insofar as they relate to the legal mechanism of countering tax abusive actions, such as the use of "unjustified tax benefits", and to implement a direct prohibition of the abuse of tax rights.

23.2. The reaction to avoidance and aggressive tax planning in the BEPS context

Unlike other countries, such as the United Kingdom, India and Australia, Russia has not yet enacted a tax law establishing the GAAR. There is therefore no separate definition of the GAAR and its tests. However, the Russian tax authorities are entitled to refuse taxpayers tax preferences, privileges and other tax benefits in connection with the fact that these are obtained by virtue of the artificial conditions for their creation.

This entitlement is based on the general provisions of the Tax Code and the interpretation given of these provisions by the Higher Arbitration Tribunal of the Russian Federation.[13] It is a set of rules that can be compared to the GAAR mainly because it consists of broad rules based on general principles to counter potential avoidance of taxation in general, in a form which cannot be visualized in advance.

The main idea behind this set of rules is elaborated on by the Higher Arbitration Tribunal and it is similar to the idea of a GAAR operating in other jurisdictions: an artificial arrangement or artificial series of arrangements that has been put into place for the essential purpose of avoiding taxation and lead to a tax benefit shall be ignored. Consequently, tax authorities shall treat these arrangements for tax purposes by reference to their economic substance.

Considering some general provisions of the Tax Code and taking into account the above-mentioned resolution of the Higher Arbitration Tribunal

13. Resolution of the Plenum of the Higher Arbitration Tribunal of the Russian Federation No. 53, 12 Oct. 2006 "On arbitration courts assessing the validity of the taxpayer receiving tax benefits".

as well as the current case law on tax disputes, the following factors should be assessed when concluding whether a taxpayer has received an unjustified tax benefit:

– the tax benefit may be deemed unjustified if business operations reported by a taxpayer are not economically justified or there is no business purpose behind them;
– the tax benefit shall not be regarded as justified if it were received without a connection with the taxpayer's genuine business activity; however, this does not mean that the taxpayer must conduct his affairs in the least tax-efficient way;
– the taxpayer could not have actually executed transactions given the available time, location of assets, availability of the requisite management, manpower and necessary business assets;
– the taxpayer takes into account only business operations that are connected with the tax benefit and omits other business operations which he would have normally taken into account; and
– achieving a tax benefit was the sole purpose behind executing a transaction.

These features and circumstances suggest that such elements (tests) as "the obtaining of a tax advantage as the essential aim of the transactions concerned",[14] "complementary business purpose test"[15] and "subjective element, consisting of the intention to obtain a tax advantage"[16] are present in the Russian GAAR and that they are its key elements.

However, the "main objective test" is not explicitly defined in any Russian tax legislation nor in any act of abstract judicial interpretation of the tax law (such as Resolution 53). Nevertheless, it can also be said to be an element of the Russian GAAR.

The result of the application of the main objective test is an answer to the question whether an accrual of a tax advantage is contrary to the purpose of the tax law provisions. Given the typical logic of judicial acts, where the issue of receiving of unjustified tax benefits arises, the tax authority or court refers to the tax law that applies in the case and then indicates what the difference is between the application of this tax law by the taxpayer and its

14. This element is separately indicated in para. 9 of Resolution 53.
15. This element is separately indicated in para. 3 of Resolution 53.
16. This element is not indicated separately in Resolution 53, but a systemic interpretation of its provisions leads to the conclusion that the tax advantages, which are subject to the GAAR tests, should be obtained intentionally. The use of tax benefits presumes the existence of an intention.

actual meaning (purpose of this particular tax law). Such a discourse means that the main objective test is used and, furthermore, it is the methodological basis for the use of other tests (elements) of the GAAR.

According to the principle of proportionality, there should be some limits to the usage of the GAAR and these should protect taxpayers' rights in cases where a tax authority's measures in application of the GAAR go too far. Unfortunately, this principle is not clearly defined in Russian case law. In particular, additional taxation due to using the GAAR can even lead to bankruptcy and this is not an uncommon situation.

Comparing the described Russian GAAR with the legal provisions enshrined in EC Recommendation C(2012) 8806 of 6 December 2012, it can be concluded that the approach of the Russian Federation is very similar, but less developed in terms of formal definition and details.

The described GAAR and its tests are not fixed by the legislator, but formed in legal practice. From this perspective, it may be argued that the GAAR is understood and applied by the courts. With regard to the tax authorities, they are eager to apply the GAAR because other more effective tools to counter circumvention of the tax law are not available (if there is no SAAR applicable to the particular circumstances). The boundaries of the application of this GAAR are constantly refined by the courts by resolving tax disputes that have precedential value.

However, the academic and professional community discusses the bills[17] that could become a law and remove the eclectic and uncertain approach that is currently practised. The Main directions point out the same idea that such rules as the GAAR should have a higher status that can be guaranteed only if they would be stipulated in a federal law. In particular, the State Duma is considering a bill that is proposed to supplement the Tax Code with principles for delineation of good conduct of taxpayers and abuse of their rights.[18] These amendments could further the development of the Russian GAAR.

17. http://www.nalvest.ru/news/detail.php?ID=15487 .
18. http://asozd2c.duma.gov.ru/addwork/scans.nsf/ID/C89AC8AA258A2BA143257CE10065B735/$FILE/529775-6.PDF?OpenElement.

23.3. TP rules, GAARs, SAARs and linking rules

New Russian TP rules provided for in section V.1 of the Tax Code (effective as from 1 January 2012) seem to be obviously designed to prevent and combat tax avoidance through artificial profit shifting schemes for the purposes of the CIT, PIT (for individual entrepreneurs and similar taxpayers), mineral resources tax and VAT.

From a cross-border taxation perspective, the anti-avoidance nature of the new Russian TP rules is confirmed by, for example, equating all transactions with the participation of an *offshore* person (person registered, domiciled or residing in the "blacklisted"[19] territory or state) to the category "transactions between related persons" and therefore subject to TP tax control. All transactions with commodities of world trading are also regarded as "controlled transactions" despite the parties thereto not being related to each other. There is also no threshold on the sum of transactions between related Russian and alien parties in order to be regarded as a controlled transaction, whereas a RUR 1 billion threshold applies when all related parties of a transaction are Russian residents.

From an interstate taxation perspective, the anti-avoidance nature of the Russian TP rules is supported by the special tax audit procedure regarding controlled transactions, which is performed by the federal tax service itself.[20] The notion of a controlled transaction is designed in such a manner as to encompass predominantly schemes between related Russian parties where at least one of the parties applies special tax regimes, applies 0% tax rate on corporate income tax, is exempt from corporate income taxation and applies other tax incentives and reliefs. In addition, TP rules (the arm's length principle and TP methods) are used as a general methodology to assess taxable bases in certain cases for the purposes of PIT, CIT and VAT where the transactions under question are not regarded as controlled transactions from the TP perspective.

TP rules were introduced into the Russian Tax Code on 1 January 1999 and there have been a few outstanding TP cases that may be regarded as "show trials" forming a trend or well-established case law.

19. *See* Decree of the Ministry of Finance, 13 Nov. 2007, No. 108н (rev. 2 Oct. 2014).
20. Local and regional tax authorities are not authorized to perform a special TP tax audit.

According to the legal database statistics,[21] there have been at least 5,000 cases tried by the Federal Arbitration Tribunals (courts of cassation instance) and more than 400 cases heard by the Higher Arbitration Tribunal and the Supreme Court of the Russian Federation that have referred to article 40 of the Tax Code governing the old TP rules that applied to transactions, income and (or) expenses or which had been acknowledged from 1 January 1999 until 31 December 2011.

By contrast, there have been around 200 cases tried by the Arbitration Tribunals of Districts and 14 cases that have been heard by the Higher Arbitration Tribunal or the Supreme Court of the Russian Federation since 1 January 2012 that refer to section V.1 of the Tax Code governing the new TP rules.

However, only a minor part of this case law concerns real TP disputes, the vast majority of rulings occasionally refer to articles in the TP rules for additional arguments in favour of or against certain conclusions, for example, in proving "unjustified tax benefit". Moreover, there is still no established case law concerning new TP rules, as these cases have not reached cassation instances or the Supreme Court of the Russian Federation[22] yet. Notwithstanding the above, there have been four remarkable cases tried under the *old TP rules* in the automotive business.

One of them is the *Mazda* case (A40-4381/2013), which was decided in favour of the tax authorities. According to the facts of the case, the Russian authorized distributor of Mazda (Mazda Motor Rus, LLC) purchased Mazda cars in 2009 from related company Mazda Motor Logistic Europe B.V. (Netherlands), both being 100% subsidiaries of Mazda Motor Corporation (Japan). The tax authorities denied Mazda Motor Rus, LLC losses in the tax year 2009 of RUR 1,362 million (approx. USD 31 million as of the end of 2009) due to the excessive purchase prices of the cars. The case has run two circles of hearings and, at the second circle, it was tried by all three instances in favour of the tax authorities who applied the resale price method (RPM). Application of the comparable uncontrolled price (CUP) method was denied by arbitration tribunals since no comparable cars or transactions have been imported into Russia due to the fact that the Russian subsidiary of Mazda was *the exclusive distributor*. Finally, Mazda Motor Rus, LLC filed an appeal to the Supreme Court of the Russian Federation with regard to

21. ConsultantPlus legal database. URL: http://www.consultant.ru/sys/english/.
22. The Higher Arbitration Tribunal of the Russian Federation ceased to be the highest instance for economical disputes on 5 Aug. 2014 and was replaced by the Supreme Court of the Russian Federation.

the decision of the Arbitration Tribunal of the Moscow District 16.06.2015.[23] However, the appeal was denied[24] and the next appeal against the latter Court's decision is currently pending.[25]

Another similar case is the *Suzuki* case (A40-111951/12) decided at the first circle in favour of the taxpayer and now pending a new hearing at the Arbitration Tribunal of Moscow District (court of cassation instance). According to the case, the Russian exclusive importer of Suzuki cars, bikes and equipment Suzuki Motor Rus, LLC was charged an additional RUR 28 million for the tax year 2010 and denied losses for the tax year 2009 in the amount of RUR 382 million. The tax authorities claimed that purchase prices from Itochu Corporation (100% shareholder, Japan) were overcharged and the distributor sold cars under the cost price (due to a marketing programme attracting customers). The tax authorities applied RPM and argued that the CUP method could not have been applied due to the exclusivity of the distributor in the Russian market and the incomparability of other cars and other distributors with Suzuki. The arbitration tribunals of the first and appeal instances upheld the taxpayer and ruled that the tax authorities failed to prove non-arm's length prices. However, the Federal Arbitration Tribunal of Moscow District in its Decision of 16 September 2013 overturned these rulings and referred the case for the new hearing to the Court of First Instance in order to reassess the facts and findings.

After rehearing the case, the arbitration court of first instance reached its ruling on 3 February 2016 in favour of the taxpayer.[26] During the new hearing of the case, a forensic examination was performed. The court upheld the taxpayer and ruled that the tax authorities had not proved that Itochu Corporation took over operational management from its Russian subsidiary and that Itochu Corporation gained profit due to the losses of Suzuki Motor Rus, LLC. The court criticized the tax authorities for their application of RPM (second method) rather than the CUP method and referred to the Presidium of the Higher Arbitration Tribunal of the Russian Federation case law,[27] according to which TP methods have to be applied consistently,

23. *See* the decision: https://kad.arbitr.ru/PdfDocument/6096f62e-fefd-4259-8fde-8749d00966d1/A40-4381-2013_20150616_Reshenija i postanovlenija.pdf.
24. *See* the decision: https://kad.arbitr.ru/PdfDocument/0c5da297-a850-486b-8033-4a0d0b597b36/A40-4381-2013_20151014_Opredelenie.pdf.
25. The taxpayer filed an appeal on 12 Nov. 2015 and on 26 Jan. 2016, which have not yet been accepted by the Supreme Court of the Russian Federation.
26. *See* the decision: http://kad.arbitr.ru/PdfDocument/f7a042a9-4b52-4d98-bcc5-9d431d2f5937/A40-111951-2012_20160203_Reshenija%20i%20postanovlenija.pdf.
27. *See* RU: Higher Arbitration Tribunal of the Russian Federation, 18 Jan. 2005, No. 11583/04, and RU: Higher Arbitration Tribunal of the Russian Federation, 19 Nov. 2002, No. 1369/01.

otherwise tax assessments shall be regarded as void. The court argued that there had been comparable transactions with Suzuki cars between Itochu Corporation and other non-related Russian companies before the second half of 2009 and these cars may be regarded as identical to cars sold in the second half of 2009 by the taxpayer. The forensic examination played a crucial role in this case as most controversial issues were resolved by the experts in the report or oral testimonials. The arbitration court of appeal agreed with the Court of Lower Instance in its decision of 4 May 2016.[28]

Another TP automotive case is the *Subaru* case (No. A40-89807/2014), decided in favour of the tax authorities (with regard to TP issues) by the first, appeal[29] and cassation[30] instances. The facts of the case are quite similar: a Russian subsidiary (Subaru Motor LLC) of Japanese corporations, Fuji Heavy Industries (the producer) and Sojitz Corporation (the global distributor) was the exclusive distributor of Subaru cars in Russia. The tax authorities applied RPM instead of the CUP method, referring to the absence of identical or comparable goods due to the fact that Subaru Motor Rus was the exclusive importer of Subaru cars. In 2009, car sales resulted in losses for the Russian taxpayer.

However, the courts held that the market of Subaru cars could not be compared to the market of other Japanese or European cars due to technical and other differences of the cars compared (e.g. a different engine). Thus, the courts upheld the tax authorities in their application of RPM instead of the CUP method and allowed a reassessment of prices having denied RUR 30.5 million in losses for 2009.

Finally, there is the *Hyundai* case (No. A40-50654/2013), also decided in favour of the tax authorities by all instances, including the cassation instance of the Supreme Court of the Russian Federation. According to the facts of the case, the exclusive representative of Hyundai cars in Russia – Hyundai Motors CIS – being an affiliate of Hyundai Motor Company incurred losses for car sales. The tax authorities applied RPM and reassessed prices, which resulted in denying the losses of RUR 136.5 million and RUR 500.9 million

28. *See* the decision: http://kad.arbitr.ru/PdfDocument/6efbbc20-a468-4070-8670-403eed5d5f12/A40-111951-2012_20160504_Postanovlenie%20apelljacionnoj%20instancii.pdf.
29. *See* the decision: http://kad.arbitr.ru/PdfDocument/b8052f32-d19b-4533-bda1-55332b2a217f/A40-89807-2014_20150205_Postanovlenie%20apelljacionnoj%20instancii.pdf.
30. *See* the decision: http://kad.arbitr.ru/PdfDocument/b8052f32-d19b-4533-bda1-55332b2a217f/A40-89807-2014_20150205_Postanovlenie%20apelljacionnoj%20instancii.pdf.

for tax years 2009 and 2010, respectively. The tax authorities proved a tax optimization scheme was used, consisting of purchasing cars at overcharged (more than 20%) prices from the related party (Hyundai Motor Company) and selling them on at lower prices to dealers, which resulted in outflows of capital abroad. Again, several examinations (during the tax audit and court trials) were taken into account and crucially influenced the outcome of the case.

Having studied the appeal by the taxpayer, the judge of the Supreme Court of the Russian Federation did not find grounds for reversing the decisions of the lower courts.[31] She confirmed there was no wholesale market of cars supplied from foreign manufacturers to Russian distributors (because the automotive business in Russia is arranged between related parties only and all transactions are transfer pricing compliant).

The recent case law on the new TP rules concerns procedural aspects of TP tax audits, including the issues whether (i) territorial tax authorities are allowed to perform a TP tax audit and whether (ii) non-controlled transactions between Russian related companies may be subject to TP control.

The first issue is due to the fact that the Ministry of Finance issued the Letter of 18.10.2012 No. 03-01-18/8-145 with explanations of several articles of section V.1 of the Tax Code on TP and clarified that territorial tax authorities (other than the Central Body of the Federal Tax Service) have the right to apply TP rules during field and desk audits in cases when they suspect a taxpayer is manipulating prices, although an "unjustified tax benefit" should be proved.

This clarification was challenged by the taxpayer Minvody-Krovlya, LLC in the Supreme Court of the Russian Federation, which rejected the claim in Decision АКПИ15-1383 of 1 February 2016. The decision was assessed by both the taxpayer and tax authorities – who came to different conclusions, each in its own favour – and it confirmed, on the one hand, that the ordinary tax authorities are not allowed to perform TP tax audits and control transfer prices although it did not, on the other hand, prohibit proving "unjustified tax benefit" obtained through manipulating prices and applying TP methods.

31. *See* the decision: http://kad.arbitr.ru/PdfDocument/c4c64f8a-79b5-448d-a8e0-bad8f5278e97/A40-50654-2013_20160120_Opredelenie.pdf.

Concerning the second issue, no case law has yet been established. Some judges and courts allow applying TP rules and methods to non-controlled transactions between related parties (*see*, for example, Ruling of the Supreme Court of the Russian Federation 303-КГ15-15675 of 7 December 2015), since the "unjustified tax benefit" had been proved. Others deny territorial tax authorities in additional assessments of taxes resulting from the application of TP methods to non-controlled transactions of related parties, e.g. arbitration courts in the case of *ITERA* A40-204810/14, but do not prohibit applying TP methods per se.

Russia follows best international practices in combating profit shifting to low-tax jurisdictions and tax deferral on the national level and introduced CFC rules into the Tax Code on 1 January 2015 (*see* chapter 3.4. of the Tax Code and amendments to the other chapters on CIT and PIT).

The main elements of the CFC taxation regime comprise: (i) a CFC concept; (ii) a controlling person (CP) concept; (iii) substance and form of the control; (iv) a mechanism for CFC taxation; and (v) a determination of the taxable profit of CFCs and CPs.

The Russian concept of the CFC includes both corporate and non-corporate bodies, e.g. trusts and other "structures without legal personality", provided they are not Russian tax residents. The controlling person may be a natural or a legal person both being only Russian tax residents. Generally, control over a CFC is determined through the legal control – direct or indirect participation (holding shares (interest)) in a CFC whereby:

- 25% (was 50% until 2016) of the shares are held by at least one CP individually; and
- 10% of the shares per CP individually (including spouse and underage), provided at least 50% of the CFC's shares are held by Russian tax residents collectively.

However, should the above-mentioned requirements on legal control not be met, the control over the CFC may be determined through the influence or capability of the person that controls that foreign company to decisively influence decisions on after-tax profit distribution due to the specific relationships of the parties thereto.

The Russian Tax Code imputes the CFC's profit in the taxable base to its CP, making this akin to a "deemed dividends" mechanism. The Russian CFC concept implies that the CFC's taxable income includes passive and

active (less than 80% of the total income)[32] income from both offshore and non-offshore jurisdictions.

The Russian Tax Code provides for different ways of computing the CFC's profit:

– under the personal laws of a CFC, provided financial statements are subject to statutory audit and a tax treaty with the country of the CFC is available; and
– otherwise, as indicated under specific chapters of the Russian Tax Code. There are, however, a number of exemptions for determining the CFC's profit under article 25.13-1 of the Tax Code and the *de minimis* rule.

The CP's taxable profit comprises profit of the CFC in proportion to the interest share on the date of the decision to distribute profit or at the end of the accounting period of the CFC. The CFC's profit may be reduced by profits accounted by other CPs in cases where participation is indirect.

The CFC's profit is determined by the results either from the accounting period of the CFC or on 31 December. This profit is included in a CP's profit on 31 December of the year following the year in which the accounting period of the CFC ends.

The CFC's profit tax in Russia (to be paid by its CP) is reduced by foreign tax or by Russian tax already withheld on this profit as well as by the Russian tax on the CFC's PE profit. Certain types of CFC's profit are exempt under the Tax Code; dividends and distributions are deductible from the CFC's profit as well. According to the Federal Tax Service, the deoffshorization campaign, which includes notification about CFCs, is making little impression.

The other national SAAR, which concerns Russian thin capitalization rules (*see* article 269(2-4) of the Tax Code), was introduced on 1 January 2001 and it is designed to combat tax avoidance by limiting excessive interest payments and requalifying them into dividends subject to withholding tax.

Generally, article 269 of the Tax Code governs the peculiarities of interest deduction for CIT purposes, and the basic rule (article 269(1)) is designed to align a taxpayer's interest under a contract (controlled transaction) with

32. The number of exemptions regarding active income of CFCs that have been introduced during 2015.

arm's length interest. In doing so, article 269(1.1.) and (1.2.) provides for allowed intervals of interest rates:

- debt in RUR: 0%-180% of the key rate of the Russian Central Bank (debt in the 2015 tax year); 75%-125% of the key rate of the Russian Central Bank (debt since the 2016 tax year), *provided all related parties are Russian residents*;
- debt in RUR: 75%-180% of the key rate of the Russian Central Bank (debt in the 2015 tax year); 75%-125% of the key rate of the Russian Central Bank (debt since the 2016 tax year), *provided at least one related party is not Russian resident*;
- debt in Euro: Euribor + 4% point - Euribor + 7% point;
- debt in Chinese yuan: Shibor + 4% point - Shibor + 7% point;
- debt in pound sterling: Libor + 4% point - Libor + 7% point;
- debt in Swiss franc or Japanese yen: Libor + 2% point - Libor + 5% point; and
- debt in other currencies: Libor in USD + 4% point – Libor in USD + 7% point.

Interest accrued under non-controlled transactions is regarded as arm's length interest, unless it is otherwise proved by the tax authorities.

Russian thin capitalization (thin cap) rules are obviously designed as a national SAAR targeted at limiting the deduction of interest paid abroad and interests paid domestically in certain cases. These rules are unlikely to deal with setting an arm's length interest rate; however, some may argue the opposite. The thin cap rules apply to a "Russian company"[33] having (1) unpaid debt claim before: (i) a foreign company owning directly or indirectly 20% of the share capital; or (ii) a Russian company regarded as an "affiliated" company of the foreign company referred to above; or (2) having an unpaid debt claim (before any other third persons, including banks), provided such an "affiliated" Russian company and/or foreign company referred to above are guarantors, warrantors or otherwise are obliged to ensure debt obligations by the Russian taxpayer. The debt-to-equity ratio is set at 3:1 (12.5:1 for banks and leasing companies). Russian taxpayers conforming to the above-mentioned requirements shall determine allowed interest each quarter and at the end of the tax year by applying the capitalization coefficient to the interest accrued under the contract. According to article 269(4) of the Tax Code, the excessive interest sum is equated to "dividends *paid* to the foreign company" and is subject to withholding tax.

33. Thus, it is arguable, whether thin cap rules apply to permanent establishments of foreign companies.

These rules have been criticized by taxpayers and academics for different reasons, including conflict with the "non-discrimination" clause of DTCs,[34] ambiguity of thin cap rules with regard to loans between a Russian company and an "affiliated" *foreign* (sister) company not owning shares of the first mentioned company,[35] application of the rules to the arm's length loans from non-related banks[36] etc.

These rules have been recently refined by the Federal Law of 15.02.2016 No. 25-FZ effective as of 1 January 2017. Since 2017, the controlled debt shall be determined with reference to article 105.1 of the Tax Code (related persons) and shall additionally include debt to persons related to the foreign controlling person (e.g. "sister" companies). However, there is no controlled debt where a taxpayer – a Russian company – does not withhold tax as a tax agent, e.g. where it pays interests to Russian entities; where the debt is paid to banks, including foreign banks, provided they are not related to the Russian taxpayer or foreign controlling person or other related person. However, a court may regard any debt as "controlled" in other cases if it determines that the ultimate purpose of the payment is to pay the foreign related person or third person related to such a foreign person.

Russia predominantly focuses on SAARs rather than a GAAR in its tax law and it has introduced some other special measures, namely:

– obligatory notification of the tax authorities by tax residents upon participation in all foreign companies in which a share exceeds 10%, and

34. Prior to 15 Nov. 2011, there was a well-established case law of the arbitration tribunals having resolved a conflict between art. 269(2.4) of the Tax Code and art. 24(4) of the DTCs in favour of the latter and overriding national thin cap rules. However, since the case RU: Higher Arbitration Tribunal, *Severniy Kukbass,* A27-7455/2010 was heard by the Presidium of the Higher Arbitration Tribunal in favour of the tax authorities and overriding the "non-discrimination" clause by reference to the anti-avoidance nature of domestic thin cap rules (and art. 9 of the OECD Model and Commentaries thereto), all subsequent case law has turned in the opposite direction.

35. Art. 269(2) Tax Code literally does not permit applying thin cap rules to loans between a Russian company and its foreign sister company. However, since the RU: Higher Arbitration Tribunal, *Naryanmarneftegaz*, (A40-1164/11), the subsequent case law has been showing the contrary (*see also* RU: Higher Arbitration Tribunal, *Pirelli Tire Services* (A40-58049/12 et seq.). The foreign sister company is usually regarded as proof of a covert form of control of the foreign parent company over the Russian taxpayer, a fortiori the loan was granted from the parent's resources.

36. Some researchers argue that thin cap rules shall apply to bank loans under arm's length conditions, although the loan is ensured by a foreign parent or Russian related company guarantee. There are no safe harbour rules or possibility to prove that the debt-to-equity ratio of 3:1 is not relevant and that an arm's length standard should apply. However, should a loan be granted between two Russian companies, the requalification of excessive part of interest into dividends will not work.

on establishing or control over structures without legal personality, e.g. trusts, partnerships and estates (article 23(3.1.) of the Tax Code);
- the Ministry of Finance "blacklist" of jurisdictions – for limiting the application of 0% tax rate on corporate income tax with regard to dividends paid by residents of such offshore jurisdictions;
- the Federal Tax Service "blacklist"[37] of jurisdictions – for the purposes of CFC rules;
- a national "beneficial owner" concept – for the purposes of application of DTCs (*see* articles 7 and 312 of the Tax Code);
- obligatory disclosure of beneficiaries – Russian companies paying income on securities that are accounted at foreign nominal shareholders to persons (beneficiaries) who are not disclosed to the Russian companies shall withhold PIT or CIT at an increased tax rate of 30% (articles 214.6, 224(6) and 284(4.2.) of the Tax Code);
- a national "PE" concept, including a dependent agent;
- limitation of application of the simplified tax system (chapter 26.2 of the Tax Code) for foreign companies; and
- limitation of economic double taxation relief for foreign companies with regard to taxation of dividends (article 275 of the Tax Code), etc.

One more legislative innovation that may be attributed to the national SAARs is the national "tax residence" concept for the purposes of CIT. Since 1 January 2015, a foreign company may be regarded as a Russian tax resident company, provided the *place of management* is in the Russian Federation, unless otherwise prescribed by a DTC. Article 246.2(2) of the Tax Code provides for two alternative requisites to qualify a foreign company as a Russian tax resident:
- the executive body (executive bodies) of a company regularly carries on its activity regarding the company from the Russian Federation; or
- the principal managing officers of a company (authorized to forecast and control the activities, manage the activities of an enterprise and bear responsibility for it) predominantly carry out managing activities of the company in the Russian Federation. Should any of the mentioned conditions be met both in Russia and in any other foreign state, the Russian Federation shall be regarded as the place of management if, at least, one of the following conditions are fulfilled:
  (i) bookkeeping and management accounting is performed in Russia;
  (ii) office work is carried out in Russia; and
  (iii) operational personnel management is performed in Russia.

37. *See* http://regulation.gov.ru/projects/List/AdvancedSearch#npa=41221.

Consistent application of the new tax residence concept will result in curtailed expansion of the Russian taxable base and recognition of all offshore and transit-jurisdictions' companies (e.g. Cypriot, Swiss, Dutch, Luxemburg and alike companies) created by Russian persons and actually managed from Russia as Russian tax residents with the appropriate tax consequences.

Some SAARs may also be found in tax treaties. DTCs concluded by the Russian Federation do not usually include LOB rules. However, LOB rules are provided for in the DTCs with Australia, Brazil, Chile, Estonia, Indonesia, Israel, Lithuania, Singapore, Spain (Protocol 1998), the United Kingdom and the United States. Recently, LOB rules were introduced into new treaties with Belgium (2015), China (2014), Malta (2013) and the Protocols to the DTCs with Singapore (2015), Cyprus (2010) and Luxemburg (2011).

Despite all LOB rules being devoted to a limitation of certain treaty benefits, they are designed in a different manner. Some DTCs refer to the abusive aims of treaty benefits claimed by a resident (person) and limit all or certain benefits in such instances (*see*, for example, the DTCs with Chile, Estonia, Singapore and Lithuania). The other DTCs introduce objective tests to be observed by a person in order to qualify for a benefit (*see*, for example, the DTCs with Brazil and the United States and the Protocol to the DTC with Spain), for instance, shareholding threshold (50% and more) for non-residents, etc.

With regard to some other BEPS measures and actions to be taken, no "linking rules" concept has yet been introduced.

23.4. Application of GAARs, TP rules and SAARs

There is no legally established hierarchy of the GAAR, SAARs and TP rules. However, the Russian judicial doctrine relies on the *lex specialis derogat generali* and *lex posteriori* principles as well. In most cases, they should be applicable to the interaction of the GAAR, TP rules, SAARs and linking rules.

While SAARs and TP rules are promulgated to counter a specific abusive behaviour, GAARs are used to support SAARs and to cover transactions that are not covered by them. Under normal circumstances, where a specific SAAR is applicable, the GAAR is not invoked.

Currently, there is no case law or administrative practice of using such SAARs like brand new CFC and TP rules. It means that the conclusions about the hierarchy of the GAAR and these SAARs are tentative.

However, the designated hierarchy of the GAAR and SAARs is indirectly confirmed by the case law. For instance, analysing the previously mentioned case A40-111951/12, where the TP rules (which were in force before the adoption of 227-FZ of 18.07.2011) were applied, and examining how the court relates these TP rules to the GAAR, the following conclusions can be drawn:

Firstly, the basis of the judgment is the application of the TP rules and the facts of the case are correlated with these rules. Secondly, the GAAR is also mentioned in the case, but as an abstract principle that serves to indicate the purpose for which TP rules are. With this approach, the GAAR does not replace SAARs and TP rules, but only helps to use them more accurately and subtly.

A similar relationship can be found in some other cases on the application of the “old” TP rules, as well as in cases of recognition of interest on loans as dividends (applying thin cap rules).

However, a more specific and accurate approach definitely has to be developed in order to avoid too broad or too narrow interpretation of SAARs, which may prevent their implementation not in accordance with the intended use.

With regard to the procedures for the application of certain SAARs, in general, they are all implemented within the overall administrative and judicial procedures. However, TP rules have certain characteristics. They can be applied only on the results of a special tax audit carried out by the central office of the Federal Tax Service. Currently the authors are not aware of one such effective tax audit. However, in the meantime, there is no reason to believe that the marked feature in the application of the brand new TP rules will have an impact on the ratio of the GAAR and TP rules (or other SAARs), as described above.

Chapter 24

South Africa

Craig West and Jennifer Roeleveld

24.1. The meaning of avoidance and aggressive tax planning and the BEPS initiative

24.1.1. The meaning of tax avoidance in South Africa

Tax avoidance does not carry a specifically defined legal meaning in South Africa per se. Both specific anti-avoidance provisions and a general anti-avoidance rule (GAAR) exist within the income tax legislation. For the purposes of the GAAR for income tax purposes, the rule attempts to distinguish between permissible and impermissible tax avoidance. Essentially any arrangement (read transaction as well) that results in a "tax benefit"[1] is considered to be avoidance. However, only those avoidance arrangements meeting the requirements for the application of the GAAR are considered "impermissible" tax avoidance. This is indicative of the GAAR being used to pursue aggressive tax avoidance rather than any tax avoidance.[2]

The GAAR was replaced in 2006.[3] The previous rule (as contained then in section 103(1)) was considered ineffective, although supported by case law. The new rule was drafted largely with reference to Canadian legislation, but with some reference to UK and US legislation.[4]

Apart from the GAAR, the administration has equally attempted to identify avoidance or potentially aggressive tax planning arrangements through the "reportable arrangements" regime.[5] Two categories of arrangements exist, firstly those that meet certain generic requirements,[6] secondly those that

1. A "tax benefit" is defined in sec. 1 of the Income Tax Act, 58 of 1962 as including any avoidance, postponement or reduction of a tax liability.
2. L. Fichardt, *A General Anti-Avoidance Rule in the UK: Sharing the spirit of the South African GAAR*, 4 Business Tax and Company Law Quarterly 2 (Siber Ink 2013).
3. L. Olivier, "South Africa", in IFA, *Tax Treaties and tax avoidance: application of anti-avoidance provisions, Cahiers de droit fiscal international*, vol. 95a (2010), at p. 720.
4. J. Hattingh, *South Africa – Corporate Taxation* sec. 10., Country Analyses IBFD (accessed 13 Jan. 2016).
5. This regime is contained in secs. 34-39 of the Tax Administration Act, 28 of 2011.
6. As contained in sec. 35(1) of the Tax Administration Act, 28 of 2011.

are publically listed[7] as reportable arrangements. The list equally excludes certain arrangements, rendering them potentially "permissible". However, all that such a regime has served to do is to identify a limited number of targeted areas of suspected avoidance.

While an advance ruling system is operated by the South African Revenue Service (SARS) in addition to the reportable arrangements, no advance ruling may be issued that "involves the application or interpretation of a general or specific anti-avoidance provision or doctrine".[8] As a result, the advance ruling system does not add to the understanding of tax avoidance specifically.

The courts have access not only to the statutory rules for anti-avoidance, but also to common law legal principles, in particular the test for a simulated transaction or substance-over-form (however, this is not considered to extend to a consideration of economic substance).[9]

All of the established case law considers the application of the former rule, but can still be consulted with respect to those aspects carried to the new rule. The case law tends to answer selected aspects with respect to the application of the statutory rules or clarifies the court's position on the application of the common law doctrines, but cannot be said to give a definitive meaning of tax avoidance. The courts have confirmed the right of taxpayers to minimize their tax liability, but within the bounds of the common law and statutory rules.[10]

> In *Smith v CIR* it was held that the ordinary meaning of avoiding liability for a tax on income was "to get out of the way of, escape or prevent an anticipated liability". In *Hicklin v SIR* the Appellate Division acknowledged that such liability may vary from "an imminent, certain prospect to some vague, remote

7. The most recent list at time of writing can be found at: ZA: GN 140 in GG 39650 of 3 February 2016, available at: http://www.sars.gov.za/AllDocs/LegalDoclib/SecLegis/LAPD-LSec-TAdm-PN-2016-02%20-%20Notice%20140%20GG%2039650%203%20February%202016.pdf.
8. Sec. 80(1)(c) of the Tax Administration Act, 28 of 2011.
9. As illustrative of this principle, *see* ZA: Supreme Court of Appeal, 17 Sept. 1999, *Commissioner for Inland Revenue v. Conhage* (*Pty*) *Ltd* (*formerly Tycon* (*Pty*) *Ltd*), (606/97) ZASCA 64, available at: http://www.saflii.org/cgi-bin/disp.pl?file=za/cases/ZASCA/1999/64.html&query=%20conhage.
10. *See*, for example, ZA: Supreme Court of Appeal, 2011, *Commissioner for the South African Revenue Service v. NWK Ltd* 2011 (2) SA 67 (SCA) 3. Equally, reference can be made to the decision of ZA: South Africa Tax Court, 1999, *CIR v. Conhage* (*Pty*) *Ltd* 1999 (4) SA 1149, 61 SATC 391, at p. 393 in which J. Hefer states: "Within the bounds of any anti-avoidance provisions in the relevant legislation, a taxpayer may minimise his tax liability by arranging his affairs in a suitable manner".

> possibility" and Trollip JA said that "it is unnecessary and hence inadvisable to decide here whether a vertical line should be drawn somewhere along that wide range of meanings in order to delimit the connotation of 'an anticipated liability'".[11]

The courts do have access to foreign judgments that may serve to be persuasive, but not binding on the court. Regular reference to UK, Australian and Canadian decisions are made by both counsel and the courts.

Special anti-avoidance rules (SAARs) appear to be the legislative vehicle of choice for action by the revenue authority and for the implementation of the base erosion and profit shifting (BEPS) action plans.[12] South Africa (separately and as a member of the G20) has indicated its support for the BEPS action plan and its implementation, particularly as regards to automatic exchange of information (in terms of the Foreign Account Tax Compliance Act (FATCA)) and with respect to transfer pricing (TP).[13] Transfer pricing, hybrid mismatches and treaty abuse are to be the key areas for reform.

Hybrid debt rules and limitation on interest deductions are recent amendments to the domestic legislation that have been directly influenced by the BEPS actions.

24.1.2. The meaning of tax planning, abusive tax planning and aggressive tax planning in South Africa

There is no definition of tax planning, aggressive tax planning or abusive tax planning. It has been suggested that all tax planning equates to avoidance, but with a clear understanding of avoidance as the full and frank disclosure of the transaction and its steps with an absence of dishonesty.[14] Simulated transactions, failure to disclose the arrangement and other transactions tend to contain elements of dishonesty that change the avoidance to evasion.

11. A.P. de Koker and R.C. Williams, *Silke on South Africa Income Tax: Anti-Avoidance 19.1* (LexisNexis 2015).
12. Albeit that SARS recognized in 2006 when amending the GAAR that SAARs have limitations. *See* ZA: SARS, Tax Avoidance and Section 103 of the Income Tax Act, 1962: An Interim Response, March 2006, available at http://www.sars.gov.za/AllDocs/LegalDoclib/RespDocs/LAPD-LPrep-Resp-2006-01%20-%20Interim%20Response%20Tax%20Avoidance%20and%20s.103%20of%20ITAct.pdf, at p. 28.
13. *See* ZA: SARS, Strategic Plan 2015/16 – 2019/20, available at: http://www.sars.gov.za/AllDocs/SARSEntDoclib/Ent/SARS-Strat-14%20-%20Strategic%20Plan%202015%202016%20-%202019%202020.pdf.
14. C. Cilliers, *Silke on International Tax: Anti-Avoidance 46.2* (A.P. de Koker ed., LexisNexis 2010).

However, the clear distinction between avoidance and evasion must be carefully considered when utilizing emotive terms such as aggressive tax planning or abusive tax planning.

The South African courts must also consider the "choice principle" as developed from the Duke of Westminster decision.

> The only reported example to date of a judge squarely facing the conflict between the choice principle and a statutory general anti avoidance provision is the passage in the judgment of Watermeyer CJ in CIR v King, where, apropos of an earlier GAAR, namely s 90 of the Income Tax Act which was the predecessor of s 103(1), he said:
>
> > " […] there are many other ordinary and legitimate transactions and operations which, if a taxpayer carries them out, would have the effect of reducing the amount of his income to something less than it was in the past, or of freeing himself from taxation on some part of his future income. For example, a man can sell investments which produce income subject to tax and in their place make no investments at all, or he can spend the proceeds in buying a house to live in, or in buying shares which produce no income but may increase in value, or he may invest the proceeds outside of the Union, or make investments which produce income not subject to normal tax in his hands eg Union Loan Certificates, deposits in the Post Office Savings Bank or shares in public companies. He can also sell shares in private companies, the holding of which may subject him to heavy taxation in his hands although he does not receive the income which is taxed, or he can sell shares in companies which pay high dividends and invest in securities which return him a lower but safer and more certain income. He might even have conceived such a dislike for the taxation under the Act that he sells all his investments and lives on his capital or gives it away to the poor in order not to have to pay such taxation. If he is a professional man he may reduce his fees or work for nothing; if he is a trader he may reduce his rate of profit or sell his goods at a loss in order to earn a smaller income. He can also secure deductions from the amount of his gross income, for example by insuring his life. He can carry out such operations for the avowed purpose of reducing the amount of tax he has to pay, yet it cannot be imagined that Parliament intended by the provisions of s 90 to do such an absurd thing as to levy a tax upon persons who carry out such operations as if they had not carried them out."
>
> There seems to be only one juridically satisfactory way of determining whether, in any given fiscal scenario, the choice principle trumps the GAAR, and that

> is to ask whether the choice exercised by the taxpayer was one which the Act explicitly or implicitly held out to him. If the answer is affirmative, then the GAAR is not applicable and the choice principle prevails.[15]

The Tax Administration Act 28 of 2011 contains various administrative penalties. The understatement penalty levies varying penalties depending on the behaviours (not defined) of taxpayers, including: “no reasonable grounds for ‘tax position’ taken”; “gross negligence” and “intentional tax evasion”. “Tax position” is defined on the basis of the effect of a position or assumption made by the taxpayer with respect to the completion of the tax return that led to the exemption, deduction or reduction of tax. This is clearly not an effective definition for tax planning as it is reactive to the behaviour rather than a positive definition of tax planning.

As the behaviours giving rise to understatement are not defined, it is unclear whether these behaviours will influence the application of the Income Tax Act GAAR. It is suggested that perhaps the meaning of these behaviours could be “borrowed” from other branches of law, such as the law of delict.

24.2. The reaction to avoidance and aggressive tax planning in the BEPS context from a non-EU Member State

24.2.1. South Africa’s GAAR

South Africa is not a member of the European Union, but it is perhaps instructive to compare the South African GAAR with the key elements as identified by the general reporter. This comparison will only be with respect to the GAAR as substituted in 2006. However, the case law with respect to the South African GAAR only considers the former GAAR. Some lessons from the success and failure of the application of that rule before the courts remain relevant for the purposes of the new GAAR. To the extent relevant, some key cases and the success or failure of the revenue authority are considered.

Any transaction (hereinafter arrangement), or part thereof resulting in the avoidance, reduction or postponement of any liability for tax in terms of the Income Tax Act is considered to be a tax benefit. An arrangement that

15. A.P. de Koker and R.C. Williams, *Silke on South Africa Income Tax: Anti-Avoidance 19.3* (LexisNexis 2015).

generates a tax benefit, but for the application of the GAAR, is considered an avoidance arrangement.[16] Such an arrangement is only an impermissible arrangement if it meets the remaining requirements of the GAAR; these being, firstly, that the sole or main purpose of the arrangement was the "avoidance, reduction or postponement of any liability for tax" (defined as a "tax benefit"). The second requirement is broken into three alternatives: either that the arrangement is in a business context; that the arrangement is in a context other than business; or certain elements are in place in any context.

For the business context, the arrangement must have been entered into or carried out by a means or in a manner that would not normally be employed for bona fide business purposes other than to obtain the tax benefit. Alternatively, the arrangement lacks commercial substance (a concept developed in a separate provision).

For the context other than business, the arrangement must have been entered into or carried out by a means or in a manner that would not normally be employed for a bona fide purpose other than to obtain the tax benefit.

Finally, in any context, the arrangement must have created rights or obligations that would not normally be created between persons acting at arm's length or would directly or indirectly result in the misuse or abuse of the provisions of the Income Tax Act (one of the so-called purposive tests of the provision).

Should the sole or main purpose be to obtain a tax benefit and any one of the second requirement elements exist, then the arrangement is an impermissible avoidance arrangement.

16. The "but for" test with respect to the definition of the "avoidance arrangement" has been criticized: "For example, what if, as Broomberg suggests, there would not have been any transaction if the tax effects had been otherwise? In other words, it may be difficult to mentally eliminate the tax benefit without also eliminating the underlying transaction itself. A different problem is that it may be easy to imagine a whole variety of different transactions that might hypothetically have been concluded. Surely it could not be suggested that either the most or least favourable hypothetical alternative should simply be used as yardstick? However, the alternative – that there may be a whole range of hypothetical possibilities – is also unworkable, since it implies that the existence or otherwise of an 'avoidance arrangement' may be a matter of degree or perspective". C. Cilliers, *Silke on International Tax: Anti-Avoidance 46.14* (A.P. de Koker ed., LexisNexis 2010).

24.2.2. South Africa's GAAR compared to the EC Recommendation

As can be seen from section 24.2.1., the South African GAAR has elements of the proposed EC Recommendation, but differs in a number of respects. Complicating the analysis is the use of different terms in the South African GAAR, for example, the use of "essential purpose" in the EC Recommendation may not necessarily be interpreted in the same way as the phrase "sole or main purpose". Secondly, while the avoidance of tax may involve some artificiality, that is not a set criterion of the South African GAAR unless one considers the second requirement purpose test as a test for artificiality. Thirdly, legal artificiality (a simulated transaction) may already be removed by a court using the common law doctrines. Fourthly, while the South African courts have moved from a literal to a more purposive interpretation, it cannot necessarily be said that the remedy (adjustments) that the Commissioner will impose would be purely to achieve the economic substance. As Prebble et al. state:

> An income tax law necessarily levies tax on the results of legal transactions rather than their underlying economic effect. It is not legally possible to tax economic profits, the target of the income tax, directly. Instead, a legal description of the economic profits is the subject of the tax, but the legal description is never anything more than a simulacrum of the profits. There is always a gap between the legal description of a set of transactions and the underlying economic reality.[17]

The remedy therefore finds its basis in the legislative purpose as found in the language used and the context of the legislation (i.e. an aim of the purposive approach is to prevent an overly literal interpretation of the words of the legislation).[18]

Finally, it appears from the recommendation that the entire arrangement would be overturned in terms of the EC Recommendation, whereas the remedy of the South African Commissioner may be with reference to the entire arrangement or any part or parts thereof.

Testing the above GAAR against the five elements identified by the general reporter with respect to the EU/EEA concept of abuse, it can be seen that

17. Z. Prebble and J. Prebble, *Comparing the General Anti-Avoidance Rule of Income Tax Law with the Civil Law Doctrine of Abuse of Law*, 62 Bulletin for International Taxation 4 (April 2008), Journals IBFD, at pp. 151-168.
18. C. Cilliers, *Silke on International Tax: Anti-Avoidance 46.3* (A.P. de Koker ed., LexisNexis 2010).

the main objective test (being the accrual of a tax advantage the grant of which is contrary to the purpose of the legal provision) is not an essential element in the South African GAAR. Rather, the test that the objective of the arrangement is contrary to the legislative intent is merely a subsidiary element in the lack of commercial substance and misuse or abuse of the legal provision tests.

The second key element is present as a critical component of the South Africa GAAR, being that the obtaining of the tax advantage is the main aim of the arrangement.

A business purpose test or economic activity test does exist within the second requirement options for the South African GAAR. Critically, the lack of commercial substance test considers arrangements containing round-trip financing, or accommodating or tax-indifferent parties as indicative of a lack of commercial substance (essentially a form of economic activity test).

The subjective element, consisting of the intention to obtain a tax advantage, is present to an extent in the South African GAAR in that should an arrangement generate a tax advantage, there is a legislative presumption that the sole or main purpose was to obtain this advantage, unless “the party obtaining a tax benefit proves that, reasonably considered in the light of the relevant facts and circumstances, obtaining a tax benefit was not the sole or main purposes of the avoidance arrangement”.

The principle of proportionality is not explicitly stated in the South African GAAR; however, the general principle can be said to be drawn from the Constitution of the Republic of South Africa, 1996, and the supporting legislation of the Promotion of Administrative Justice Act, 3 of 2002. This is perhaps an element that deserves further clarity in the development of the South African GAAR.

It can therefore be concluded that, while one of the aims of the South African GAAR would be to prevent abuse of domestic law, it is certainly not its sole aim.

The tax cases on tax avoidance consider the former GAAR. However, it remains instructive to consider these cases.

It is recognized that South African courts have adopted the Duke of Westminster principle with respect to tax planning/avoidance, in that a taxpayer is free to minimize tax as much as the law allows. The principle

is, of course, tempered with a purposive interpretation and the common law in maxims such as *plus valet quod agitur quam quod simulate concipitur* and *fraudem legis*. The common law rules do have limitations, but even where transactions may pass the common law tests, they may still fail the GAAR requirements. All of the above mechanisms, however, do result in the transaction being recharacterized by the courts to reflect the economic reality as the legislation does not contain such a concept. The case of *Commissioner for Inland Revenue v. Conhage* (*Pty*) *Ltd* (*formerly Tycon* (*Pty*) *Ltd*) (606/97) [1999] ZASCA 64 (17 September 1999) clearly illustrates this impact. In this case, Conhage had entered into a sale and leaseback arrangement with respect to certain assets in an attempt to raise finance, i.e. chose a sale and leaseback arrangement rather than borrowing from a bank. This structure led to tax advantages (deductions) greater than that which would have been achieved through direct borrowing. As the parties followed and demonstrated the intent to properly achieve the sale and leaseback, no simulation existed and the legal substance did not differ from the legal form. Simulation should not, however, automatically be considered dishonest.

> South African law recognises that effect will be given to the legal consequences which the parties involved actually intended to create, even if they harboured the bona fide but mistaken belief that they concluded a transaction of a particular type or nature under which different legal consequences would follow.[19]

24.2.3. South Africa's GAAR compared to the Anti-Tax Avoidance Draft Directive[20]

When examining Article 7 of the proposed directive next to the South African GAAR, it is evident that the intended application may be different. The draft directive requires adjustment to the corporate tax liability through the mechanism of ignoring those tax provisions that made the "tax advantage that defeats the object or purpose of the otherwise applicable tax provisions" possible. Once impermissible tax avoidance is identified (as detailed in section 24.2.1.) for the South African GAAR, the Commissioner is provided with a range of options to mitigate against the tax benefit generated.

19. C. Cilliers, *Silke on International Tax: Anti-Avoidance 46.7* (A.P. de Koker ed., LexisNexis 2010).
20. Proposal for Council Directive 2016/0011 (CNS) of 28 January 2016 on laying down rules against tax avoidance practices that directly affect the functioning of the internal market. Available at: http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52016PC0026&from=EN (accessed on 21 June 2016).

The Income Tax Act provides that the Commissioner *may* determine the tax consequences by:

(a) disregarding, combining, or re-characterising any steps in or parts of the impermissible avoidance arrangement;
(b) disregarding any accommodating or tax-indifferent party or treating any accommodating or tax-indifferent party and any other party as one and the same person;
(c) deeming persons who are connected persons in relation to each other to be one and the same person for purposes of determining the tax treatment of any amount;
(d) reallocating any gross income, receipt or accrual of a capital nature, expenditure or rebate amongst the parties;
(e) re-characterising any gross income, receipt or accrual of a capital nature or expenditure; or
(f) treating the impermissible avoidance arrangement as if it had not been entered into or carried out, or in such other manner as in the circumstances of the case the Commissioner deems appropriate for the prevention or diminution of the relevant tax benefit.[21]

In addition, the Courts also have access to the common law maxims such as *plus valet quod agitur quam quod simulate concipitur* and *fraudem legis* (as detailed in section 24.2.2.). However, the substance over form tests have generally been limited to legal substance rather than economic substance. In this regard, there may be a difference between the draft directive outcome and the South African GAAR outcome. In general, the draft directive appears to be guided by economic substance.

24.2.4. South Africa's SAARs and the EU Anti-Tax Avoidance Draft Directive

South Africa would not be bound by the EU directive and so would not have to make any changes to its domestic law SAARs. A brief review of the SAARs under scrutiny in the draft directive:

(a) Interest limitation rule: The South African "limitation of interest deductions in respect of debts owed to persons not subject to tax"[22] in terms of the determination of "normal tax" has elements similar to the draft directive, but the determination of the limit is constructed differently.

21. Sec. 80B of the Income Tax Act, 58 of 1962
22. Sec. 23M of the Income Tax Act, 58 of 1962

(b) Exit taxation: The exit taxation in the draft directive focuses on the transfer of assets between Member States and Member States and third countries. While such a rule (and the inclusion of permanent establishment asset transfers) is within the scope of the capital gains tax provisions in the Income Tax Act, the notable difference to the draft directive is the possibility to defer payment for transfers within the European Union and with countries party to the EEA Agreement. No similar regional rule exists for South Africa. In addition, temporary transfers are equally not contemplated.

(c) Switch-over clauses: South Africa does not yet have switch-over clauses.

(d) Controlled foreign company (CFC) legislation: The CFC legislation in South Africa is restrictive and possibly more aggressive than that proposed by the draft directive.

(e) Hybrid mismatches: While South Africa has legislated provisions for hybrid instruments, hybrid entity mismatches are not fully resolved.

All of the above issues are development areas within the South African legislation, so changes may also be made in the near future.

24.3. TP rules, GAARs, SAARs and linking rules

South African fiscal legislation contains a number of specific provisions aimed at preventing certain avoidance behaviours, including transfer pricing, CFC and other SAARs. Within the treaty network, a few of the South African treaties have limitation on benefits (LOB) provisions. These measures are reviewed in turn below.

24.3.1. Transfer pricing

While legislative measures preventing the abuse of transfer pricing have been included for some time, it is interesting that no matter on transfer pricing has been decided by the courts. It would seem that disputes arising from transfer pricing are settled by the Revenue Authority instead.

The transfer pricing legislation was modernized in 2010 to better align with OECD transfer pricing guidelines and concepts as reflected in tax

treaties. Specifically, it was stated that: "The new transfer pricing rules are closely aligned with the wording of the OECD and UN Model Tax Conventions and are in line with tax treaties and other international tax principles. Accordingly, South Africa will continue to follow the OECD Transfer Pricing Guidelines closely both with respect to transfer pricing in general and the power to recharacterise transactions in the application of the transfer pricing rules".[23] Further amendments were made in 2011 with an effective date of 1 April 2012. To date, no guidance as to the application of the transfer pricing legislation has been issued by the revenue authority.

The "Large Business Centre" within SARS has within its ambit a focus on transfer pricing. Transfer pricing risk is carefully considered by SARS. It is specifically stated on the revenue authority's website that:

> Transfer pricing is also a key focus area for SARS. It can lead to the erosion of the South African tax-base through South African businesses transacting with their foreign connected parties on a "non-arm's length" basis. The purpose of the project is to improve our current approach to identifying and dealing with transfer pricing risks. As foreign investment and global trade is imperative to grow the South African economy, we are also considering the implementation of Advance Pricing Arrangements (APAs) in the near future. When the APA program is implemented, taxpayers will be able to engage SARS prior to entering into transactions with foreign connected parties to agree their pricing arrangements. This will provide taxpayers with certainty around the pricing of their transactions with connected persons, limiting their risk to transfer pricing adjustments and the potential of double taxation.[24]

24.3.2. Controlled foreign companies

CFC legislation in varied forms has been in place in South Africa since the transition from a source to a residence basis in 2000. Essentially, the CFC rules do not target genuine business activity offshore, where significant shareholding by South African resident taxpayers exists.

Where "participation rights"[25] are held in the majority by South African tax residents, the foreign company is considered a controlled foreign company.

23. Explanatory Memorandum on the Taxation Laws Amendment Bill (2010), at p. 76.
24. Available at the time of writing at: http://www.sars.gov.za/ClientSegments/Businesses/LBC/Pages/Risk-and-Intelligence-Function.aspx. The Large Business Centre has since been restructured.
25. "participation rights" in relation to a foreign company means—
(a) the right to participate in all or part of the benefits of the rights (other than voting rights) attaching to a share, or any interest of a similar nature, in that company; or

However, this classification does not necessarily create a tax effect for a resident taxpayer. A portion of a legislatively determined "net income" will only be included in the resident taxpayer's taxable income if the participation rights held amount to 10% or greater of total participation rights. Furthermore, a number of exclusions may then be applied, but most importantly, should the foreign taxes on income proven to be payable to a foreign government with no right of recovery equate to 75% or more of the taxes that would have been levied on the taxable income of the CFC, had the CFC been a resident taxpayer in South Africa, then no inclusion is required. Should an amount still remain to be attributed to the South African resident shareholder, then the net income may be further reduced by a number of exclusions from net income, most critically to the extent that the amount is attributable to a "foreign business establishment".[26] A number of other exclusions, reductions to net income and anti-avoidance provisions are also included in the legislation.

In the event that the "net income" of a CFC is included in the taxpayer's taxable income, the dividend received from such a CFC will be exempt to the extent that profits have been included in taxable income.

The CFC rules have been seen as a critical anti-avoidance measure.

24.3.3. Domestic SAARs

The South African Income Tax Act is littered with specific anti-avoidance measures. For ease of reference, these have been categorized into groupings.

(a) Trusts

Trusts have been used extensively for tax planning (particularly estate planning) purposes. Seen largely as an avoidance tool, it is understandable that a number of specific anti-avoidance provisions have arisen with respect to trusts.

(b) in the case where no person has any right in that foreign company as contemplated in paragraph (a) or no such rights can be determined for any person, the right to exercise any voting rights in that company.

26. This definition essentially looks to the operations in the foreign jurisdiction and how such operations function, i.e. a test for genuine business operation rather than a conduit or passive income holding structure.

The first of the category of avoidance rules are attribution rules.[27] Attribution rules, where income or capital is attributed to the beneficiary or to the founder/donor of the trust, exist. The mechanisms in place are an attempt to prevent the transfer of income and capital gain to minor children done for income and capital gain splitting purposes.[28] Furthermore, income or capital gains retained in a trust may also be attributed back to the founder/donor.[29] Finally, where a non-resident benefits in terms of a trust, the amount may be attributed back to the resident as the founding cause of such benefit.[30] In all cases, the income or capital gain must have arisen by virtue of some gratuitous element in the acquisition by the trust of the underlying asset. The courts have also ruled that the provisions cannot be circumvented by, for example, retaining the income in the trust and only distributing investment returns earned on such retained funds in later years.

Secondly, the creation of a foreign trust by a non-resident in favour of a South African beneficiary has its own anti-avoidance measures to prevent the recharacterization of income as capital.

Distribution of tax losses from trusts is equally prevented.

(b) Hybrid instruments

New rules with respect to hybrid debt and hybrid equity instruments have been introduced seeking to recharacterize the income arising from such instruments. Further avoidance rules exist for preference share arrangements of less than three years and dividends from third-party backed shares.

(c) Limitation of deductions

Deductions and allowances must be read in conjunction with a plethora of limitations and disallowances.[31]

(d) Special regimes

Special regimes for mining, insurance, micro business, public benefit organizations, recreational clubs and associations, for example, all come with SAARs peculiar to those regimes.

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27. Sec. 7 for income and paras. 68-73 of the Eighth Schedule to the Income Tax Act, 58 of 1962.
28. Sec. 7(3) of the Income Tax Act, 58 of 1962.
29. Sec. 7(5) of the Income Tax Act, 58 of 1962.
30. Sec. 7(8) of the Income Tax Act, 58 of 1962.
31. These are largely contained in secs. 23 to 23O of the Income Tax Act, 58 of 1962.

(e) Selected special rules

Rules with respect to corporate restructuring are accompanied by SAARs within each provision.

Further avoidance measures apply to the utilization of assessed losses and dividend swap arrangements.

24.3.4. Linking rules and domestic legislation with reference to BEPS

Domestic law measures of themselves do not always prevent avoidance actions. Linking with treaty provisions should be considered a critical element, particularly where the characterization of the transaction, entity or instrument may differ between contracting states. It is often insufficient where a treaty's provisions override the domestic position, if terms are not defined in the treaty. In this regard, and with reference to hybrid instruments, the OECD recommends "linking rules" "that align the tax treatment of an instrument or entity with the tax treatment in the counterparty jurisdiction but otherwise do not disturb the commercial outcomes".[32]

In this regard, South Africa has not yet gone so far as to insert provisions with links to the treaty country, but has attempted to create hybrid debt and hybrid equity rules that aim to reflect the commercial reality of the instrument rather than the legal form. The Davis Tax Committee tasked with reviewing the tax system noted in its recommendations for Action 2 that:

> The hybrid debt and interest rules require attention as they are not linked to the tax treatment in the hands of the counterparty and may themselves lead to mismatches and double taxation. A rule needs to be put in place that links the hybrid rules to the treatment in foreign counties. This would prevent tax abuse in cases where there is a denial of deduction in SA but not in other countries.[33]

32. OECD, *Neutralising the Effects of Hybrid Mismatch Arrangements, Action 2 – 2015 Final Report*, OECD/G20 Base Erosion and Profit Shifting Project (2015), OECD Publishing, Paris, available at: http://dx.doi.org/10.1787/9789264241138-en, at p. 11.
33. ZA: Davis Tax Committee, *Preventing Base Erosion and Profit Shifting in South Africa: Davis Tax Committee Interim Report*, Summary of Recommendations for South Africa: OECD September 2014 Deliverables (2014), available at: http://www.taxcom.org.za/docs/New_Folder/9%20DTC%20Interim%20BEPS%20Report%20%20Summary%20of%20Recommendations%20on%20OECD%20Sept%202014%20deliverables.pdf, at p. 12.

It further noted and recommended that:

(a) It is strongly recommended that South Africa moves away from anti-avoidance sections aimed at particular transactions and establish anti-avoidance principles which can be applied to a broad range of transactions without undue technicality; even if there is a risk that one or two transactions fall through the cracks, a principle approach to drafting legislation is significantly preferential to a transaction-by-a-transaction [sic] approach which we currently appear to have. An example explained in the main report is section 8F and 8FA which unintentionally provide a solution to the problems encountered in section 8E and 8EA. This type of unintentional tax effect only arises due to overly complex and poorly thought out tax legislation.

(b) There is need for specific double tax treaty anti-avoidance clauses.

(c) The inconsistencies between hybrid debt and hybrid equity rules should be addressed. For instance there should be alignment with respect to security for equity as is the case for debt.

(d) It is important that the rules are in line with international best practices otherwise they would result in double taxation or double non-taxation of income.[34]

One provision with respect to the limitation of interest deductions has, however, been inserted into domestic legislation with the explanation for its insertion, in part, directly linked to BEPS.[35] Essentially the deduction of interest is limited where the amount is loaned directly or indirectly to a South African resident company from a foreign entity that is in a controlling relationship with the South African resident company. The provision contains various exclusions, adjustments, interest rate caps and formulae to derive the allowable deduction. A critical feature of the provision is that it applies where the interest will not be subject to tax in the hands of the person to which it accrues.

34. Id. at pp. 14-15.
35. Sec. 23M in the Income Tax Act, 58 of 1962.

24.3.5. Preventing treaty abuse through the use of LOB provisions

South Africa has LOB provisions in a few of its tax treaties. These rules vary in form, but the purpose is generally the same, that is to prevent entitlement to treaty benefits in certain circumstances. The South African tax treaties with LOB provisions are specified below with a brief description of the LOB provision used. The countries with which the treaties specify a limitation of benefits as a separate article include: Denmark (1995), Ghana (2004), Mexico (2009), Norway (1996), Sweden (1995), Tunisia (1999), the United States (1997), and the United Kingdom (2002). But the LOB is not always included as a separate article as in the case of the treaty with Australia, which expresses limitations for and within the articles for dividends, interest and royalties.

The LOB provisions of Denmark and Sweden are identical. The protection offered refers to one of the contracting states not taxing selected activities onshore or taxing such activities as if they were offshore, results in the limitation to tax imposed by the treaty being removed for the other state. Furthermore, for dividends, should the dividend arising in the contracting state be deemed to be derived from a source outside the state and therefore not taxed, the other contracting state is freed from limitations to tax in terms of the treaty. This additional aspect of dividends in the treaties with Denmark and Sweden appears as the LOB provision in the treaty with Norway.

More general and principle rules appear in the treaties with Ghana and the United Kingdom as regards the non-taxation of incomes by one of the contracting states. The treaty with Tunisia, however, links the LOB to instances where a person has changed residence to one of the contracting states to access the treaty benefits. In such cases, a mutual agreement procedure (MAP) is used to address the exclusion of the person from the treaty.

The treaty with Mexico has a general exclusion category for a person resident in a contracting state obtaining relief from taxation in terms of the treaty unless a controlling beneficial ownership is held, either alone or in a combination of individuals resident in one of the contracting states, listed companies or the contracting state itself, its political subdivision or local authorities. Further rules are provided for the dividends, interest and royalty provisions. Key is the override of this provision, where it is shown that the principal objective was not to obtain the benefits under the treaty. The rule

further requires that the competent authorities consult before applying the rule denying relief.

Finally, the US treaty has an LOB article based on the 1996 US Model Income Tax Treaty. Some variations occur within the actual LOB provision of the South Africa-US treaty. The variations are generally to clarify the impact for selected entities, such as trusts and charitable organizations. The only variation of significance is a paragraph of exclusions from the LOB provision and the insertion of a paragraph addressing the situation of a South African company operating in the United States, but where the income earned is attributable to a permanent establishment in a third state.

24.4. Application of GAARs, TP rules and SAARs

In terms of the application and interaction of GAARs, TP rules and SAARs, there is no legislative authority indicating any hierarchy, co-ordination or overlapping measures. There is equally a lack of clarity as to whether the GAAR can be extended to treaty abuse. However, it is clarified that the GAAR may be used "in the alternative for or in addition to any other basis for raising an assessment".[36]

The GAAR has tended to be used by the revenue authority as the last option.[37] With respect to its application, the procedure was summarized as:

> The SA GAAR includes specific notice provisions. SARS is obliged to give notice of its intention to apply the GAAR and it is also obliged to set out its reasons for this. The taxpayer is then given a specified period to submit reasons why the GAAR should not be applied. Thereafter, also within a fixed period of receipt of the taxpayer's statement, SARS must request additional information in order to determine whether or not the GAAR applies, or it must give notice to the party that its GAAR notice has been withdrawn, or it must determine the tax liability.[38]
>
> If the GAAR is applied, the taxpayer can appeal the decision and the matter is dealt with by the relevant tax court. Under the Income Tax Act, the burden of proof to show that any amount is exempt from or not liable to tax is usually on the taxpayer. Under the GAAR, the onus of proving the existence of tainted elements falls on SARS.[39] However, the express provisions that would

36. Sec. 80I of the Income Tax Act, 58 of 1962.
37. This is in line with it being considered a deterrent mechanism.
38. Sec. 80J of the Income Tax Act, 58 of 1962.
39. *See Commissioner for Inland Revenue v. Conhage* (*Pty*) *Ltd* (*formerly Tyson* (*Pty*) *Ltd*) 1999 (4) SA 1149 (SCA), dealing with the previous version of the SA GAAR in sec. 103(1).

indicate lack of substance and the presumptions of purpose would assist SARS to discharge that onus. The onus of proof that tax avoidance was not the main purpose of the transaction falls on the taxpayer.[40]

40. L. Fichardt, *supra* n. 2, at sec. I.I.

Chapter 25

Spain

Jorge Martín López and Elizabeth Gil García

25.1. The meaning of avoidance and aggressive tax planning and the BEPS initiative

25.1.1. The meaning of tax avoidance in national legal systems

There is no legal or regulatory definition of tax avoidance in the Spanish legal system. Nevertheless, a concept may be drawn from the different (general or specific) anti-avoidance provisions established in our legal system. Primarily, Art. 15 of the General Tax Act (GTA) contains a domestic general anti-avoidance rule (GAAR). This provision counteracts abusive tax advantages – such as no tax or lower tax – that taxpayers achieve through wholly artificial arrangements and without having relevant economic or legal effects, different from legitimate tax saving. Secondly, other weapons, of a general nature, in the fight against tax avoidance are contained in Art. 13 ("taxation of the real transaction" rule) and Art. 16 (anti-sham rule) of the GTA. On the one hand, Art. 13 allows the Tax Administration (*Agencia Tributaria* – AT) to reassess legal transactions as well as to require the fulfilment of tax obligations based on its real nature, regardless of its form or name. On the other hand, Art. 16 states that, in the case of sham acts or transactions, the tax event subject to tax will be the one actually made by the parties. Finally, some SAARs that fix a link between tax avoidance and a lack of valid economic reasons, i.e. the deductibility on financial expenses ("intragroup"), restructuring operations, exemption for dividends or PE income derived from tax havens.[1]

1. According to Soler Roch, at the Spanish level, the current GTA contains not only one general anti-avoidance rule, but also two others. Nevertheless, only the provision of Art. 15 of the GTA regulates correctly the *fraus legis*, strictly speaking. On the other hand, with regard to SAARs, that author affirms that the majority of specific clauses are based on the absence of valid economic or corporate reasons different from the tax saving (M.T. Soler Roch, *Las normas antiabuso generales y especiales*, VII Jornada Metodológica de Derecho Financiero y Tributario Jaime García Añoveros, Instituto de Estudios Fiscales, No. 12 (2011), pp. 177 et seq.).

Concerning the impact of tax rulings on tax avoidance, the Spanish legal system provides some legal forms. On the one hand, Arts. 88 and 89 of the GTA allow taxpayers to request tax rulings from the AT about the application of tax law in regard to regime, classification or tax category. Hence, tax rulings are a taxpayer's instrument to be provided by the AT with the necessary assistance and information to fulfil their tax obligations. The General Tax Directorate (*Dirección General de Tributos* – DGT) must issue the tax ruling in six months, having a binding effect for those bodies in charge of tax application, provided that no changes are made in the legislation or in the case law.

Consequently, the tax ruling is not an agreement between the AT and a taxpayer, being published on the "open access" database of the DGT. Although the purpose of tax rulings is to provide legal certainty to taxpayers, they may have, to some extent, an impact on avoidance. For instance, Art. 76 and those following it in the Corporate Income Tax Act (CITA) establish the regime for restructuring operations. That regime will not be applied when the main objective of the operation is tax avoidance. That is, with the sole purpose of obtaining a tax advantage. As a result, in order to be eligible for such a regime, it is necessary to determine the existence of a valid economic reason under that restructuring operation (Art. 89.2 of the CITA). Taxpayers can make a request to the DGT to obtain clarity and legal certainty about the application of tax law regarding that operation. The tax ruling issued by the DGT can have a deterring effect in case the response is negative, because of the consideration of any valid economic reason for carrying out such an operation. However, in the case of a positive answer, following that ruling, the taxpayer will not be subject to any penalty according to Art. 179 of the GTA. This extends to other taxpayers, because all tax rulings are binding not only for the requester, but also for other taxpayers in the same factual situation.

On the other hand, advance pricing agreements (APAs), established in Art. 90 of the GTA, allow the taxpayer to make a written request to the AT – where the specific regulation provides that[2] – in order to obtain ex ante (and in a binding way) the assessment about the income, products, goods, expenses and other elements of the tax debt. In this case, APAs are especially relevant for related-party transactions and transfer pricing rules, expressly stated in Art. 18.9 of the CITA. There is no doubt that transfer pricing rules are typically associated with a high risk of tax litigation. Thus, an APA

2. For instance, the Spanish IP box regime, regulated in Art. 23 of the CITA, allows the option to request an APA related to income earned in the asset assignment and expenses generated by it.

can provide ex ante certainty about them. Thereby, corporate taxpayers shall request the AT to assess ex ante the transactions between related parties, grounding the request on the arm's length principle. That APA will be applicable for the tax periods expressly mentioned in the agreement with a maximum of four tax periods after the approval date, being possible to amend it in case of a variation in the economic circumstances. It is also possible for agreements between the AT and other administrations to determine jointly the market value of such transactions.

On another level, bilateral agreements between the AT and a corporate taxpayer can be performed under the Best Tax Practices Code.[3] That is, the possibility of voluntary disclosures under bilateral agreements in the framework of the Code. The Code was set out in July 2010 and contains recommendations voluntarily followed by the AT and large companies to improve the application of the Spanish tax system with more legal certainty, reciprocal cooperation, good faith and legitimate trust.

At the case law level, the Supreme Court has tried to draw a general concept of tax avoidance. For instance, in its Judgment of 30 May of 2011, the Supreme Court draws a distinction between three dogmatic categories to obtain the desired result, that is, a tax advantage:

> [T]ax avoidance, which does not infringe the tax law but avoids its application; tax evasion, which infringes directly the law; and, the non-aggressive tax planning ("*economía de opción*"), which means legally choose the low tax burden option, among various possibilities. In tax avoidance, in contrast with what happens in the non-aggressive tax planning ("*economía de opción*"), despite the use of valid acts or legal transactions not covered by the tax event, the tax system wants to keep the taxation (…). In our legal system, the fight against tax avoidance, as an indirect infringement of the tax legislation, is constitutionally based on the "solidarity of all to the support of public expenditures" or on the "fair distribution of the tax burden" (Judgment of the Supreme Court No. 76 of 26 April 1990) and, specially, on the ability to pay principle as assumption of the duty to contribute and on the requirement of a fair tax system, grounded on equality and generality principles (Article 31 of the Spanish Constitution).

This line of interpretation is supported by the Judgment of the Constitutional Court No. 46 of 17 February 2000, where the need to counteract elusive

3. In November 2015, an annex to the Code was approved that contains 11 compliance indicators to improve transparency and legal certainty. Among other aspects, the Annex deals with the compliance with the OECD BEPS Guidelines. Moreover, in December 2016, a Tax Transparency Report has been proposed with the purpose to strengthen good practices among entities following the Code.

potential actions at the expense of the solidarity of all to the support of public expenditures is expressly recognized.

This delimitation of tax avoidance can be found in successive judgments of the Supreme Court.[4] Accordingly, the Judgment of the Supreme Court of 18 June 2015 affirms that tax avoidance represents the boundary of the non-aggressive tax planning ("*economía de opción*"), regardless of its form as an indirect transaction, *fraus legis* or sham transaction. The Supreme Court case law seems to identify within the concept of tax avoidance the following three categories: (i) the indirect transaction, defined as an actual transaction that has the agreement of the parties involved, but it is aimed at obtaining effects not in compliance with the original purpose of the transaction; (ii) *fraus legis*, that is, when an actual and valid legal transaction, covered by a provision with a different nature, leads to a reduction of the tax burden. So, it is in compliance with the provision but not with its purpose; and, (iii) the sham that implies a legal reality as a pretence to conceal a different legal reality or even the absence of acts or transactions.[5]

Nevertheless, the Supreme Court recognizes that this theoretical subdivision of tax avoidance is problematic in practice,[6] because the scope of delimitation of anti-avoidance provisions regulated in Arts. 13, 15 and 16 of the GTA usually leads to confusion: the classification power, the declaration of abuse – similar legal form, to some extent, to *fraus legis* – and sham transactions.[7] Hence, some court decisions affirm that sham transactions and cases of *fraus legis* are subcategories of the general category of abnormal legal transactions[8] and even that indirect transactions and cases of relative sham transactions are means for *fraus legis*.[9] As a result, some confusion

4. *See* judgments SP: Supreme Court, 19 Apr. 2012; SP: Supreme Court, 17 Mar. 2014; SP: Supreme Court, 30 May 2014; SP: Supreme Court, 18 June 2015, among others.
5. SP: Supreme Court, 30 May 2011.
6. This difficulty is expressly recognized in judgments of the SP: Supreme Court, 30 May 2011; SP: Supreme Court, 28 Mar. 2012; or SP: Supreme Court, 27 Mar. 2014, among many others.
7. The scientific doctrine has also partaken in the judicial confusion about the application of the different anti-avoidance clauses and, in particular, regarding the conflictive delimitation between the sham and the *fraus legis*. *See*, among others, M.T. Soler Roch, *El fraude a la ley tributaria en la jurisprudencia española y europea,* Estudios de Derecho Judicial, No. 156 (2009), p. 396; C. Palao Taboada, *La aplicación de las normas tributarias y la elusión fiscal*, Lex Nova (2009), p. 209; G. Marín Benítez, *¿Es lícita la planificación fiscal? Sobre los defectos de neutralidad y consistencia del ordenamiento tributario*, Lex Nova-Thomson Reuters (2013), p. 233; and A. Delgado Pacheco, *Las normas antielusión en la jurisprudencia tributaria española*, Thomson-Aranzadi (2004), p. 111.
8. The judgments SP: Supreme Court, 27 May 2008; SP: Supreme Court, 15 July 2008; and SP: Supreme Court, 1 Oct. 2009.
9. SP: Supreme Court, 30 May 2011.

arises when delimiting these legal forms and when using anti-avoidance provisions. Recently, the Supreme Court has stated that the GAAR of Art. 15 of the GTA covers cases of *fraus legis* and so-called indirect transactions. The High Court insists on it being distinct from the sham provision of Art. 16 of the GTA.[10] However, the delimitation among such categories is far from clear, due to the tendency to extend the legal form of sham transactions, instead of *fraus legis*, based on the assimilation between the purpose of the transaction and the presence of a mere tax purpose.[11]

The mentioned vagueness is also due to the Constitutional Court case law, particularly regarding the distinction between *fraus legis* and a sham transaction. Initially, the Constitutional Court, in its Judgment No. 120 of 20 May 2005, considered that the lack of concealment and direct infringement of the tax system is inherent to *fraus legis*, being not punishable and different from a sham transaction. Concretely:

> [I]n the avoidance or fraud (in general) there is not a factual concealment, only the use of a more favourable legal environment ("the coverage provision") established for a different aim with the purpose of avoiding the application of a less favourable legal environment ("the main provision"). In regard of the *fraus legis* in the tax field, this legal detour implies a reduction of the tax burden. Thus, there is not sham or distortion of the tax base, but a transparent action even if considered as stratagem; and, neither a direct infringement of the legal system. For that reason, the consequence stated in Article 6.4 of the Civil Code for *fraus legis* cases is the application of "the main provision"; that is, to normalise the legal situation.

However, that initial position was reconsidered in its Judgment No. 129 of 27 October 2008. Accordingly, performing a legal transaction with the sole purpose of tax avoidance means, to some extent, a trick and thus a sham transaction. In such a case, fraudulent behaviour may "imply the use of legal forms apart from their intended objective and generating the avoidance of taxes payment".

In regard to the administrative approach, the Central Economic Administrative Court does not create a real concept of tax avoidance, but there are some references in its case law. For instance, its Judgment of 5 September 2009 affirms that "it is not possible to speak about non-aggressive tax planning ("*economía de opción*") when the aim desired is the tax avoidance through unnecessary legal forms with the only purpose to harm

10. SP: Supreme Court, 17 Mar. 2014.

11. M.T. Soler Roch, *supra* n. 1, at sec. I.I., pp. 179-180; and A. Delgado Pacheco, *supra* n. 7, at sec. I.I., p. 116.

the Public Finance"; or, its Judgment of 8 October 2010 that connects tax avoidance with the artificial creation of legal structures without an actual content estate. Moreover, it is also seen an unclear delimitation among the different elusive categories and the anti-avoidance provisions regulated in the GTA by Central Economic Administrative Court case law. In fact, the abnormal legal transaction is tacitly assimilated to *fraus legis* and a sham transaction – including the consequences at the penalty level[12] – and even it is admitted the use of the classification power for correcting cases of *fraus legis*.[13]

On the other hand, the influence of comparative law, European law and international law is relevant for the legal delimitation of tax avoidance derived from (general and specific) anti-abuse clauses stated in the Spanish legal system. In regard to GAARs, the substance-over-form principle is the common cornerstone of its legal form,[14] but different doctrinal influences can be appreciated among them. For instance, Art. 15 of the GTA is composed of the business purpose test and the concept of a valid economic reason,[15] when it requires, *a sensu contrario*, that the legal transaction should produce legally or economically relevant effects, different from mere tax saving. Additionally, the thesis of the misuse of legal forms or artificial arrangements[16] as well as the step transaction theory[17] are also present. This is because transactions, individually or in conjunction, are wholly artificial to obtain the result. In contrast, Art. 16 of the GTA is related to the category of the sham,[18] considered transactions that pretend unreal or not genuine legal situations. Moreover, a high number of Spanish SAARs are grounded on the valid economic reason theory, as it happens at the corporate tax level (Arts. 8.1, 21.9, 22.7, 89.2 and 100.16 of the CITA) and at the non-resident income tax level (Art. 14.1 h) and m) of the Non-Resident Income Tax Act (NRITA)).[19]

12. Judgments SP: Central Economic Administrative Court, 11 Jan. 2008; and SP: Central Economic Administrative Court, 30 Apr. 2009, among others.
13. SP: Central Economic Administrative Court, 24 Nov. 2009.
14. C. Palao Taboada, *supra* n. 7, at sec. I.I., pp. 176-177.
15. A. Delgado Pacheco, *supra* n. 7, at sec. I.I., pp. 34 & 42; and V. Ruiz Almendral & G. Seitz, *El fraude a la ley tributaria (análisis de la norma española con ayuda de la experiencia alemana)*, Revista de Contabilidad y Tributación, No. 53 (2004), p. 42.
16. G. Marín Benítez, *supra* n. 7, at sec. I.I., p. 330.
17. A. Delgado Pacheco, *supra* n. 7, at sec. I.I., pp. 24 & 42.
18. C. García Novoa, *La cláusula antiabusiva en la nueva Ley General Tributaria*, Marcial Pons (2004), p. 337; and G. Marín Benítez, *supra* n. 7, at sec. I.I., p. 304.
19. M.T. Soler Roch, *supra* n. 1, at sec. I.I., pp. 180-181.

Further still, the last High Court case law has referred not only to the OECD BEPS Project, but also to the Recommendation of the European Commission about aggressive tax planning in its fight against tax avoidance in the field of the deductibility of financial expenditures in loan transactions between associated companies. In such a way, two Judgments of the Supreme Court of 9 February 2015 expressly point out the need for a legal reaction against abusive practices addressed, through intragroup transactions, to erode the tax bases and shift the profits to low-tax jurisdictions, without any economic or corporate justification.

Once Final Reports of the BEPS Action Plan were published in October 2015, the post-BEPS era started, that is, the time to implementation by Member States. The Spanish system had implemented anti-BEPS measures since the very beginning (and even before final results were released). Thus, a specific impact on the meaning of avoidance has already taken place in our legal system. Generally speaking, the amendments made are mainly limited to the corporate tax level.[20] For instance, the rules on the limitation on deduction of financial expenses have been strengthened. In addition, the rules on hybrid instruments have introduced specific measures to protect our domestic tax base. As a result, rules are applied unilaterally for avoiding not only double taxation, but also double non-taxation.

Regarding transfer pricing documentation, BEPS has had a strong influence on the Corporate Income Tax Regulation (CITR).[21] Actually, its Explanatory Memorandum expressly refers to the BEPS Action Plan in the context of related parties. In particular, BEPS Action 13 has influenced the introduction of the country-by-country reporting (CbCR). The Spanish legal system has been ground-breaking in introducing such an amendment.[22] Accordingly, information will be requested on income, taxation and employees, among others, at the level of each country. This information will be requested just at the CIT level. The CbCR will be provided annually by the parent company; otherwise, it will be required from the Spanish subsidiary. Currently, there will be no penalty if this obligation is not fulfilled. This sensitive information cannot be used for transfer pricing regulation, thus it will be monitored what kind of information will be exchanged and in terms of which countries.

20. F. Serrano Antón, *La influencia del Plan de Acción BEPS en la tributación española: impacto en la normativa, incremento de la litigiosidad y el papel de los tribunales*, Revista de Contabilidad y Tributación, No. 391 (2015), pp. 96-104.
21. Approved by Royal Decree No. 634, 10 July 2015.
22. According to the Explanatory Memorandum, the introduction of the CbCR in the CITR is covered by the Tenth Final Provision of the CITA and Art. 93 of the GTA.

Secondly, the General State Budget for 2016 (Act No. 48, 29 October 2015) amended the patent box regime to be in line with the agreements adopted within the European Union and the OECD.[23] In such a way, income generated by intellectual property (IP) benefits from a reduction in the tax base that is calculated applying the percentage resulting from the following formula: 60% x (qualifying research, development and innovation (R&D (&I)) expenditures, increased in a 30% / overall R&D (&I) expenditures). According to BEPS Action 5,[24] when calculating qualifying expenditures, taxpayers may apply up to a 30% "up-lift" to expenditures that are included in qualifying expenditures. As a result, the Spanish formula is addressed to benefit taxpayers that undertake R&D (&I) activities themselves.[25] This amendment has taken full effect since 1 July 2016. Additionally, the Act includes a grand-fathering clause. The former scheme can be applied until June 2021. As a result, the Spanish patent box is compliant with international standards, and is even more restrictive than the OECD's nexus approach, because it limits the IP scope and the ratio. It does, however, raise the question as to whether or not this is the best regime for Spanish companies in terms of competitiveness.

Moreover, the new Art. 21 of the CITA introduces an exemption for dividends and capital gains to avoid double taxation. The purpose of this provision is to be more competitive and to dismantle planning structures. The "controlled foreign company regime" (Art. 100 of the CITA) supplements the above-mentioned article with the aim to avoid that the exemption is applied to certain income. Indeed, the exemption does not apply when at least 15% of the entity income is subject to CFC legislation (Art. 21.5 (c) of the CITA). It is commonly held that CFC rules prevent tax avoidance via CFCs located in low-tax jurisdictions. However, according to BEPS

23. In this context, it should be noted that, in Spain, together with the common system of the corporate income tax, there are certain regions, i.e. Guipúzcoa, Biscay, Alava and Navarre, with their own regional "*fueros*" (laws). That is, these regions have their own corporate income tax, and then they grant their own IP box regime. Currently, these schemes do not apply to the formula based on the nexus approach and they are, in general terms, more favourable than the national regime. However, as the Report of the Code of Conduct Group (doc. 9912/16, 13 June 2016) said, Navarre has already started the work to amend its patent box regime.

24. OECD, *Countering Harmful Tax Practices More Effectively, Taking into Account Transparency and Substance*, Action 5: Final Report (Oct. 2015), pp. 24 et seq.

25. For example, if qualifying expenditures are equal to 100 and overall expenditures are 150: 60% x 130/150 = 52%. On the other hand, if qualifying expenditures are equal to 40 and overall expenditures are 150: 60% x 52/150 = 20.8%. As we can see, the percentage of the tax base reduction is clearly higher when the amount of qualifying R&D (&I) expenditures is considerably higher.

Action 3,[26] not all CFC income should be attributed under CFC rules, that is, income that arises from economic and value creating activities. In this vein, Art. 100.2 of the CITA establishes that the taxpayer will include in the tax base the total income from the CFC, unless the entity has the employees and facilities for earning the actual income.

Another point related to the amendments of the CFC legislation is the extension of such regime to the benefits generated by the IP exploitation (Art. 100.3 (d) of the CITA). Hence, IP income generated by a Spanish subsidiary located in a low tax jurisdiction will be taxed in our country. Curiously, the IP income generated by a company located in Spain will benefit from the patent box regime (Art. 23 of the CITA), but the IP income generated by a Spanish company under a preferential tax treatment abroad will be penalized in terms of its inclusion in the CFC regime. This provision is addressed to attract R&D (&I) centres to our jurisdiction.[27]

25.1.2. The meaning of tax planning, abusive tax planning and aggressive tax planning in national legal systems

As in the case of tax avoidance, there is no legal or regulatory definition of tax planning or abusive or aggressive tax planning. Generally speaking, tax planning, even if considered aggressive, is not illegal. However, the line between legal tax planning and abusive or aggressive tax planning can be inferred from the GAAR stated in Art. 15 of the GTA, as well as from other anti-avoidance clauses provided in our legal system. With regard to the impact of tax rulings on the meaning of tax planning (or aggressive tax planning), we refer to the same considerations made in the case of tax avoidance.

Furthermore, the Supreme Court case law has also shed some light on the delimitation of the concept of tax planning, so-called legitimate tax planning ("*economía de opción*")[28] in the field of taxation. In fact, the Judgment of

26. OECD, *Designing Effective Controlled Foreign Company Rules*, Action 3: Final Report (Oct. 2015), pp. 47 et seq.

27. F. Serrano Antón, *supra* n. 20, at sec. I.I., p. 104. Despite such provision, it should be highlighted that according to BEPS Action 3, in case of IP income, the compliance with a nexus-IP regime should be taken into account. Therefore, if a Spanish company has a controlled party in a jurisdiction granting a nexus-compliant IP regime, the IP income derived from the CFC should not be attributed, unless such income does not qualify for the regime.

28. The Spanish expression used for legitimate (or non-aggressive) tax planning by the Courts is "*economía de opción*". Thus, the Spanish case law uses the expression "*economía de opción*" instead of tax planning.

30 May 2011 tries to clarify the scope of the legitimate tax planning and the differences with tax avoidance: "The 'legitimate tax planning' has different contents. Firstly, the classic notion of 'different valid options offered by the legal system', allowing the taxpayer the possibility to choose the less onerous option without its consideration as elusive or abusive. Secondly, the so-called 'fiscal options' that imply a taxpayer's right in order to choose freely the option applicable to the legal status. Finally, when the options appear implicitly within the provision".

In this vein, the Supreme Court connects legitimate tax planning – and hence, the validity of the tax planning – with the existence of a valid economic reason:

> In the legitimate tax planning, the taxpayer chooses legally among different options not only according to its lower-tax burden but also based on the existence of a legal or economic relevant effect. Under no circumstances, the "legitimate tax planning" can be understood as a taxpayer's faculty to perform transactions "without valid economic reasons" and with the only purpose to obtain a tax advantage. The legitimate tax planning ends when the tax avoidance begins. Thus, it is required that the freedom of transaction definition does not imply the distortion of the correct and normal application of the tax rules (…) The "valid economic reason" is the test to appreciate the legitimate tax planning, and its absence may imply the existence of an abusive or elusive practice targeted to obtain a tax advantage not established in the tax legislation.[29]

In sum, the Supreme Court case law comes to the conclusion that legitimate tax planning allows tax saving without being contrary to the legal system or to the law aim. Thus, the tax legislation provides different options to the taxpayer from which to choose the one with the lowest tax charge and without the need to use artificial or abusive arrangements: the legitimate tax planning presupposes the existence of various legal options, choosing the one less onerous.[30] Nevertheless, the Court expressly recognizes, in its Judgment of 1 October 2009, that the main issue arises when tax planning is based on the use of legal gaps for an attempted reduction of the tax burden: "Certainly complex transactions of the so-called 'fiscal engineering' make difficult to distinguish 'valid' legal transactions, qualified as 'legitimate tax planning', from 'abnormal' legal transactions or with tax elusive element".[31]

It is important to highlight that the latest Supreme Court case law about tax planning and tax avoidance has already been influenced by the international

29. Similarly, *see* SP: Supreme Court, 9 Feb. 2015.
30. SP: Supreme Court, 14 Mar. 2005; and SP: Supreme Court, 18 June 2015.
31. Similarly, SP: Supreme Court, 20 Sep. 2012.

and European soft law. Indeed, it is expressly recognized that some abusive practices, such as financial intragroup transactions without a valid economic reason, are at the heart of the OECD and the European Union's concerns. Thus, it has been stated its legal inadmissibility based on the European case law on abuse of rights.[32]

Within the framework of the administrative approach, some resolutions of the Central Economic Administrative Court, i.e. the Judgment of 25 June 2009, expressly mention international tax planning. In particular, it is pointed out that legitimate tax planning becomes an abuse of rights when an aggressive scheme aims to obtain a tax advantage and there is no valid economic reason for such an operation. As a result, tax planning will not be considered legitimate under two conditions: firstly, if there are no legal or economic effects, different from mere tax saving, that lead to the absence of a substantial activity; and, secondly, if it is proved to be an artificial item, that is, the use of an inappropriate legal transaction with the only purpose to avoid the consequence required by the tax system.[33] As can be seen from this reasoning, the Central Economic Administrative Court identifies abusive tax planning with the operations that fall within the scope of the GAAR established in Art. 15 of the GTA. Nevertheless, there is a lack, within the administrative practice, of a clear system in the application of that anti-avoidance provision. It can even be said that there is a shifting from Art. 15 to Art. 16 of the GTA and that there is a tendency to extend the scope of the sham to subsume certain avoidance behaviours in the sham legal transaction category.[34]

As stated in section 25.1.1., some legislative amendments have arisen from BEPS on the meaning of avoidance in our legal system. In the framework of tax planning, or abusive or aggressive tax planning, the same considerations could be made. Indeed, the BEPS Project has influenced, to a certain

32. SP: Supreme Court, 9 Feb. 2015.
33. In this sense, *see* the SP: Central Economic Administrative Court, 8 Oct. 2009.
34. SP: Central Economic Administrative Court, 11 Jan. 2008; SP: Central Economic Administrative Court, 30 Apr. 2009; and SP: Central Economic Administrative Court, 7 Apr. 2010, among others. According to Palao Taboada, "it is confused and useless the concept of 'abnormal legal transaction', because it does not have a negative connotation itself" (C. Palao Taboada, *Calificación y abuso del Derecho*, VII Jornada Metodológica de Derecho Financiero y Tributario Jaime García Añoveros, Instituto de Estudios Fiscales, No. 12 (2011), p. 191). According to Falcón y Tella, the absence of a reason under the legal transaction is not related to the sham and "it has become a hotchpotch that allows the free reassessment of transactions (…), providing with legal uncertainty" (R. Falcón y Tella, *La abstracción tributaria de la causa y sus consecuencias en la calificación de los negocios,* VII Jornada Metodológica de Derecho Financiero y Tributario Jaime García Añoveros, Instituto de Estudios Fiscales, No. 12 (2011), p. 174).

extent, the strengthening of the limitation on the deduction of financial expenses, the introduction of measures on hybrid instruments legislation, CbCR issues, the adaptation of the patent box regime to the OECD's nexus approach, and amendments to the CFC legislation.

25.2. The reaction to avoidance and aggressive tax planning in the BEPS context

25.2.1. Domestic GAARs

As mentioned in section 25.1.1., Art. 15 of the GTA contains a GAAR whose origin is in the *fraus legis* in the field of taxation of the former Art. 24 of the repealed GTA of 1963.[35] Although there are other anti-avoidance provisions in the current GTA, such as the "taxation of the real transaction" rule (Art. 13) and the anti-sham rule (Art. 16),[36] the prime example of a GAAR in the Spanish legal system is the one regulated in Art. 15 of the GTA.[37]

The factual situation covered by this provision is the total or partial avoidance of the tax event or the reduction of the tax base or tax debt through acts or transactions that are, firstly, wholly artificial to obtain the final result, individually or in conjunction; and, secondly, when there are no relevant legal or economic effects different from the tax saving or from the normal consequences derived from genuine or appropriate acts or transactions.

The application of this GAAR takes place through a specific procedure that requires a preliminary positive report delivered by the advisory commission. This commission is made up of two representatives of the DGT (one of them will act as the President) and two representatives of the acting Tax Administration. The report is binding and, in the case of the declaration of abuse, the legal consequences are, on the one hand, the payment of the tax that would result from the application of the rule to the genuine act or transaction or removing the tax advantages enjoyed; and, on the other hand, the assessment of interest on arrears.

35. SP: Supreme Court, 9 Feb. 2015.
36. M.T. Soler Roch, *supra* n. 1, at sec. I.I., p. 178.
37. According to Delgado Pacheco, a broad concept of the GAARs allows to identify such as, the rules stated in Arts. 13, 15 and 16 of the GTA, even though the *fraus legis* of Art. 15 of the GTA is considered as the typical GAAR in the Spanish legal system (A. Delgado Pacheco, *supra* n. 7, at sec. I.I., pp. 15-16).

Regarding the punishability of the abuse, with the last reform of the GTA performed in September 2015, the absolute prohibition on imposing penalties in such circumstances has been abolished. Therefore, the new Art. 206 *bis* of the GTA states that behaviours covered by Art. 15 of the GTA are punished when there is substantial equality between the case subject to tax regularization and the one that has been declared abusive according to a previous and published administrative opinion. This new provision raises doubts regarding not only the guiding principles of the power to impose penalties – such as the legality, criminality, proportionality and liability principles – but also the basic items of the tax infringement – in particular, the unlawfulness.[38]

The Spanish doctrine deems that the GAAR regulated in Art. 15 of the GTA is, in general, in line with the GAAR recommended by the EC in its Recommendation of 6 December 2012 on aggressive tax planning,[39] since it is based on the same core ideas, that is, an artificial transaction made by the taxpayer with tax saving as a consequence of this mechanism. Actually, the model proposed by the Commission in its 2012 Recommendation is grounded on the artificial arrangement, linked to the lack of commercial substance. This coincides with the CJEU case law on "wholly artificial arrangements" and the lack of economic substance.[40] Our domestic GAAR is referred to acts or transactions that are inappropriate or wholly artificial for obtaining the result. Thus, it mentions the misuse of the legal forms – not the falseness or the sham – in terms of an abnormal legal transaction or not adequate transaction for the purpose reached.[41]

38. There has been several criticisms to such a rule; *see*, among others, A. Menéndez Moreno, *La modificación parcial de la Ley General Tributaria*, Quincena Fiscal, No. 14 (2014), pp. 14-15; F. Escribano, *Sobre el Proyecto de Ley de modificación parcial de la Ley General Tributaria*, Civitas Revista Española de Derecho Financiero, No. 166 (2015), pp. 15 et seq.; and J.A. Sánchez Pedroche, *La reforma parcial de la Ley General Tributaria operada por la Ley 34/2015*, Fiscal Impuestos, CEF, pp. 14 et seq. In this sense, it should be noted the proposal made by Palao Taboada, based on the so-called "model of independence". Accordingly, "the application of the penalty is disassociated from the previous assessment of the transaction as elusive and it only depends on the taxpayer behaviour" (C. Palao Taboada, *El nuevo intento de sancionar la elusión fiscal del Anteproyecto de Ley de modificación de la Ley General Tributaria*, Civitas Revista Española de Derecho Financiero, No. 165 (2015), pp. 27 et seq.).

39. J.M. Calderón Carrero, *La estrategia europea de lucha contra el fraude y la evasión fiscal: el plan de la acción de la Comisión UE y sus principales implicaciones*, Revista de Contabilidad y Tributación, No. 363 (2013), p. 28.

40. J.J. Bayona Giménez and M.T. Soler Roch, *À propos de la recommandation de la Commission européenne relative à la planification fiscale agressive*, Revue de Droit Fiscal, No. 24 (13 June 2013), p. 19.

41. C. García Novoa, *supra* n. 18, at sec. I.I., pp. 350 et seq. According to Ferreiro Lapatza, "the improper use of a transaction according to Article 15 of the GTA of 2003

Moreover, the GAAR of Art. 15 of the GTA tries to eliminate the presence of subjective factors when establishing the factual situation. Indeed, it leaves out the elusive intention of the taxpayer and puts in objective terms the fraudulent character of the result achieved through abnormal or artificial transactions. In contrast with what happened in the former *fraus legis* of Art. 24 of the repealed GTA of 1963, where "the proved intention to evade the tax" was required, the abuse casts aside the intentional element.[42]

Equally, the compatibility between the Spanish GAAR of Art. 15 of the GTA and the European case law concept of abuse of rights in the field of taxation is noted. On the one hand, there are certain similarities in the essential aim of obtaining a tax advantage encompassed in the notion of "abusive practice" in the field of indirect taxation; or, in the "valid economic reason" theory in the scope of restructuring transactions; it being necessary, according to Art. 15 of the GTA, that the transaction leads to legally or economically relevant effects different from tax saving. On the other hand, the artificial behaviour required by Art. 15 of the GTA falls in line with the "artificial arrangement" category made by the CJEU. Nonetheless, the first addresses the inadequate legal form, while the second targets the lack of economic substance.

In respect to the application of the Spanish GAAR, two items are required. The first is the artificiality or inappropriateness of the legal transaction in connection with the result achieved. Therefore, a judgment on its adequacy will be made, as it is expressly said in Judgments of the Central Economic Administrative Court of 25 June and 8 October 2009. The second is the absence of legally or economically relevant effects. Hence, a test is needed to justify the transaction, similar to the business purpose or the valid economic reason.[43]

should not mean the absence of the typical reason for performing such transaction, because it could also be a sham case" (J.J. Ferreiro Lapatza, *El abuso en la aplicación de la norma tributaria en el Anteproyecto de Ley General Tributaria,* Quincena Fiscal, No. 11 (2003), p. 10).

42. E. Simón Acosta, *El abuso de la norma tributaria*, Actualidad Jurídica Aranzadi, No. 568 (2003), p. 3; and C. García Novoa, *supra* n. 18, at sec. I.I., p. 350.

43. C. García Novoa, *supra* n. 18, at sec. I.I., p. 390; and G. Marín Benítez, *supra* n. 7, at sec. I.I., pp. 330-331. As Palao Taboada affirms, "the doctrine of these two notes comes, respectively, from the abuse of the legal form of Paragraph 42 of the German Tax Ordinance and the 'valid economic reasons' or business purpose test of the North American case-law" (C. Palao Taboada, *supra* n. 7, at sec. I.I., p. 168).

In our opinion, the GAAR of Art. 15 of the GTA is, in general terms, in line with the provision designed by the ATAD.[44] Its aim is to neutralize an arrangement or a series of arrangements that, having been put into place for the main purpose or one of the main purposes of obtaining a tax advantage that defeats the object or purpose of the applicable tax law, are not genuine having regard to all relevant facts and circumstances. Non-genuine arrangements are defined as those that are not put into place for valid commercial reasons that reflect economic reality.[45] That means its legal form is based – as well as the Spanish scheme – on the artificiality and the lack of economic substance of the transaction carried out by the taxpayer. In this regard, it will not be necessary to amend Art. 15 of the GTA.[46]

In any case, the difficulties in the practical application of the GAAR of Art. 15 of the GTA should be highlighted – some difficulties were already present and derived from the former *fraus legis* of the GTA of 1963. In this context, it is required to go through a specific procedure, and the legal unfeasibility of imposing penalties has led to the use of other mechanisms, such as the "taxation of the real transaction" rule of Art. 13 of the GTA and the anti-sham rule of Art. 16 of the GTA, by the AT.[47] Certainly, the judicial bodies at times have corrected such an administrative tendency; however, as mentioned, in some cases assimilation between the different categories has been allowed. Most likely, the tax reform of Art. 15 of the GTA (in connection with Art. 206 *bis* of the GTA) may contribute to encouraging the use of the GAAR as well as to avoiding the use of other forms, such as the sham, which do accept the application of penalties.

44. *See* Council Directive (EU) 2016/1164 of 12 July 2016 laying down rules against tax avoidance practices that directly affect the functioning of the internal market.
45. Proposal for a Council Directive laying down rules against tax avoidance practices that directly affect the functioning of the internal market – Outcome of ECOFIN meeting, 17 June 2016.
46. According to Calderón Carrero, the GAAR proposed by the Commission is in line "with the test of artificiality/valid economic reasons developed by the ECJ, without including the concept of abuse of genuine transactions and commercial reasonability" (J.M. Calderón Carrero, *La dimensión europea del proyecto BEPS: primeros acuerdos del ECOFIN, la aprobación del mecanismo del intercambio automático de "tax rulings", y el paquete anti-elusión fiscal 2016*, Quincena Fiscal, No. 6 (2016), p. 140).
47. E.Y. Abogados: *Cláusula general antiabuso tributaria en España: propuestas para una mayor seguridad jurídica*, Fundación Impuestos y Competitividad (2015), pp. 47 et seq. In regard of the reasons of the difficulties in the application of Art. 24 of the former GTA of 1963, *see* C. Palao Taboada, *supra* n. 7, at sec. I.I., pp. 163 et seq.

25.2.2. EC Recommendation C-(2012) 8806 of 6 December 2012 and subject-to-tax rule

The EC Recommendation of 6 December 2012 on aggressive tax planning addresses the risk of double non-taxation when: (i) Member States do not tax certain items of income without taking account of whether such items are subject to tax in the other party of the DTC; or when, (ii) Member States unilaterally exempt items of foreign income, irrespective of whether they are subject to tax in the Source State. Therefore, it encourages Member States to introduce a subject-to-tax rule in their double taxation conventions.[48] However, paragraph 15 of the Commentary on Article 1 of the OECD Model (2014) does not recommend "[f]or a number of reasons", such introduction, but it "correspond[s] to the aim of tax treaties".

At the present time, 102 DTCs have been signed by Spain. Among them, 92 remain in force and the other 10 are still in working progress (Andorra, Azerbaijan, Bahrain, Belarus, Cape Verde, Qatar, Montenegro, Namibia, Peru and Syria). Additionally, some of them have been renegotiated (Austria, Belgium, Canada, the United States, Finland, India, Mexico and the United Kingdom).

In terms of royalties, DTCs signed by Spain, on the one hand, and Canada (1981, modified in 2015), Poland (1982) and Tunisia (1987), on the other, have included subject-to-tax rules. Under the formula "if royalties are subject to tax in the first Contracting State", the exemption in the Source State is conditional upon the royalties being subject to tax in the Residence State.

48. The position of the European Commission may be reinforced by the proposal of BEPS Action 6. Under the condition of defining "special tax regime", BEPS Action 6 states three new provisions for Art. 11 (interest), Art. 12 (royalties) and Art. 13 (other income): "…arising in a Contracting State and beneficially owned by a resident of the other Contracting State may be taxed in the first-mentioned Contracting State in accordance with domestic law if such resident is subject to a special tax regime…". These new provisions are more specific than the EC Recommendation, because it allows the taxation in the Source State when there is a preferential tax regime (in the Residence State of the beneficial owner) and such regime is defined in the Convention. (OECD, *Preventing the Granting of Treaty Benefits in Inappropriate Circumstances*, Action 6: Final Report (Oct. 2015), pp. 96-98). In a similar manner, the new US Model Income Tax Convention (17 Feb. 2016) denies reductions to withholding taxes under the treaty for deductible related-party payments when the beneficial owner of the payment pays little or no tax on the related income as a result of a "special tax regime".
On the other hand, initially, the ATA package (launched on 28 Jan. 2016) contained a switch-over clause, which has disappeared in the later version (ECOFIN, 17 June 2016). Since the beginning, this clause has been viewed in conflicting lights. In our opinion, this clause could lead to tax competition among Member States due to the disparities of corporate tax rates within the European Union.

Due to the date of these DTCs, this specific rule was settled by bilateral negotiations, without the influence of any EC document.

With regard to the tax treaty between Canada and Spain (1981), a Protocol for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income and on Capital was signed. Paragraph 5 of the Protocol establishes that "income derived by a resident of Spain from a trust or an estate which is a resident of Canada may be taxed in Canada; however, provided that the income is taxable in Spain, the tax so charged shall not exceed 15 per cent of the gross amount of the income". On the other hand, the renegotiated DTC between Spain and the United Kingdom (2014) has introduced a provision in Art. 23 that can be considered, to some extent, as a subject-to-tax rule. In particular, if "a Contracting State reduces the rate of tax on, or exempts from tax, an item of income, profit or gain of a resident of the other Contracting State and under the laws in force in that other Contracting State that resident in respect of that item is subject to tax in that other State only on that part of such income, profit or gain which is remitted to or received in that other State and not by reference to the full amount thereof, then the reduction or exemption shall apply only to so much of the income, profit or gain as is taxed in that other State". This same provision was contemplated in paragraph 1 of the Protocol signed together with the Spain-Ireland tax treaty (1994).

Concerning the latest DTCs signed by our country, i.e. Nigeria (2015) or Senegal (2014), no subject-to-tax rule has been introduced. Thus, the Spanish government is not following the aforementioned proposal for the time being. Additionally, some information related to the 10 DTCs that are still in working progress has been published. Among them, no subject-to-tax rule is foreseen.

25.3. Transfer pricing rules, GAARs, specific anti-avoidance rules (SAARs) and linking rules

In the Spanish tax system, transfer pricing rules are regulated, under the name of associated entities, in Art. 18 of the CITA as well as in Chapter V of the new CITR. Such tax legislation follows the arms length principle, according to which transactions performed between related parties or entities should reflect market value. It also states that in cases where there is a relationship between the parties, what the methods should be for the determination of the market value and the obligation for transfer pricing documentation, as well as the penalty system in the case of unfulfilment.

As stated in the Explanatory Memorandum of the CITA, the legislation in the field of transfer pricing addresses the effective fight against tax fraud, at the national and international level, following the line taken by the OECD in the BEPS Project. Indeed, the CITR points to the need for taking into account the conclusions of Action 13. As a novelty, CbCR has been introduced.[49] This instrument will allow the assessment of the risk of the transfer pricing policy within the corporate group, but it will not allow the AT to make transfer pricing adjustments. This information will be required as of 2016, in the terms and conditions fixed by the OECD.[50]

It should be noted the tax litigation raised by the previous transfer pricing legislation regulated in Art. 16 of the former CITA, which is the precursor of today's regulation. In such a way, the Constitutional Court ruled, in its Judgment No. 145 of 11 July 2013, an exception of unconstitutionality raised by the Supreme Court on the adequacy of the penalty system in transfer pricing issues to loyalty and proportionality principles – particularly, in the matter of infringements, on the one hand, on the non-contribution or incomplete or untrue contribution of the documentation required and, on the other hand, on the discrepancy between the declared value for tax purposes and the resultant value of that documentation. Nevertheless, the Constitutional Court understood that elements of illegal conduct of the former CITA were enough from the constitutional guarantees perspective, because the provision contained sufficiently both objective and subjective elements of the illegal behaviour and the regulation was suitably subject to specific legal guidelines.[51]

As a result of this Judgment of the Constitutional Court, the Supreme Court, instead of abolishing some regulatory provisions that restricted the possibility to request appeals in the administrative channel or certain presumptions, adopted a positive attitude, in its Judgment of 27 May 2014, regarding the tax system of the related-parties transactions. And, concretely, the shifting of the duty to establish the market value towards the taxpayer, the requirement of documentation or the system of infringements and penalties, among others.

49. CITR approved by Royal Decree No. 634, 10 July 2015.
50. F. Serrano Antón, *supra* n. 20, at sec. I.I., pp. 102 et seq.
51. T. Cordón Ezquerro, *Obligaciones de documentación y régimen sancionador en las operaciones vinculadas. De la Ley 36/2006 a la Ley 27/2014 del Impuesto sobre sociedades*, Crónica Tributaria, No. 155 (2015), pp. 74 et seq.

In any case, the high amount of tax litigation derived from transfer pricing rules should be emphasized.[52] In this sense, for instance, the recent judicial decisions on the assessment power for related-party transactions in the scope of indebtedness intragroup, performed under *fraus legis*, it can be mentioned.

Firstly, the Supreme Court gave its opinion, in its Judgment of 4 November 2013, on the declaration of *fraus legis* in regard to loan transactions between financial entities of the same group and, in particular, on the interest deduction at the tax base of the CIT. In that case, the High Court made use of the principle of *venire contra factum proprium non valet* to admit such a deduction; because the transactions were performed in past tax periods, that is, periods that were already subject to tax audit without the consideration of *fraus legis*.[53]

Afterwards, the question was raised of the declaration of abuse of related-party transactions performed in fiscal periods beyond the statute of limitations, but having effects in active periods.[54] A priori, the Supreme Court was in opposition, in its Judgment on the *H-P* case of 4 July 2014, to that possibility, grounded on the legal certainty principle. Nevertheless, the Central Economic Administrative Court, in its Judgment of 11 September 2014,

52. Even if there is not a well-established case law in the field of transfer pricing in Spain, some litigation raises from transfer pricing. For the Central Economic Administrative Court (TEAC) the mere existence of a link is not enough to affirm that the transaction between related parties is not based on market prices. The lack of sufficient justification of the TP's existence has led to resolutions in favour of the taxpayer: SP: TEAC, 14 June 1989; SP: TEAC, 3 Apr. 1991; SP: TEAC, 19 Oct. 1994; or SP: TEAC, 1 Dec. 2000, among others; SP: Spanish Audiencia Nacional, 12 Feb. 2000; and SP: Spanish Audiencia Nacional, 15 June 2000. In the opposite direction, the Supreme Court proved the TP's existence in SP: Supreme Court, 18 June 1992, as well as in the SP: TEAC, 9 Mar. 2000 (confirmed by the SP: Spanish Audiencia Nacional, 6 Feb. 2003). More recently, the SP: TEAC, 3 Oct. 2013 (Coca-cola case) stated that the right to a defence was handicapped because of the inspection action. In that case, regarding the valuation of transfer transactions in the framework of the CIT, the inspection presented the details of other companies without any explanation to the taxpayer regarding the identity, the criteria for that choice, or the product that they manufacture. The use of this kind of confidential data in a procedure of valuation makes it difficult for the applicant to mount an appropriate defence against the valuation made by the AT, in effect, leaving the taxpayer without any defence at all.

53. About this Judgment, *see* C. Palao Taboada, *Doctrina de los actos propios, comprobación de ejercicios anteriores y fraude de ley*, Revista Contabilidad y Tributación, No. 376 (2014), pp. 5 et seq.; and J.M. Herrero de Egaña y Espinosa de los Monteros, *La vinculación de la Administración Tributaria a los actos propios en su función de comprobación*, Quincena Fiscal, No. 7 (2014), pp. 109 et seq.

54. L.A. Martínez Giner, *La seguridad jurídica como límite a la potestad de comprobación de la administración tributaria: doctrina de los actos propios y prescripción del fraude de ley*, Quincena Fiscal (printing press).

admitted the tax audit of transactions performed in tax periods beyond the statute of limitations when they had effects in still existing periods, as the beginning of the deduction of financial expenses was considered *dies a quo* of the statute of limitations. Additionally, the Central Economic Administrative Court argued the absence of judicial doctrine related to that legal solution, because the *H-P* case, since it is only one judicial decision, does not constitute a line of case law. Indeed, the Supreme Court has changed its initial position and has developed well-settled case law in favour of the declaration of abuse in regard to transactions beyond the statute of limitations, but having tax effects in active periods. As the power to check and investigate can be extended to periods beyond the statute of limitations, the AT may exercise such faculties in order to assess, being able to act against fraudulent transactions.[55]

This case law is reflected in the last tax reform of the GTA. In this way, Art. 66 *bis* of the GTA and amended Art. 115 of the GTA were introduced. The first establishes that the statute of limitations will not generally apply to the power to check and investigate. The second extends the assessment powers to transactions performed in fiscal periods beyond the statute of limitations, but having effects in still existing periods.[56]

As mentioned in Sec. I, the Final Report of BEPS Action 5 has been taken into account by the Spanish legislator to amend its patent box regime. As mentioned in section 25.1.1., SAARs usually fix a link between tax avoidance and a lack of valid economic reasons.[57] This means, *a sensu contrario*, that the presence of an economic valid justification prevents the application of the SAAR. In the case of an IP box regime, the fulfilment of the nexus approach requirement implies that there is substantial and genuine economic activity behind the IP income that will apply to the preferential tax treatment. Hence, only income that arises from IP where the actual R&D (&I) activity was undertaken by the taxpayer itself will benefit from the IP box regime (excluding its considerations as a harmful preferential tax regime). Thus, the nexus approach can be seen as a specific anti-avoidance measure. In this regard, the proposal for amending the Interest & Royalties

55. SP: Supreme Court, 5 Feb. 2015 (*COTY* case); SP: Supreme Court, 26 Feb. 2015; and SP: Supreme Court, 23 Mar. 2015. Nevertheless, *see also* the interested dissenting votes made by the Judge Huelin Martínez de Velasco to SP: Supreme Court, 5 Feb. 2015; and SP: Supreme Court, 23 Mar. 2015.
56. The scientific doctrine has made relevant criticisms to the tax reform: C. Lozano Serrano, *Prescripción tributaria y facultad de comprobación*, Civitas Revista Española de Derecho Financiero, No. 165 (2015), pp. 35 et seq.; F. Escribano, *supra* n. 38, at sec. II.I., pp. 18 et seq.; and J.A. Sánchez Pedroche, *supra* n. 38, at sec. II.I., pp. 25-34.
57. *See supra* n. 1.

Directive (I&R Directive)[58] to include a MET clause could be highlighted. Accordingly, any interest and royalty payment would be exempted from taxes in the Source State when the effective tax rate resulting from the tax regime applicable to those payments in the Residence State is at least 10%.[59] The proposed clause is, in fact, a specific anti-avoidance provision, which strengthens the effective taxation of interest and royalty payments in the Residence State. The current work on the MET clause is taking into consideration the nexus-compliant IP regimes as Member States may keep the possibility to provide companies with effective tax incentives to invest in genuine R&D (&I) in the European Union. Therefore, a balance between the R&D (&I) promotion and a minimum level of effective taxation should be kept in this context. In case of the introduction of this clause, the Spanish IP box regime will be in line with such proposal as, on the one hand, it will be over the mentioned threshold (in many cases)[60] and, on the other hand, it is compliant with the nexus approach since July 2016.

Action 6 of the OECD Project identifies treaty abuse, and in particular treaty shopping, as one of the most important sources of BEPS concerns. With this in mind, the Final Report (October 2015)[61] includes new treaty anti-abuse rules that provide safeguards against the abuse of treaty provisions. In particular, it proposes a specific anti-abuse rule based on the LOB rule (as well as the PPT rule), already included in many US treaties.[62] Thus, this is the prime example of the introduction of this kind of provision in DTCs. What is more, the United States has inserted an LOB rule in nearly all of

58. Council Directive 2003/49/EC of 3 June 2003 on a common system of taxation applicable to interest and royalty payments made between associated companies of different Member States.
59. According to the EU Action Plan, it should be amended the I&R Directive so that Member States are not required to give beneficial treatment to interest and royalty payments if there is no effective taxation elsewhere in the European Union (COM (2015) 302 final: *A Fair and Efficient Corporate Tax System in the European Union: 5 Key Areas for Action*, Brussels, 17 June 2015, p. 9). As a result, the "*Working Party on tax Questions – Direct Taxation*" of 16 Feb. 2016 has considered the minimum effective tax rate should be 10%. That is, any interest and royalty payment would be exempted from taxes in the Member State where they arise when the effective tax rate resulting from the tax regime applicable to those payments in the Member State of the beneficial owner is at least 10%.
60. A case study can be seen in: E. Gil García, *Una nota sobre la propuesta de modificación de la Directiva de Intereses y Cánones*, Crónica Tributaria: Boletín de Actualidad, No. 1 (2016), pp. 21 et seq.
61. OECD, *Preventing the Granting of Treaty Benefits in Inappropriate Circumstances*, Action 6: Final Report (Oct. 2015).
62. Actually, this is the approach of paragraph 20 of the Commentary on Article 1 of the OECD Model (2014).

its treaties and is unwilling to conclude a tax treaty that does not contain an LOB clause.[63]

Concerning the Spanish tax treaty network, precisely the DTC signed by Spain and the United States in 1990 is the only Spanish convention including a complete set of LOB rules.[64] In this sense, the Protocol to the US-Spain treaty (January 2013) updated the LOB provision (Art. 17).[65] Accordingly, Art. 17 states that a resident of a Contracting State shall not be entitled to the benefits of the Convention otherwise accorded to residents of a Contracting State, unless the resident is a "qualified person". Paragraph 2 of Art. 17 establishes the criteria to be a qualified person, i.e. an individual; a Contracting State, or a political subdivision or local authority; a company, if some conditions are fulfilled;[66] etc.

Different kinds of situations are covered by this new LOB clause, such as the automatic exception for listed companies. That is, a company where its principal class of shares is primarily traded on one or more recognized stock exchanges located in the Contracting State of which the company is a resident. This exception to the LOB provision not only applies to stock exchanges located in Spain or the United States, but also applies for any stock exchange located within the European Union or in any state that is party to the North American Free Trade Agreement. Secondly, the headquarters company for a multinational corporate group, under certain conditions, is also excluded from the LOB rule application (Art. 17.5 of the US-Spain treaty). Finally, the so-called triangular cases are regulated too. A company of a Contracting State that derives income from the other Contracting State shall not be entitled to the benefits of the Convention where the income is attributable to a permanent establishment[67] located in a third state with

63. A. Rust, *Article 1. Persons Covered*, in *Klaus Vogel on Double Taxation Conventions*, p. 131 (E. Reiner & A. Rust eds., Kluwer Law International 2015).

64. J.M. Almudí Cid, *Las cláusulas antiabuso específicas y los convenios de doble imposición: España*, in *Memorias de las XXVII Jornadas Lationamericanas de Derecho Tributario,* Tomo II, p. 296 (J.C. Zegarra ed., Instituto Peruano de Derecho Tributario 2014); F.A. Vega Borrego, *Las medidas antiabuso en los convenios bilaterales para evitar la doble imposición internacional*, Manual de Fiscalidad Internacional, Ed. 4th, Ministerio de Hacienda y Administraciones Públicas (printing press).

65. This Protocol has already been ratified, but it has not entered into force yet.

66. Additional conditions are just required for entities, because individuals, by the mere fact of being residents of a Contracting State, will be entitled to benefits of the Convention (J.M. Almudí Cid, *supra* n. 64, at sec. III, p. 297).

67. Beyond the considerations in regard of the LOB clause, a relevant point that could be noted is the hybrid PE mismatches concerning a Member State and a third state addressed by the Code of Conduct Group in its Report of 13 June 2016 (doc. 9912/16).

reduced tax rates (that is, less than 60% of the general rate of corporate tax applicable to the company).

On the other hand, Spain and Argentina signed a Memorandum of Understanding (MOU), annexed to the new DTC, in 2013. This MOU provides that treaty benefits shall not be granted to a person who is not the beneficial owner of the income originated in the other Contracting State or the items of wealth situated therein. In a similar way, the DTC signed by Spain and Switzerland (1967, modified in 2006 and later on by Protocol 2013) establishes that "[t]he Contracting States declare that their domestic rules and procedures with respect to the abuses of law (including tax treaties) may be applied to the treatment of such abuses. In the case of Spain, abuses of law include situations covered by Article 15 of [the GTA] or any other similar provision in any tax law in force or to be enacted". In the same vein, recent DTCs signed by the Spanish government provide for LOB rules in order to counteract the use of conduit companies, i.e. Salvador (2009), Jamaica (2008), Moldavia (2007), Serbia (2010), Trinidad and Tobago (2009), or Dominican Republic (2011).[68] Finally, a number of Spain's DTCs follow the approach provided by paragraphs 13 to 19 of the Commentary on Article 1 of the OECD Model (2014) – that is, the look-through or the channel approach.[69]

As mentioned in section 25.1.1., Art. 100 of the CITA establishes CFC rules to counteract tax avoidance situations. In this regard, the Explanatory Memorandum of the CITA expressly mentions that "an increase in effective measures in the fight against tax fraud is required, not only at the domestic level but also in the international framework. In the case of the latter, the OECD work on BEPS is an essential tool for the analysis of international tax fraud. In this scope, tax reform is pioneering in introducing measures addressing such aims, i.e. the treatment of hybrids or amendments related to CFC legislation" (authors' translation). Thus, the Spanish legislator modified the CFC regime at the end of 2014 to be in line with the OECD's Action Plan on BEPS.

68. N. Carmona Fernández, *Ámbito de aplicación de los convenios de doble imposición, in Convenios Fiscales Internacionales y Fiscalidad de la Unión Europea*, Wolters Kuwer (2014), p. 109.
It is also the case of Albania, Armenia, Azerbaijan, Andorra, Barbados, Bosnia, Cyprus, Costa Rica, Georgia, Germany, Singapore, Hong Kong, India, Kazakhstan, Kuwait, Moldavia, Nigeria, Oman, Panama, Pakistan, Senegal, United Kingdom, Uruguay, Uzbekistan, among others (F.A. Vega Borrego, *supra* n. 64, at sec. III).

69. Seventeen DTCs has implemented these kinds of clauses, particularly the look-through clause, i.e. Bolivia, Croatia, Ireland, Malaysia, Portugal or South Africa (F.A. Vega Borrego, *supra* n. 64, at sec. III).

In general terms, the CFC regime allows incorporating into the tax base of Spanish taxpayers the passive income derived from non-resident entities with direct or indirect holdings in Spain. Following the reform of the CITA at the end of 2014, the cases of CFC income attribution have increased. As a general rule, the taxpayer will include in the tax base the total amount of the CFC income unless the entity has the employees and facilities for earning the actual income. As a result, the CFC regime does not apply when the taxpayer proves that: (a) the activities and transactions are carried out with the employees and facilities of the non-resident entity; or, (b) there is a valid economic reason under the creation and business running of the entity.

This general rule is supplemented by specific provisions in case it is not possible to apply it. It is said that the general rule prevails over specific provisions stated in Art. 100.3 of the CITA. This latter article is associated with certain categories of income, that is, income from specific sources will be included in the tax base. Regarding these specific provisions, CFC rules will not apply when the sum of certain income categories (of Art. 100.3 of the CITA) is lower than 15% of the total amount of income obtained by the non-resident entity (Art. 100.5 of the CITA). There will be no attribution of income when such income categories imply expenditures for entities resident in Spain that have not been deductible from tax (Art. 100.6 of the CITA).

Paragraph 16 of Art. 100 of the CITA concludes that the CFC legislation will not be applied when the non-resident entity is established in an EU Member State, provided that the taxpayer proves there is a valid economic reason under the creation and business running of the entity and the existence of a real economic activity. Additionally, the CFC rules do not apply to "undertakings for the collective investment in transferable securities" (UCITS) covered by Directive 2009/65/EC (amended by Directive 2014/91/EU) either. In this case, no substantial or economic requirements are expressly mentioned. That question arises over a possible situation of discrimination in a comparable scenario.

The CJEU in its Judgment *European Commission v United Kingdom of Great Britain and Northern Ireland* (C-112/14) of 13 November 2014 (Taxation of Chargeable Gains Act 1992) considered that the CFC legislation "is such as, first, to discourage residents of the United Kingdom, whether natural or legal persons, from contributing their capital to non-resident close companies". In fact, CFC rules could see as a disincentive for

the investment or carrying out of certain projects or activities.[70] The CJEU followed saying that the English regime "is not confined specifically to targeting wholly artificial arrangements which do not reflect economic reality and are carried out for tax purposes alone, but also affects conduct whose economic reality cannot be disputed". In the Spanish case, it is clear that Art. 100 of the CITA aims to address wholly artificial arrangements, because, according to BEPS Action 3,[71] income that arises from economic and value creating activities are out of the CFC legislation scope. However, in the case of entities classified as UCITS, no requirement of genuine activity is made; therefore, the CFC rules would not apply, in any case, to UCITS.

In the context of the EU Action Plan, Arts. 7 and 8 of the ATAD deal with CFC rules. Accordingly, the Member State of the taxpayer shall include in the tax base – when an entity is treated as a CFC – some categories of income, i.e. interests, royalties or dividends, among others. This categorical approach is complemented by the inclusion in the tax base of income arising from non-genuine arrangements that have been put in place for the essential purpose of obtaining a tax advantage. Therefore, Art. 100 of the CITA is in line with these provisions as it combines the categorical approach with a substance analysis.

Concerning the treatment on hybrid capital instruments, some changes have been introduced by the tax reform of the CITA (November 2014) to increase the effectiveness in the fight against tax fraud. The proposal at the supranational level for introducing linking rules does not seem applicable currently, due to the lack of coordination. Consequently, linking rules have not been introduced yet in Spain. Nevertheless, the Spanish legislation has been amended to introduce rules to safeguard the Spanish tax base. These measures can be applied unilaterally and are able to prevent both double taxation cases and double non-taxation situations.

On the other hand, the tax treatment of the financial expenses, which was fundamentally reformed through the Royal Decree-Law No. 12 of 30 March 2012, is currently regulated in Arts. 15.h) and 16 of the CITA. The legal regime stated is in line with the recommendations in this field made by international organizations.[72] In accordance with Art. 15.h) of the CITA,

70. A. Zalasinski, *General Report – Tax Aspects of Research and Development within the European Union*, in *Tax Aspects of Research and Development within the European Union*, LEX-Wolters Kluwer Business (2014), p. 61.
71. OECD, *Designing Effective Controlled Foreign Company Rules*, Action 3: Final Report (Oct. 2015), pp. 47 et seq.
72. F. Serrano Antón, *supra* n. 20, at sec. I.I., p. 100.

financial expenses arising from debts with group companies generated from acquisitions of shares in other group companies or contributions to capital or equity of other group companies will not be deductible unless there is evidence that there are valid economic reasons for such expenses. Therefore, this is an anti-avoidance provision that allows the deductibility on financial expenses intragroup when the indebtedness is reasonably justified from an economic perspective, i.e. an authentic restructuring transaction within the corporate group.

In addition, Art. 16 of the CITA provides that the amount of net deductible financial expenses in the tax period is generally limited to 30% of operating profit for the year, while such a limit will not apply to financial expenses of less than EUR 1 million. In cases where this limit applies, the excess amount may be deductible in the following tax years (taking into account the same restrictions). This provision is in line with BEPS Action 4 as it recommends including a corridor of possible ratios of between 10% and 30%.

In general terms, Art. 16 of the CITA is in line, although with important nuances, with the interest limitation rule of the ATAD. Accordingly, the exceeding borrowing costs shall be deductible in the tax period in which they are incurred only up to 30% of the taxpayer's earnings before interest, tax, depreciation and amortization (EBITDA). Nevertheless, the ATAD provides that the taxpayer may be given the right to deduct exceeding borrowing costs up to EUR 3 million. Additionally, the ATAD contains a grandfathering clause, not included at the Spanish level, that refers, among other issues, to the possibility of providing the taxpayer with the right to fully deduct its exceeding borrowing costs if it can demonstrate that the ratio of its equity over its total assets is equal to or higher than the equivalent ratio of the group. The ATAD also excludes the interest limitation rule with regard to the exceeding borrowing costs incurred on loans that were concluded before 17 June 2016 and loans used to fund a long-term public infrastructure project where the project operator, borrowing costs, assets and income are all in the European Union. However, such provisions are not included in the Spanish tax legislation.

Moreover, there are other SAARs regulated in the CITA whose legal form is based on the absence of a valid economic reason different from mere tax saving. Firstly, there is the presumption of residence in Spain for companies located in a tax haven or in a low-tax jurisdiction, when its main assets are goods located or rights exercisable in Spain or its main activity is developed in Spain, unless the mentioned entities prove that its purpose and effective management are performed in such a country or territory, as well as the

constitution and functioning of the entity are due to valid economic reasons and substantial corporate reasons different from the management of stocks or other assets (Art. 8.1 of the CITA). Secondly, there is the non-application of the exemption to avoid double taxation on dividends and income derived from transfers of shares in respect of the amount of undistributed earnings of resident and non-resident entities in Spain when the entity resides in a tax haven, unless it resides in an EU Member State and the taxpayer proves that its constitution and functioning are due to valid economic reasons and it develops economic activities (Art. 21.9 of the CITA). Thirdly, there is the non-application of the exemption on foreign income obtained through permanent establishment when it is located in a tax haven, unless it resides in an EU Member State and the taxpayer proves that its constitution and function are due to valid economic reasons and it develops economic activities (Art. 22.7 of the CITA). Moreover, the non-application of the special tax regime on restructuring a transaction when the transaction was not performed for valid economic reasons, but with the only purpose to obtain a tax advantage (Art. 89.2 of the CITA). Finally, there is the application of the CFC regime on resident entities in an EU Member State when they do not prove the existence of valid economic reasons under its constitution and functioning (Art. 100.16 of the CITA).

It should be highlighted that the current CITA has implemented certain anti-hybrid rules for avoiding situations of double deductions or double exemptions, as contained in BEPS Action 2. In such a way, Art. 15.j) of the CITA establishes the non-deductibility of expenses incurred between related entities that – as a result of a different tax classification – do not produce any income or the income generated is exempted or subject to tax below 10%. On the other hand, Art. 21.1 of the CITA establishes the non-application of the double taxation exemption for dividends or profit shares whose distribution implies a deductible expenditure for the payer entity. This is connected to the anti-hybrid clause integrated into the Parent-Subsidiary Directive by the Council Directive 2014/86/EU of 8 July 2014 as the recipient entity will benefit from the exemption if the distribution of dividends among the subsidiaries are non-deductible for them.[73]

Furthermore, Art. 19 of the CITA establishes the so-called exit taxation for those resident entities in Spain that move their residence abroad, incorporating into the tax base of the Spanish CIT the difference between the value

73. According to Calderón Carrero, it is not clear the interrelation between the anti-hybrid clause introduced by the Council Directive 2014/86/EU and the measures proposed by the ATAD to tackle hybrid mismatches (J.M. Calderón Carrero, *supra* n. 46, at sec. II.I., p. 142).

market and the tax value of their property assets, unless such assets are assigned to a permanent establishment located in Spain. That said, in case of assets transferred to a Member State of the EU or the EEA – existing effective exchange of information – the tax debt may be postponed by the AT, on application, to the date assets are transferred to third parties, being applicable the provisions of the GTA in regard of interests on arrears and the establishment of guarantees.[74] Hence, these exit tax provisions are essentially in line with Art. 5.2.c) of the ATAD.[75]

In addition, SAARs are also provided in the scope of the NRITA. Firstly, there is the consideration as income obtained in Spain of the capital gains from rights or shares in an entity, resident or not, whose assets are mainly, directly or indirectly, immovable property located in Spain. Additionally, capital gains from the transfer of rights or shares in an entity, resident or not, whose title deed has the right of use of the immovable property in Spain (Art. 13.1.i) of the NRITA). Secondly, there is the non-application of the exemption on the benefits distributed by the subsidiary companies located in Spain to their parent companies located in other EU Member States or to the parent company's PEs in other EU Member States, when the majority of the voting rights of the parent company is held, direct or indirectly, by individuals or legal persons that do not reside in the EU or within the EEA, should an effective agreement for exchange of information for tax issues exist, unless the constitution and the functioning respond to valid economic reasons (Art. 14.1.h) of the NRITA). Thirdly, there is the non-application of the exemption on royalties paid by a resident entity in Spain or a PE of an entity resident in another EU Member State to an entity resident in another EU Member State or a PE located in other EU Member State of an entity resident within the European Union, when the majority of the voting rights

74. In case of individual taxpayers, exit taxation is regulated in Art. 95 *bis* of the Personal Income Tax Act (PITA). Accordingly, when the taxpayer misses such condition due to a change of residence, it will be considered as capital gains the positive differences between the value market of shares of any type of entity, and its acquisition value, provided that the taxpayer has held such condition at least during 10 years of the 15 previous tax periods and any of these circumstances are met: a) the market value of shares is jointly over EUR 4 million; b) when condition a) is not met, in the accrual date of the last tax period, the percentage of participation in the entity should be more than the 25%, provided that the value market of shares is over EUR 1 million. In this case, it will only be applicable Art. 95 *bis* of the PITA to capital gains related to shares referred in letter b).

75. According to Art. 5.2.c) of the ATAD, a taxpayer shall be given the right to defer the payment of an exit tax referred to in paragraph 1, by paying it in instalments over 5 years, in any of the following circumstances: (…) (c) a taxpayer transfers its tax residence to another Member State or to a third country that is party to the EEA Agreement. For further information on this issue, *see* A. Ribes Ribes, *La cláusula exit taxation en la propuesta de directiva europea para luchar contra la elusión fiscal*, Crónica Tributaria, No. 159 (2016) (printing press).

of the recipient entity is held, direct or indirectly, by individuals or legal persons that do not reside within the EU, unless the recipient entity proves it has been set up for valid economic reasons and not with the purpose of unduly enjoying such a regime (Art. 14.1.m) of the NRITA).

Finally, it should be noted that Art. 18.5 of the NRITA establishes an exit tax for non-resident entities operating in Spain through a PE in case assets previously assigned to that PE are transferred abroad. Thus, the difference between the market value and the carrying amount should be integrated into the tax base. The NRITA also contains the possibility of postponing the tax debt when assets are transferred to a Member State of the EU or the EEA – should an effective exchange of information exist – until the transfer date, being applicable the provisions of the GTA in regard to interest on arrears and the establishment of guarantees.

25.4. Application of GAARs, TP rules and SAARs

Regarding the interaction among the different anti-abuse provisions established in the Spanish tax system, it should be distinguished, on the one hand, the relationship among the three GAARs and, on the other hand, the relationship between GAARs and SAARs and other specific provisions, such as transfer pricing rules.

Firstly, as mentioned in section 25.1.1., there are three categories of GAARs regulated in the GTA: the "taxation of the real transaction" rule (Art. 13 of the GTA), the so-called *fraus legis* (Art. 15 of the GTA) and the anti-sham rule (Art. 16 of the GTA). The main issue is the hazy delimitation between the factual situations of every clause. Art. 15 of the GTA is the only one describing the elusive behaviour and the legal consequences, while Arts. 13 and 16 of the GTA just state the legal effects derived from the "taxation of the real transaction" and the sham.[76] As a result, there is certain confusion in the practice about the application of GAARs. The case law, as cited above, has not contributed to a better understanding and even it has arisen more doubts in the delimitation and the application of every anti-abusive form.[77]

Secondly, there is, to some extent, incompatibility between GAARs and SAARs, the application of SAARs taking precedence. In such a way, if a specific behaviour is covered by the factual situation of a SAAR, it will be

76. M.T. Soler Roch, *supra* n. 1, at sec. I.I., pp. 188 et seq.
77. A. Delgado Pacheco, *supra* n. 7, at sec. I.I., p. 47.

applicable under the *lex specialis* principle (excluding the application of the corresponding GAAR).[78] The same considerations could be made about the TP rules or the limitation on the deductibility of financial expenses, whose application will be preferred (to the GAAR).

Regarding the procedure for applying every anti-avoidance clause, there is only a specific regulation for the GAAR of Art. 15 of the GTA, as well as in the field of TP rules. Therefore, the remaining forms will be applied within the corresponding audit procedures.

Focusing on the expressly procedure stated for the GAAR of Art. 15 of the GTA, according to Art. 159 of the GTA when the acting body considers the factual situation of Art. 15 of the GTA is done, it will communicate that to the interested taxpayer. He will be able to present allegations and to give evidence within 15 days. Hereafter, the full dossier will be sent to the advisory Commission in order to deliver a report within 3 months (with a possible extension of one more month through agreement, with reasons). This Commission, as anticipated, is made up of two representatives of the DGT (one of them will act as the President) and two representatives of the acting AT. If such a report is positive, it will have binding effects for the acting body in respect of the declaration of abuse. The report cannot be independently appealed, but it is possible to impugn the resulting acts and assessments. Finally, these incidents imply a "stop the clock" on the audit procedure.

The procedural requirement of delivering a report *ex ante* by the advisory commission for the declaration of abuse by the AT has arisen, in practice, to the non-use of such administrative formality and therefore the use of other anti-avoidance clauses that do not require additional bureaucracies, i.e. the "taxation of the real transaction" rule and the anti-sham rule. Moreover, as stated above, the tendency to avoid the application of Art. 15 of the GTA has not always been done properly by Spanish courts.

On the other hand, the audit procedure for related-party transactions has formal specialities regulated in Art. 18.12 of the CITA and Art. 19 of the CITR. Firstly, the assessment proposal should be included in an independent document when there is a broader scope of tax regularization within the audit procedure. Secondly, there is an obligation to notify other parties or entities concerned whether the taxpayer has made an appeal or complaint against the assessment. Thus, such interested parties will be able to take

78. Among other authors, M.T. Soler Roch, *supra* n. 1, at sec. I.I., p. 189.

part in the corresponding procedure or, in the second case, to bring jointly an appeal or complaint. Thirdly, once the assessment has acquired the authority of a final decision, it the *ex officio* regularization by the AT of the tax situation of other related-parties takes place, unless such parties would have already made it. Finally, there is the express provision for the interested related entities to apply the mutual agreement procedure or arbitral procedure, stated in the corresponding DTC to eliminate double taxation derived by the correction.

Finally, with regard to the application of SAARs, as mentioned, there are no specific procedures. However, two cases can be highlighted. The first, under Art. 15.h) of the CITA, financial expenses (under certain conditions) are not deductible unless there is evidence that there are valid economic reasons for such expenses. This means a shifting of the burden of proof to the taxpayer, because he is in charge of proving the existence of a valid economic reason under the transaction performed.[79] On the other hand, in the scope of restructuring transactions, taxpayers can obtain a tax ruling from the DGT about the existence of valid economic reasons under such a transaction (Art. 89.2 of the CITA). In the case of a positive answer, following that ruling, the taxpayer will not be subject to any penalty according to Art. 179 of the GTA.

79. Such shifting can be debatable under the proportionality principle. This could be similar to the situation of BE: CJEU, 5 July 2012, C-318/10, *SIAT*. In this regard, *see* J.M. Calderón Carrero, *La seguridad jurídica como límite comunitario a la articulación de cláusulas de prevención y lucha contra el fraude y la evasión fiscal: una nota sobre la STJUE de 5 de julio de 2012, asunto SIAT, C-318/10*, Revista de Contabilidad y Tributación, CEF, No. 356 (2012).

Chapter 26

Sweden

Anders Hultqvist

26.1. Tax avoidance revisited: Exploring the boundaries of anti-avoidance rules in the EU BEPS context

In Sweden, tax avoidance has been on the agenda since the 1930s. During the 1950-60s, there was one doctoral dissertation on the subject (Dag Helmers, 1956) and a public committee working for almost 10 years, presented its final report in 1962.[1] Both concluded that tax avoidance is first and foremost a legislative problem and that a GAAR by the lack of foreseeability of its application would threaten the legal security of the taxpayer. However, many SAARs were introduced to counter the various possibilities to avoid special tax treatment through capital gains, SMEs and so on.

During the 1970s, the tax avoidance discussion was put back on the legislative agenda again by an expert group within the Corporate Tax Committee. In 1975, a proposal was presented and discussed widely. It resulted in a proposal for a GAAR legislation, which caused discussion among scholars and in public consultations as it was brought through the legislative process that took about 5 years before a proposal was presented to parliament. The final part was the review of the *Lagrådet* (the Legislative Council consisting of Supreme Court Judges and Supreme Administrative Court Judges), whose opinion this time was divided (with two of the four judges disapproving and advising against the proposal and two approving with some proposed changes).

A "compromise GAAR" was proposed to parliament in 1980 and entered into force in 1981. It was limited in time until the end of 1985. In no case brought before the Supreme Administrative Court was the GAAR applied. After a change of government in 1982, a wider GAAR was proposed to and decided by parliament. The Legislative Council again hesitated and expressed its doubts, but did not want to disapprove, considering its limitation in time and scope, and due to the possibility to apply for advance ruling.

1. *See* D. Helmers, *Kringgående av skattelag*, Stockholm (1956). The public committee was named *1953 års skatteflyktskommitté* (Tax Avoidance Committee) and it presented its final report in SOU 1963:52.

The wider GAAR entered into force on 1 March 1983. It was meant to be in force for some years and then be evaluated. Politically controversial, it was abolished in 1992, after general elections in 1991, and brought back into force in 1995, after another general election in 1994. It was re-examined by a legislative committee during 1995-96, changed in 1998 and is currently still in force.

During the 35 years that the Swedish GAAR has been in force, it has been challenged, tried and applied in numerous court cases and discussed in academic literature, which will be addressed in section 26.4. (All versions of the GAAR are translated, presented and discussed below.)

This legislation has been built on the *concept of tax avoidance* (in Swedish, *skatteflykt*).[2] Theoretically, it might lead to a circular definition: it shall be possible to target tax avoidance using the GAAR, and the GAAR's application defines what is tax avoidance. The Swedish definition of *skatteflykt* lacks clear measurable criteria, which first will be addressed, before discussing and relating this concept to the terms and concepts mentioned in the questionnaire, of "tax planning", "aggressive tax planning" and "abusive tax planning".

26.2. The meaning of tax avoidance in the Swedish legal system and the BEPS initiative

As mentioned above, in the 1950s, tax avoidance was discussed as "circumvention of tax law". The proper remedy was to meet this with better tax legislation. When the efforts to create a GAAR were reopened in the 1970s, a definition and more precise criteria were needed. The discussion started with a committee report from 1975 and a government report in 1978 following the committee report.[3]

The task of defining tax avoidance started with some negative limitations. It does not include tax evasion (*skattebrott, skattefusk)* which is, per definition, leaving false facts in the self-assessment. It is a *factual question*. Neither are sham transactions a problem since such transactions are not recognized

2. The Swedish word *skatteflykt* normally rather implies tax evasion or at least bringing the assets and income abroad (compare with the German word *Steuerflucht*), and therefore contains some misguiding connotation.
3. *See* the committee report in *Statens Offentliga Utredningar* (SOU) 1975:77 *Allmän skatteflyktsklausul* ("A general anti-avoidance rule"), and the government report, Ds B 1978:6.

by private law (other than in relation to third parties in good faith) and have no legal effect on taxation.[4]

Another situation that falls outside the definition is *wrongly categorized transactions*. If a contract under private law is a purchase, not leasing, it would also under tax law be relevant as a purchase, i.e. an acquisition or investment, and payments not categorized as rent or leasing payments. The taxpayer may choose to buy or rent assets, but not to categorize a purchase as rent or lease.

The categorization of transactions is a matter of law, in this case private law. Contracts and transactions shall be correctly characterized and the tax administration and the courts may therefore *recharacterize* them, giving them the right legal character (label and name) and, accordingly, the appropriate tax treatment.

Theoretically, this is not a problem from a tax avoidance point of view, but it is an investigational and factual problem. In reality, it has a lot to do with the investigation of tax avoidance schemes, since a thorough investigation may also lead to *recharacterization* of the transactions involved. Even a series of contracts that may lead to a composite transaction, when regarded as a whole should be given another legal character (also addressed below).

So the definition of tax avoidance did not address these types of situations. However, it is transactions that are sustainable from a private (civil) law point of view, correctly characterized and truthfully used and/or stated in the self-assessment, but which lead to what may be regarded as "unjust tax benefits", that cause the problem of tax avoidance. Not all tax benefits have this character and some may even have been put into the tax legislation intentionally. So a definition had to exclude those kind of tax effects.

The first (draft) definition of tax avoidance during the 1970s accordingly became: "Transactions, correctly characterised, which lead to 'tax benefits' not intended to by the legislator." The definition is obviously weak for a number of reasons. Firstly, the responsibility to create a good and solid tax legislation is the legislator's. Secondly, what other intentions may the legislator have than what is written in tax statutes and why, if there are any more, does the legislator not write them explicitly?[5] Furthermore, this is

4. *See* the committee report in SOU, *supra* n. 3, at sec. II, pp. 47-48.
5. An early objection to this content was published by Prof. L.A.E. Hjerner in *Sken – Bulvanskap – Kringgående, Genomsyn eller förträngning?,* in *Festskrift till Hans*, Thornstedt (1983), p. 288 et seq.

from a methodological and theoretical point of view not a sustainable way to argue in jurisprudence. Some scholars have shown that the legislator is not a person, but an institution (the parliament) and institutions cannot have "intentions", only people within parliament can, and there is probably no way to empirically prove any other common intention than that which ended up in the statutory law. Supporters of the view of "legislative intent" as something more than the decided statutory law are used to referring to the preparatory works and all discussions there, but this could be challenged by the argument "why did the authors of the legislative draft not write this properly in the proposed legislation, because they ought to be competent enough to do that".

The discussion has nowadays more or less vanished from the agenda, but, as shown below, the argument what might or might not have been considered during the legislative process still remains important. This kind of reasoning might also have bearing on the new words "abusive" and "aggressive" tax planning, so those terms and concepts play a role in the Swedish discussion.

26.3. The meaning of tax planning, abusive tax planning and aggressive tax planning in the Swedish legal system

Everyone is entitled to arrange his or her affairs as they want within the law. There are a lot of aspects that might have to be considered. If there is a choice between two actions to reach a most similar situation with different tax consequences, the tax alternatives may even influence a person's choice as, for example, in buying or leasing a car. Lower tax on environmentally more sustainable cars and other goods may also have been intentionally meant to affect our choice. Considering the tax effects of common or trivial transactions is not normally called tax planning.

Since the expression *tax planning* has no legal significance, there is no definition to be found of the exact meaning, but normally an arrangement seems to require some intellectual effort to qualify as tax planning and that tax considerations have been at least a substantial part of the motive for how the transactions are performed. Different tax experts provide different examples of what constitutes good tax planning. Such examples included choosing lower taxed fringe benefits instead of salary, acquiring assets and leasing them back (sale and leaseback), using advantageous rules for depreciation, different arrangements spreading income through family members,

interest deductions on intra-group loans after acquiring intra-group assets, and so on. None of these structures seem to last forever since the tax legislation will change if an arrangement is too advantageous during a longer period of time.

Another, more politically inspired meaning of tax planning is, in contrast to tax avoidance, arrangements that are within the legislator's intention. This is, however, also an intellectually confusing definition (compared to above). Sometimes it is possible to verify that some kind of political acceptance for a certain way of organizing private or commercial affairs exists, but normally no one has any idea of what the combined effect of the transactions will be before they are discovered or "invented" by tax consultants. It has been argued that the effects of transactions or organizing private or business affairs – which have been well known for a longer period of time without being challenged by the legislator – may be "accepted tax planning". Within academia however, the argument of "the legislator's intentions" has been criticized as a specious argument for what is more an own moral/ethical valuation of the scheme or, if trying to exclude the subjective element, the purpose of the law in some more general meaning.[6] The problem with the latter position is that the purpose of the law is normally considered when interpreting the law, so it suggests there is a purpose that has not been considered in the ordinary interpretation that may be used and understood outside the normal interpretation of the law.

Normally, *tax planning* is accordingly referred to as something that is legal and possibly also accepted by the legislator and, from an theoretical point of view, an ethical and vague argument for what ought not be challenged by the tax authorities.

The concepts of *abusive tax planning* or *aggressive tax planning* do not exists within Swedish tax law, neither as legal concepts nor as significant concepts in tax policy. However, the latter is sometimes used as a rhetorical device in discussions or as reasons for reform proposals of tax law,[7] and even more in argumentation in cases where the GAAR might be applied (*see* section 26.4.). As a result, the terminology might then indicate the

6. These issues are discussed in the Swedish tax law literature; *see*, for example, A. Hultqvist, *Legalitetsprincipen vid inkomstbeskattningen*, Juristförlaget (1995), p. 383; and U. Rosander, *Generalklausul mot skatteflykt*, JIBS Dissertation series, No. 40 (2007), p. 18.
7. *See*, for example, the government proposal in prop. 2012/13:1, p. 251 (the purpose of the proposed legislation was to prevent "aggressive tax planning" with interest deductions).

borderline between tax planning, as an acceptable way of caring about tax consequences before acting or organizing transactions, and aggressive tax planning, as something bad in contradiction to the legislative intent and which means more or less the same as tax avoidance.

Once known by the Swedish tax authority, a scheme may be made known as an aggressive tax scheme *(skatteupplägg)* on the authority's homepage, normally accompanied by a remark that it will be challenged by the tax authority in taxation and in court if necessary. This may include use of the GAAR. Tax authorities may however not provide (binding) regulations on tax legislation, so this reflects only their view on the matter.

Since the EU Court has used the abuse of law doctrine in *Halifax* (C-255/02), *Cadbury Schweppes* (C-196/04) and other cases, the term *abusive* might be reserved for transactions that show these characteristics. Legal scholars, courts and government have not yet used the term or the expression in any significant way – other than if referring to EU Court practice in the mentioned cases – but as the concept is quite unclear it may be used in different ways in the tax debate.

Conclusions about the terminology

As mentioned above, there are no coherent or sharp definitions of tax avoidance, tax planning, aggressive tax planning or abusive tax planning that are used or can be used in a legal sense. However, there are some tendencies to be noticed in the semantics and the use of the terms more generally.

Tax planning could embrace everything adopted by taxpayers in the present legal system, but normally it requires some intellectual effort to think about the tax consequences in advance, choosing among alternative ways of ordering transactions and/or private or business affairs trying to minimize the tax effects. Normally, the term also implies that the scheme is acceptable or at least will not be challenged by the tax authorities, but it may also be used in a broad sense where no distinction between different forms of tax planning is made.

Aggressive tax planning does not have any legal significance, but may indicate that it might be challenged using the GAAR or at least has to be met with new or changed legislation, since the person or institution using it is normally using not acceptable ways to order transactions or at least to obtain tax consequences that are not acceptable (if they could not be nullified using the GAAR).

Abusive tax planning does not normally have any legal significance, but it may have it if it is used as an argument and in the meaning used by the EU Court (abuse of law, *abuse de droit*). Otherwise it at least indicates that the person or institution using it is arguing that the scheme should be tried under the GAAR or at least be met with new legislation.[8]

Both the terms aggressive tax planning and abusive tax planning often have a moral and/or ethical dimension as well (in a negative sense). Tax planning may have that for some people, but normally it is used more neutrally.

The older and more traditional terms *tax avoidance* and *circumvention of tax* – together with the Swedish *skatteflykt*, or German *steuerflucht* – have neither legal significance, nor are they defined in a theoretically sustainable manner, but they have been used politically to identify what is meant to be challenged using the GAAR. The name of the Swedish GAAR is also *lagen mot skatteflykt* (the act against tax avoidance). Tax avoidance might then correspond to aggressive and abusive tax planning, or at least embraces the latter.

However, according to most Swedish scholars (including the authors), it is not meaningful to seek the precise meaning or use these terms in legal science, but because the terms are often used in the political debate it is necessary to refer to them broadly in some sense and publicly and to also understand or explain the morals about certain tax consequences.

26.4. The Swedish GAAR

As mentioned above, Sweden already had a legislative GAAR in 1980. It was politically controversial and built on the concept of *circumvention of tax legislation*. It set out four criteria to be applied:[9]

(1) The taxpayer must have performed a legal act which was part of a tax avoidance procedure (a tax-motivated scheme in other words).

8. In the first proposal for a Swedish GAAR, tax avoidance was also described as abuse of law (*see* SOU, *supra* n. 3, at sec. II, p. 43), at this time, however, not in the meaning of EU law, since this was not known at the time.
9. The translated English version of the wording of the GAAR is from L. Mutén, *The Swedish Experiment with a General Anti-Avoidance Rule*, in *Tax Avoidance and the Rule of Law* (Graeme S. Cooper ed., IBFD Publications 1997), p. 312.

(2) The tax avoidance procedure must constitute a roundabout way in relation to a normal and in economic terms essentially equivalent alternative course of action.

(3) The transaction must result in a substantial tax benefit which can be assumed to have been the decisive reason for the choice of the course of action taken.

(4) The procedure must, finally, be a clear violation of the purpose of the legislation.

The 1980 version of the GAAR did not apply in any Supreme Administrative Court case, especially since it was difficult to show the second requirement (what is "a normal course of action") and that the chosen way was a roundabout way. Other problems were to show that the tax benefits were decisive for the chosen procedure or that the transaction was a clear violation of the purpose of the law. After a general election in 1982, the GAAR was changed in 1983 to make it easier to apply. Now there were only three criteria:

(1) The legal act is to be disregarded, taken for itself or in conjunction with another action to which the taxpayer (or the entity, on the income of which the taxpayer is assessed) is directly or indirectly a party, is part of a procedure implying a not unimportant tax advantage to the taxpayer.

(2) Such a tax advantage according to the circumstances can be assumed to have been the main reason for the action being taken.

(3) An assessment on the basis of the action would be in violation of the purpose of the legislation.

This GAAR was supposed to be in force for just a few years and then be evaluated. It was applied very carefully, according to the government's Chancellor of Justice after examining court cases until 1987. The GAAR was applied in only seven court cases out of 40 during 1985-87 where it had been under discussion. A Supreme Court judge, however, found that court practice showed the GAAR was used to eliminate deficits in the primary tax legislation more than judging what the taxpayer actually had done.[10] Prof.

10. *See* S. von Bahr, in *Skattenytt* (1992), p. 606; and S. von Bahr, in *Skattenytt* (1988), p. 585.

Mutén shared this view and questioned whether an "and alike" had to be assumed after every legal definition in statutory tax law.[11]

All Supreme Court practice in 1980-1994, the discussion among legal scholars and the issue how the GAAR relate to the constitution and rule of law was presented in a dissertation in 1995.[12] The conclusions were that the GAAR led to a set-aside of the rule of law (*legalitetsprincipen*, the legality principle) by using the GAAR to tax by analogy.

Most of the cases in the Supreme Administrative Court were about transactions concerning closely related parties.[13] The others were structured cases to take advantage of deficits in tax legislation concerning sale and resale of real property (RÅ 1984 Aa 189), interest deductions by paying interest for several years in advance (RÅ 1985 1:25), transfer of the possibility to deduct losses (RÅ 1988 not. 159), partner leasing (RÅ 1992 ref. 21) and swapping income tax treatment through dividend distribution funds (RÅ 1990 ref. 101) and dividends through specially arranged companies, respectively (RÅ 1994 ref. 56, RÅ 1995 not. 107). Another deficit in the tax legislation using losses twice in partnerships was tried in RÅ 1994 ref 52 I (compare RÅ 1995 ref. 32-35, RÅ 1996 not. 240).[14]

The GAAR was politically very controversial and, after another shift in government in Sweden in 1991, it was abolished in 1992, since it was regarded to be arbitrary and it was impossible to foresee its application. As the case numbers above show, it could be applied to transactions and taxations made before the abolishment.

Most of the possibilities to arrange affairs and transactions were still there, but the 1990 Tax Reform rendered most of them meaningless, since the reform had, as one of its main objectives, made income tax legislation more

11. *See* L. Mutén, *Svensk skattetidning* (1992), p. 283.
12. *See* A. Hultqvist, *supra* n. 6, at sec. III, chs. 7 and 8.
13. Cases in *Regeringsrättens Årsbok* (RÅ - Supreme Administrative Court case reports). RÅ 1985 1:13, RÅ 1985 Aa 62 och RÅ 1990 not. 500 concerned transactions with spouses involved. In RÅ 1984 1:46, RÅ 1984 1:92, RÅ 1985 1:42, RÅ 1985 1:68, RÅ 1985 1:69, RÅ 1985 Aa 218, RÅ 1986 ref. 54 and RÅ 1990 ref. 22, transactions between or involving parents and children were tried. Transactions between close related companies and/or its owner were addressed in RÅ 1983 1:35, RÅ 1987 ref. 131, RÅ 1989 ref. 31, RÅ 1989 ref. 83, RÅ 1989 not. 66, RÅ 1990 ref. 11 and RÅ 1990 not. 95.
14. These and other cases are discussed in A. Hultqvist, *supra* n. 6, at sec. III, p. 400 et seq.

neutral. Different ways of arranging business or private transactions often led to the same tax result.[15]

The political controversy continued as the GAAR was reintroduced in 1995 after another shift in government. At the same time, a Committee had to evaluate and, if necessary, give a proposal for a reformed GAAR, which it presented in 1996. The proposal met a lot of criticism, was modified again, and when presented it split parliament evenly, with one half for and the other half against the GAAR. The new GAAR entered into force in 1998 and still exists. It sets out four criteria (the earlier three criteria split into four and modified to some degree):[16]

The legal act is to be disregarded, if:
(1) the legal act, taken for itself or in conjunction with another legal act, is part of a procedure implying an important tax advantage to the taxpayer;
(2) the taxpayer directly or indirectly has taken part in the legal act or these legal acts;
(3) the tax advantage, according to the circumstances, can be assumed to have been the predominant reason for the action being taken; and
(4) an assessment on the basis of the action would be in violation of the purpose of the legislation as it appears by the tax legislation's general design and those rules which are to be applied directly or have been circumvented through the actions taken.

So in reality the changes concerned:
- the tax advantage, from not unimportant to important;
- the reasons for the transactions, from main reason to predominant reason; and
- the norm *purpose of the law*, which now should be able to be found directly, reading the legislation.

The new GAAR entered into force in 1998 and is still current. It was scarcely used in the first years,[17] and has been discussed in other dissertations.[18]

15. *See*, for more information, the committee report in SOU, 1995:104, pp. 32 et seq.
16. In this translation, the earlier style of translation has been applied, but the responsibility for its accuracy is the author's. However, the wording and its meaning is not even clear in Swedish and it has been questioned even by the Legislative Council.
17. *See* A. Hultqvist, *Den nya skatteflyktslagen – Vad har hänt?,* in *Festskrift till Gustaf Lindencrona*, Stockholm (2003), pp. 193-209.
18. *See* U. Rosander, *supra* n.6, at sec. III. *See also* T.S. Almendal, *Skatteanpassade transaktioner och skattebrott*, Norstedts Juridik (2005).

One of the major arguments to counter criticism of a GAAR has been the possibility to apply for an advance ruling. The few cases that have reached the Supreme Administrative Court with regard to the GAAR are also decisions relating to the unique system for advance rulings in Sweden, where one or more taxpayers apply to the Council for Advance Tax Rulings for an advance ruling. The Council is an authority under the Finance Department and consists of civil servants, judges, professors and consultants or other tax experts. The decisions can be appealed before the Supreme Administrative Court directly without leave. Often the Supreme Administrative Court just confirms the decision by the Council, which is why arguments and different opinions only can be found in the Council's decision.

In an early advance ruling (RÅ 1998 not. 15) appealed before the Supreme Administrative Court, the taxpayer planned to issue a convertible profit-sharing loan with a 96-year duration. The idea was of course to convert non-deductible dividends to deductible interest payments. The legal characterization of the legal acts was not challenged, which could have been an alternative, but the Court found the taxation with regard to the legal actions taken to be contrary to the purpose of the law. The GAAR was applied.

In another case the year after (RÅ 1999 not. 153), a company group wanted to sell part of its business in one of its Swedish companies to another newly formed Swedish company owned by a Dutch parent company within the group, using the rules of restructuring which makes it possible to sell at book value (instead of market value). The idea was to avoid paying income tax on the difference between market value and book value. The Dutch company would not be liable to capital gains tax and, if the newly formed Swedish company was sold, the difference between market value and book value would not be taxed (as it would have been in a direct sale from the Swedish original seller). However, the result was considered to be a consequence of the Swedish tax legislation and the GAAR was not applied.

In RÅ 2000 ref. 21 I, the issue concerned a legislative mistake in the rules on the use of losses, which had been addressed by Prof. Wiman years earlier.[19] The normal qualifying period of 5 years after a takeover of a company with losses did not formally apply to a commission agent arrangement, which the taxpayer would use. However, the majority of Court members found the GAAR to be applicable, since it otherwise would give rise to a tax benefit. The minority of Court members found it to be unclear what a tax benefit is and that the tax statute and its consequences were clear.

19. *See* B. Wiman, *Skattenytt* (1994), p. 734.

In another case concerning the same legislation (RÅ 2000 ref. 21 II), the Supreme Administrative Court was divided. As with the Council for Advance Rulings, the minority of the Court found the scheme that created a loss by giving a group contribution, financed through shareholder's contributions, acceptable, since it must have been considered by legislators during the recent reform of the legislation, but the majority (3-2) found it to be in accordance with an earlier judgment in 1989 to apply the GAAR.

These cases were discussed in the academic literature by several authors. Prof. Påhlsson found the cases showed it is possible to supplement legislation with the GAAR.[20] Prof. Bergström found the decisions to be (materially) correct, but they should have been corrected by changing the legislation.[21]

The following years the GAAR did not apply in a case (RÅ 2001 ref. 12) about a convertible profit- sharing loan, as it fell outside the special provision for these kind of loans, and also fell outside the rules for owner-led companies (the so-called 3:12 rules). The argument was that this effect must have been considered by the legislators during the legislative process. To Prof. Bergström, the outcome showed in an instructive way how the GAAR should be applied, but he also argued that it should have led to not applying the GAAR in the case RÅ 2000 ref. 2I 1 (*see* above), since the legislator even in that case must have been aware of the effect of the legislation (especially since Prof. Wiman had pointed it out).[22]

In other cases in the same year (RÅ 2001 ref. 66 and RÅ 2001 not. 188), some persons sold their companies via a complicated, arranged scheme to avoid tax on capital gains. The reason for not applying the GAAR was that the procedure was considered to be within the framework of the legislation about restructuring, which normally cannot violate the purpose of the legislation. Also the case in RÅ 2001 ref. 79, where a municipality sold all its companies to its own holding company, financed with loans on which the holding company could pay deductible interest, and thereby avoid showing taxable profit, was considered not to be in violation of the purpose of the legislation.

Trying to summarize the cases about the new GAAR, Prof. Bergström found he could not see any established principle in case law.[23] Another study,

20. *See* R. Påhlsson, *Skattenytt* (2001), p. 320.
21. *See* S. Bergström, *Skattenytt* (2001), p. 340.
22. *See* S. Bergström, *Skattenytt* (2002), p. 291.
23. S. Bergström, *supra* n. 22, at sec. IV, p. 292.

which also included other cases in the following years (RÅ 2002 ref. 24, RÅ 2002 not. 133 and RÅ 2003 not. 90), came to the same conclusion.[24] There was no possibility to provide a reasonable explanation for the cases when the GAAR was applied, nor when it was not applied. It seemed, however, that at the time it was scarcely applied, and in very odd cases. Moreover, it was not possible to understand the method, since the courts never explained how they found tax benefits nor how the purpose of the legislation is anything else than what is understood when interpreting the law.

Only courts may apply the GAAR. Tax authorities therefore had to turn to the courts if they wanted the GAAR to be used. The courts try the "GAAR cases" in two steps. First the case is tried in relation to (ordinary) tax legislation. If this does not lead to the taxable result, the tax authorities request the GAAR to be considered. This procedure illustrates the weaknesses of the GAAR.

Firstly, this means that the taxable result is in accordance with relevant tax legislation, interpreted normally, and yet there is a *tax benefit*. Since there is, according to the Swedish constitution, no tax without tax legislation, it is intellectually challenging to find tax benefits when the (normal) interpretation of tax legislation gives this result in the case tried.[25]

Secondly, in no case does the Supreme Administrative Court provide any explanation of how to find a "purpose" with the legislation applying the GAAR that could not be found interpreting tax legislation in the first place. This indicates that there is an extension or even an analogy applied. In no cases was anything mentioned about how the Court finds this other "purpose", only that it does. As the cases above indicate, this has led to criticism of looking for "legislative intent" or even what the legislator should have accepted if noticed, which is speculative.

In her dissertation in 2007, Ulrika Rosander could not find any explanation of how to apply the GAAR and pointed out that court practice showed it had been scarcely used.[26]

24. *See* A. Hultqvist, *Svensk skattetidning* (2005), pp. 319-320.
25. *See* the criticism in A. Hultqvist, *supra* n. 6, at sec. III, pp. 419-420; and A. Hultqvist, *supra* n. 24, at sec. IV, p. 307. *See also* the dissenting opinion in RÅ 2000 ref. 21 I, and judges G. Sandström, *Skattenytt* (1996), p. 79 and S. von Bahr, *Skattenytt* (2007), p. 645; and S. von Bahr, *Svensk skattetidning* (2014), p. 435.
26. U. Rosander, *supra* n. 6, at sec. III, pp. 113-114.

In 2009, the Supreme Administrative Court applied the GAAR in five cases (RÅ 2009 ref. 31; RÅ 2009 ref. 47 II; RÅ 2009 not. 86; RÅ 2009 not. 88; and RÅ 2009 not. 201). In the literature, it was noted and questioned whether those cases marked a trend shift.[27] Significantly, not one of the cases contained a better explanation of how to understand the concept of tax benefit or how the purpose of the legislation as it appears by the tax legislation can be something else than what already has been found by normal interpretation.

Later on, a well-known scheme with capital insurances was tried (RÅ 2010 ref. 51), where a person signed up for an insurance and instructed his insurance capital to be invested in a company where he worked and managed the business. The company was owned by the insurance company and the dividends were accordingly paid to the insurance company, increasing the value of the insurance. The insurance company could also sell the company and distribute the gain to the insurance capital. According to Swedish tax legislation, there was a certain tax levied on the value of the insurance, but on the other hand payments from the insurance were exempt from tax. The possible arrangement of structuring ownership via an insurance company was well known to the Ministry of Finance, since it had been informed about this more than 10 years earlier, but without changing the legislation. A lot of people used this way to hold a small company, and accordingly to avoid the special rules with high taxes on dividends paid to a sole or few owners. The Supreme Administrative Court however found this to be against the purpose of the tax legislation, that had been circumvented by the arrangement.

In HFD 2012 ref. 6, the issue was whether an arrangement concerning loan arrangements and deductibility of interest paid on such loans, which did not fall under the special anti-avoidance rules for certain intra-group loans, not even the proposed changes in those rules, could be targeted using the GAAR. All arrangements were also done with the intention to avoid the (new) proposed rules. Neither the Council for Advance Tax Rulings nor the Supreme Administrative Court applied the GAAR.

In a judgment concerning business taxation, where the taxpayer used companies located in Peru, although the double tax treaty between Sweden and Peru gives Peru the right to tax the company's business income (and Swedish tax is exempted), the issue about using the GAAR was discussed by the Supreme Administrative Court (HFD 2012 ref. 20). As the case was

27. *See* Hultqvist, *Svensk skattetidning* (2009), p. 780; and Tjernberg and N. Hermann, *Skattenytt* (2011), p. 163.

solved on other grounds (interpretation of the DTC), the issue was not emphasized, but it was at least mentioned obiter dictum in the judgment of the Supreme Administrative Court. The Court stated that the GAAR could be applicable since nothing in the DTC excludes using the Swedish GAAR on legal actions covered by the treaty. Prof. Dahlberg has, however, with reference to the OECD Commentary and the fact that the DTC was from 1966, been rather critical of such a simplified view, if international treaties are to be respected, but also open to change in the future, when treaties are renegotiated.[28]

When the special rules on restructuring (at book value) were fulfilled by the taxpayer in HFD 2012 ref. 58 neither the Council for Advance Tax Rulings nor the Supreme Administrative Court found the GAAR to be applicable.

In HFD 2012 not. 30, a limited company sold real estate to a partnership at book value (no taxable profit), in which partnership the seller company owned 0.1% of the partnership and an intra-group partner (a company in Cyprus) owned 99.9%, and the partnership then sold the real estate to a third party at market value, the Supreme Administrative Court applied the GAAR. The capital gains were, according to Swedish tax rules, allocated by 99.9% to the Cyprus company, which was not a taxable person nor did it have a permanent establishment in Sweden. Every transaction was, according to the Court, within the tax legislation, the transaction to book value as well as the allocation of income from the partnership, but it violated the purpose of the law, the Court found.

The reasoning and the application of the GAAR in this case has been discussed and criticized in the literature, especially as it also concerns EU law, since it was only the fact that it was a Cyprus company as a partner in the partnership that caused the GAAR to be applicable.[29]

In a very recent case (HFD 2015 ref.17), it is obvious that the GAAR is used to create an analogy, instead of analysing the legal acts (the transactions and the scheme) when the taxpayer has found a way to restructure his business not covered by the ordinary legislation. The dissenting opinion in the Council's decision (of which Prof. Påhlsson was a part) shows this very

28. *See* M. Dahlberg, *Skattenytt* (2013), p. 357. Dahlberg has developed his view in his book M. Dahlberg, *Internationell beskattning*, 4 ed., Studentlitteratur (2014), pp. 264 et seq. (especially p. 269). *See also* M. Hilling, *Skattenytt* (2012), p. 590 et seq.

29. *See*, for example, the analysis of the case and discussion by the former judge, in both the Supreme Administrative Court and the CJEU in S. von Bahr, *Svensk skattetidning* (2014), p. 428 et seq.

clearly. The Supreme Administrative Court did not give any reasons of their own, but confirmed the decision by the Council.

Moreover, the GAAR has been discussed and used as a secondary argument in a range of other cases, where, however, the cases have been solved by interpretation and use of ordinary tax legislation. Nowadays, most applicants before the Council for Advance Tax Rulings also ask whether the GAAR may be applied and whether there is any unexpected or controversial tax effect of a planned transaction, just to be sure whether the GAAR may be applied or not.

Conclusions

The Swedish GAAR has been implemented in three different versions. One has been very restricted with a circumvention prerequisite in 1981-1983, another more obviously pointing out the possibility to tax by analogy in 1983-1992 and 1995-1997 and the last one from 1998 and still in force, which tried to meet the criticism of contradicting the legality principle (rule of law) by stating the purpose of the legislation *as it appears by the tax legislation's general design* and *those rules* which are to be applied directly or have been circumvented through the actions taken.

Officially, putting the GAAR into practice has been a very cautious process, but critics (among them the author) have held that the application of the GAAR is very unpredictable and that it is impossible to interpret the criteria for its application from practice. Even though there are four specific criteria mentioned in the legislation, it is only on very rare occasions that the Council or Court mentions anything about *how* the Council or the Court finds the criteria to have been met, only *that* it does. This makes it impossible for scholars to develop any theory about the GAAR's application. There have however been guesses or statements of how the GAAR is used, or should be used, in practice. One of them – the beginning of the new GAAR proclaimed by Prof. Bergström – that loopholes known by the legislators should not be a violation to use, only unexpected loopholes. Some cases also showed such tendencies, but then there were others where this guideline did not apply (meaning the loophole revealed by Prof. Wiman and the well-known consequence of the capital insurance rules).

There are rather few cases where the legal actions, i.e. the validity of the transactions, are discussed in a manner that reflects the abuse of law concept used by the CJEU. Swedish tax law includes the doctrine of disregarding sham transactions and in all cases where private law concepts are used for

taxation (i.e. sale, loan, lease etc.) it is possible to first investigate, give evidence on and try the legal acts' true character. The Court is not bound by the character stated by the taxpayer. These kind of cases, where a possible recharacterization of the legal acts (and the transaction and scheme as a whole) may be involved, include only on rare occasions also an application of the GAAR. More often the GAAR is an alternative to recharacterization, as discussed in RÅ 2010 ref. 51.

26.5. The GAAR in EC Recommendation C(2012) 8806 of 6 December 2012

There is no official position on whether the Swedish GAAR is similar to the GAAR proposed by the EC or if it is compatible with the concept of abuse of law as used by the European Union or European Economic Area. The recommendation did not lead to any changes in the current Swedish GAAR.

When the EC proposed changes in the Parent-Subsidiary Directive (PSD) (2011/96/EU) in 2013, with a mandatory GAAR to be implemented in national law, the government had to turn to the Swedish parliament (*Riksdagen),* since part of the Constitution (at that time chapter 10, paragraph 6 *Riksdagsordningen*) states that it is the Swedish parliament that decides if a proposal from the EU Commission is against the principle of subsidiarity.[30]

The Swedish government questioned whether the EC had the right to challenge the Member States' sovereignty over income tax to propose a mandatory GAAR in the directive. The parliament concurred and found the EC proposal with a GAAR to go further than necessary and that it breached the principle of subsidiary. After a proposal by the Parliament Tax Committee *(Skatteutskottet)*, the parliament decided to leave a formal notice to the European Union that the proposal violated the principle of subsidiarity.[31]

When the EC came back with a new proposal in January 2015,[32] it did not contain a mandatory GAAR, but it had article 1, which had requirements

30. *See* COM(2013) 814 final, Proposal for a Council Directive amending Directive 2011/96/EU on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States.
31. *See* 2013/14:SkU23 and rskr. 2013/14:145.
32. *See* Council Directive 2015/121/EU of 27 January 2015 amending Directive 2011/96/EU on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States.

that Member States shall not grant the benefits of the PSD to an arrangement or a series of arrangements, which, having been put into place for the main purpose or one of the main purposes of obtaining a tax advantage that defeats the object or purpose of the directive, *are not genuine* having regard to all relevant facts and circumstances. In the proposed changes of Swedish law to cover the anti-abuse rule in the directive, the memorandum from the Ministry of Finance discusses and argues that the Swedish GAAR encompasses the abuse rule and has even a broader scope.[33]

This is also the author's view. The Swedish GAAR's scope is probably wider than the abuse of law doctrine and that may also lead to conflict with EU law in cross-border transactions, as might have been in the case HFD 2012 not. 30 above. If the GAAR is only applied because of tax benefits as a result of transactions with or through parties in another EU Member State and if those transactions would not meet the criteria of abuse of law, it is questioned whether applying the Swedish GAAR would violate EU law.[34] It is also difficult to understand the implications of the proposed EU GAAR and whether that will affect the abuse of law concept developed by the CJEU.

The Swedish GAAR has the elements of a *main objective test* (even predominant objective test), with the *tax advantage* as an essential aim of the transaction (although this is criticized, as mentioned above) and the *subjective element* of an intention to obtain a tax advantage (but rather if it is typical than proven in the actual case). The complementary business purpose test, mentioned in the questionnaire, is rather consumed by the objective test and the principle of proportionality is absent, except for the criteria of "an important tax advantage", which means that the GAAR will not be used in cases concerning smaller amounts. It would also be possible to argue that proportionality is considered in the reasoning about the "purpose" test, since practice has shown that tax effects that are well known by the legislator will on more rare occasions be challenged with the GAAR.

33. *See* further the memorandum from the Ministry of Finance, *Begränsad skattefrihet för utdelning och nya bestämmelser mot skatteflykt i fråga om kupongskatt'*, Apr. 2015, p. 22 et seq.
34. *See* A. Hultqvist, *Skatteflykt och EU-rätten*, Lexnova (May 2013); and S. von Bahr, *supra* n. 29, at sec. IV, p. 433.

26.6. Subject-to-tax rule in recommendation C(2012) 8806 of 6 December 2012

Sweden has not implemented the proposed subject-to-tax rule in any DTC. On the contrary, the rule has been criticized for being very vague.[35]

As mentioned above, the Swedish government did not take the view that a new or changed GAAR was necessary in the PSD, but rather to propose to the parliament to legislate a similar specified domestic rule (in the income tax legislation, chapter 24, section 19). Dividend on shares from foreign companies will be treated as taxable income if it is deductible as interest or similar in the distributing company. This is a more targeted rule aimed at hybrid mismatches and it entered into force from 2016. Also the withholding tax act has been amended, to ensure that withholding tax is levied in a beneficial owner situation (the so-called *bulvanregeln*).

The Supreme Administrative Court has also found it possible to use the Swedish GAAR in a case where a DTC is involved, although its application is disputed by scholars.

26.7. The ATAD Proposal of 28 January 2016

The proposal of an Anti-Tax Avoidance Directive was sent out for consultation to authorities, universities, organizations and others – the normal procedure in Sweden – and also to the Swedish parliament for a subsidiarity assessment. Many of the answers contained criticism of the preparation and poor justification of the Directive, although it was considered a high political priority to combat tax avoidance and tax evasion.

The Swedish parliament found large parts of the Commission's proposals to go farther than the OECD BEPS proposal. The parliament emphasized that the tax sovereignty for Member States must be safeguarded. An excessively extensive application of the rules providing the European Union with legislative competence will eventually lead to an erosion of Member States' sovereignty as regards levying and maintaining sufficient tax revenue in order to finance welfare. The proposal was considered to go beyond what is necessary to achieve the stated objectives and that the proposal in its entirety was designed in such a manner it must be considered to be *incompatible with the subsidiarity principle*. Parliament decided to submit a reasoned

35. *See* K. Andersson, *Svensk skattetidning* (2013), p. 665.

opinion to the European Union that the proposal violated the principle of subsidiarity.[36] However, following the reply from the Commission and renegotiated versions of the Directive, the Swedish government now supports the Directive.

26.7.1. The ATAD's GAAR and the Swedish GAAR

The ATAD's GAAR is in a broad sense quite similar to the Swedish GAAR described above. There are however some important differences. Firstly, the Swedish GAAR required, as does the ATAD GAAR, the tax benefit to be the main reason for the action being taken, until changes in 1998. This was interpreted as "otherwise almost meaningless".[37] In 1998, this requirement was lowered to the predominant reason (interpreted as more than 50% of the reasons). The proposed GAAR in the Directive is in this aspect more limited than the Swedish GAAR. Secondly, and in combination with this first remark, the proposed GAAR has a different and new wording (i.e. "not genuine arrangement") which is supposed to be equivalent to the CJEU case law (*Halifax,* C- 255/02; *Cadbury Schweppes*, C-196/04) where the requirements seems to be even higher ("wholly artificial schemes"), which is more limited than what is considered to be tax avoidance according to the Swedish GAAR, as described above.

Since the Directive contains rules with a minimum level of protection, this may not require Sweden to change its GAAR. On the other hand, it may rather lead to a discussion and development of a more narrow interpretation or application of the Swedish GAAR, at least with regard to cross-border transactions concerning parties in another Member State. The broader scope of the Swedish GAAR may infringe EU freedoms when applied in these cases, an issue which was raised in the above- mentioned case HFD 2012 not. 30.

26.7.2. Redrafting/amendment of SAARs according to the rules in the ATAD Proposal

First of all, the ATAD will have an impact on the already ongoing work with reforming the rules limiting interest deductions. Current Swedish legislation is under heavy criticism from both practice and the EC. A proposal

36. *See* the decision by the Swedish parliament in rskr. 2015/16:183 and 2015/16:SkU28.
37. *See* prop. 1996/97:170 sec. 43 et seq.; compare SkU 1982/83:20 sec. 20.

was presented in 2014 (SOU 2014:40), but has not led to legislation and the work has continued. Since the ATAD rules are in line with Action 4 of the G20/OECD BEPS Project, there will probably be a proposal within this framework soon.

The other parts of the ATAD may have some impact on existing SAARs, but not necessarily more than a few adjustments, since the parts offer a minimum level of protection and most of the ATAD rules are covered by Swedish legislation already.

The Swedish CFC rules are clear and comprehensive and concern not only passive income (as in the ATAD), but active income as well. However, there are some differences that may have to be regarded and adjusted, i.e. the requirement of "efficient taxation" in the other state. The Swedish rules are in this sense more precise and simple.

The exit taxation rules are also quite similar to the existing Swedish rules (chapter 20 and chapter 22 paragraph 5 in the IT Act), but may need some adjustments to comply with the minimum level of protection. There has to be some consideration of the switch-over clause and the hybrid mismatches rules, which presently are not part of Swedish legislation. An issue raised during public consultations is how these rules relate to DTCs, since international law takes precedence over EU law and this has to be considered.

26.8. Transfer pricing rules, GAARs, SAARs and linking rules

26.8.1. Transfer pricing

Transfer pricing cases have become more common in recent years, since tax authorities have targeted transfer pricing as an important area. In RÅ 2004 ref.13 and RÅ 2006 ref. 37, the Supreme Administrative Court stated that the transfer pricing rules in the Swedish tax legislation (similar to article 9 in the OECD MC) have precedence over other rules calculating business income. However, there are, on rare occasions, cases that go before (are granted leave to) the Supreme Administrative Court. Most cases are handled in the lower courts, especially since it is often an issue of evidence in the case (which normally is not considered by the Supreme Court).

In the courts of appeal, there have been a number of cases about the arm's-length level of interest rates (on interest to be deducted). The tax authorities

have the burden of proof and have lost most of the cases since the courts did not find the evidence to be sufficient. The reason has mainly been that the tax authorities relied upon a judgment in a domestic pricing case (not TP) as the conclusive argument, where the Supreme Administrative Court lowered the interest deduction to a more reasonable interest rate because of the group structure where the risks were controlled within the group (the case of *Diligentia*, RÅ 2010 ref. 67). Accordingly, the tax authorities did not provide enough investigation with evidence of comparable situations in the following TP cases, but rather relied upon an arbitrary estimation. The courts of appeal did not find the *Diligentia* case to be relevant in the TP cases, where the burden of proof lies on the tax authority. Other types of TP cases have also been tried in the lower courts, some have been won by the tax authorities and some by the taxpayers, often depending upon the evidence and the preceding investigation.

However, the tax authorities' new strategy is not in the first place to litigate these arbitrary cases, but rather to encourage horizontal monitoring, working together with the taxpayers, since experience shows that most companies want to comply and have their documentation in order, especially if this kind of cooperation takes place in advance. There is also a possibility to receive an advance pricing agreement (APA), but only bilateral agreements, which are negotiated by the competent authority (a special group within the Swedish tax authority).

26.8.2. LOB rules

Limitation on benefits rules, of the nature discussed in Action 6 of the BEPS Project and in the US Model Treaty, exist only in Sweden's DTC with the United States and Barbados.

Some Swedish DTCs, however, contain articles excluding certain types of companies or companies engaged in certain types of business from being covered by the treaty or certain benefits in the treaty. Typical types of businesses are banking, shipping, financing and insurance. Companies with functions as headquarters office or so-called coordination centres have sometimes also been excluded. The overall objective has been to target low-taxed entities from enjoying treaty benefits.[38]

38. The subject has been thoroughly investigated by M. Dahlberg, *Svensk skatteavtalspolitik och utländska basbolag – En studie av svensk skatteavtalspolitik i förhållande till utländska basbolag mot bakgrund av svensk intern internationell skatterätt*, Iustus förlag (2000), ch. 5.

In more recent DTCs (i.e. Estonia, Kazakhstan and Macedonia), a more general rule concerning these types of businesses has been introduced, since it will be open to future development in the other contracting state.[39]

There is, however, also concern about how these types of rules relate to EU law. If the DTC concerns another EU Member State and the excluding rule targets a low-taxed company in that Member State, it may be argued the rules violate fundamental freedoms in EU law. It is possible such a case would also end up in a *Cadbury Schweppes* situation, the rules applicable only in situations of wholly artificial schemes.

26.8.3. CFC legislation

The Swedish tax legislation contains CFC rules.[40] The rules were introduced in 1990, revised in 2004 and have been changed some more since then, especially with regard to EU law. If a company is considered to be a controlled foreign company, the owner will be taxed as if it were a partnership, the share of the total business income.

The prerequisites for applying the CFC rules are ownership or control of 25% of the votes or capital in a low-taxed foreign company, directly or indirectly through related parties. The prerequisite "control" is vague and may be interpreted in a way to make it possible to consider many different forms of control.

As "low taxed" means 55% of the Swedish corporate tax rate, which at the moment is 22%, this makes 12.1% the limit. However, the legislation is supplemented with a list of countries or certain parts of that country (the "white/grey list") which are deemed to have sufficient tax and will not be considered "low taxed". To avoid multiple taxation, it is possible to receive credit for tax paid in the other state.

There is also a complementary rule to deal with the consequences of the *Cadbury Schweppes* ruling (C-196/04), since the use of CFC rules within the European Union probably only targets wholly artificial schemes.[41]

39. *See* M. Dahlberg, *supra* n. 28, at sec. IV, p. 320.
40. The Swedish CFC rules (in chapter 39a of the IT Act) are described in more detail in English in A. Gerson, *The Taxation of Foreign Passive Income for Groups of Companies (Swedish national report)*, Cahier de droit fiscal international (2013), p. 708 et seq.
41. *See* M. Dahlberg and B. Wiman, *General Report – The Taxation of Foreign Passive Income for Groups of Companies*, Cahier de droit fiscal international (2013), p. 44.

Changes in the CFC rules, as a result of the BEPS Project, have not yet been presented or proposed, but may now be examined to comply with the ATAD. As mentioned above, the existing rules are more or less within the framework, but they may need some adjustments.

26.8.4. Limited interest deduction

There are also Swedish rules on limiting interest deductions (chapter 24, 10 a-10 f §§ in the IT Act). The rules set a limit for deductions on intra-group loans, if the interest is taxed lower than 10% according to the tax laws in the receiving state. Even if interest is taxed by 10% or more, but it leads to a "substantial tax benefit" for the company group, the deduction may be refused. On the other hand, a lower taxation than 10% may not limit the deductibility if there are good business reasons for the loans on which interest is paid. What can also be taken into consideration is the possibility of capital contribution and whether the loan originates from another member of the company group.

The rules have been heavily criticized for being very arbitrary and most are impossible to interpret and apply in practice. The Supreme Administrative Court has found them impossible to apply in advance ruling cases (HFD 2014 not. 84-85) so there will be no case law for a long time either. The EC has also started an infringement procedure (no. 2013/4206) and it has sent Sweden a letter of formal notice, that Sweden through this legislation does not comply with EU law (article 49 of the EU Treaty and article 28 of the EES Treaty).

Although work continues to provide a new legislation, currently it is a little unclear what the outcome will be, but it seems likely to be a legislation that will meet the result of Action 4 of the BEPS Action Plan (something like a EBIT or EBITDA model) and, now, the requirements in the ATAD mentioned above.

26.9. Application of GAARs, TP rules and SAARs

With regard to practice using the GAAR, if transfer pricing rules or a SAAR is applicable, they have to be tried first, before application of the GAAR. The GAAR is in that sense the tool of last resort. As described, there is a two-step procedure in every GAAR case: first how does normal legislation (including transfer pricing rules or other special targeted rules) apply, then,

if this leads to a tax benefit, the GAAR can be taken into consideration and applied.

Another observation is – and it was even an argument during the older version of the GAAR – that if a SAAR has been tried and not found applicable, it might reduce the probability for the GAAR to be applicable. The reason for this was, at least earlier, that if the legislator has been concerned with a certain area of tax legislation, all possible implications have been considered and carefully regulated. An example of this is the reasoning in HFD 2012 ref. 6. Other examples concerns the rules of restructuring company groups, where the taxpayer has acted according to and fulfilled the requirements, in which case there is no room to apply the GAAR (i.e. RÅ 2001 ref. 66, RÅ 2001 not. 188 and HFD 2012 ref. 58).

A special feature of the Swedish GAAR is that it can only be applied by the court. Hence the tax authority has to turn to the court if it want the GAAR to be applied. Sometimes the tax authority has denied deductions or taxed the taxpayer to a higher amount on the grounds of recharacterization of the legal acts in the transactions or interpreted the legislation in disfavour of the taxpayer and the taxpayer's appeal to the court. The tax authorities may at

that stage then also move for an application of the GAAR as an alternative ground, which is not unusual in more complicated cases.

TP rules and SAARs may be used by the tax authorities in taxation like any other tax rules. However, the tax authorities have the burden of proof, if TP rules are to be applied, to show that pricing is not at arm's length. A modern approach is to encourage companies to participate in horizontal monitoring to reach acceptance for transfer pricing models used or even to apply for an APA.

Chapter 27

Turkey

Funda Başaran Yavaşlar, Mustafa Sevgin and Namık Kemal Uyanik

27.1. Concept of tax avoidance and aggressive tax planning and the BEPS initiative

27.1.1. Concept of tax avoidance

27.1.1.1. Meaning of tax avoidance in the Turkish literature

The concept of tax avoidance is not defined in Turkish tax law. Furthermore, there is no clear definition of this concept in tax administration regulations and judicial decisions. However, especially in public finance doctrine, tax avoidance is often described as a reaction against tax, whereas in tax law doctrine it is not even treated, except for a few studies.[1] Nevertheless, by taking into consideration that some of the public finance studies were penned by tax lawyers, we can propound two common and undisputed characteristics of this concept found in the (public finance and tax law) literature:[2] (i) tax avoidance is an act serving the purpose of paying less taxes or no taxes at all; and (ii) this is a completely legal act, which constitutes that it is subject to neither criminal tax penalty or administrative tax penalty, nor collateral tax sanctions.[3]

1. For example, M. Akkaya, *Vergi Hukukunda Ekonomik Yaklaşım* (Turhan 2002); D. Şenyüz, *Vergi Hukuku Açısından Özel Hukuk Sözleşmeleri* (Yaklaşım 2002), p. 21.
2. *See and compare* A. Akdoğan, *Kamu Maliyesi* (Gazi 2003), p. 163; G. Akgül Yılmaz, *Kamu Maliyesi* (Türkmen 2009), p. 163; Y. Artar, *Vergi Kaçakçılığı ile Vergiden Kaçınmaya İlişkin Düzenlemeler, Görüş ve Öneriler*, Legal Mali Hukuk Dergisi 103 (2013), available at http://yusufartar.com/2013/07/01/vergi-kacakciligi-ile-vergiden-kacinmaya-iliskin-duzenlemeler-gorus-ve-oneriler/ (accessed 3 Nov. 2015); N. Bilici, *Kamu Maliyesi* (Seçkin 2015), p. 160; M. Erdem, D. Şenyüz & İ. Tatlıoğlu, *Kamu Maliyesi* (2015 Ekin), p. 205; A. Erginay, *Kamu Maliyesi* (Savaş 2010), pp. 159-160; S. Gülgün, *Agresif Vergi Planlaması*, VSD 327 (2015), p. 135; R. Kumkale, *Vergiden Kaçınma ve Vergi Kaçırma*, Dünya Gazetesi (12.05.2015), available at http://www.isvebilgi.com/content/467-525-/62-65/VERG%C4%B0DEN+KA%C3%87INMA+VE+ VERG%C4%B0+KA%C3%87IRMA.aspx (accessed 12 Nov. 2015); H. Nadaroğlu, *Kamu Maliyesi* (Beta 2000), pp. 278-279; O. Pehlivan, *Kamu Maliyesi* (Murathan 2011), p. 163.
3. *See* i.e. J. D. Blank, *Collateral Compliance*, 162 U. PA. Law Rev (2013).

The fundamental principles regarding how tax avoidance can be performed can be classified as follows:[4]

(a) not performing the act that would generate taxes (for example, not earning any income);
(b) bringing about a situation that requires less taxation (for example, choosing to own a second-hand car instead of a new car);
(c) taking advantage of tax exemptions, tax immunities or tax allowances (for example, being involved in an activity in the field of education, engaging in commercial activities in free zones, engaging in research and development activities for inventing new products or methods);
(d) using the option for tax deferment (for example, having retirement saving accounts or not distributing profit); or
(e) using the gaps in law (for example, exploiting ambiguous legal terms such as "manners and customs" or "casual commercial transaction execution").

Therefore, first and foremost, in terms of the Turkish literature, tax avoidance should be evaluated as a concept *related to the fundamental rights and freedoms guaranteed in the constitution*.[5] Legal persons have the right and freedom to choose whether or not to earn revenue, acquire wealth or consume and, if they do, they have the right and freedom to choose when, where, how and with whom they would like to accomplish these things.[6]

On the other hand, it is certain that taxpayers have the right to benefit from tax immunities, exemptions and allowances. In fact, tax immunity, exemption and reduction concepts are clearly against the principle of equality in taxation and the principle of ability to pay. Nevertheless, they figure in the

4. For example, *see and compare* Akdoğan, *supra* n. 2, pp. 163-164; Akgül Yılmaz, *supra* n. 2, pp. 163-164; H. Ay, *Kamu Maliyesi* (Nobel 2014), p. 162; Bilici, *supra* n. 2, p. 160; Erginay, *supra* n. 2, pp. 159-160; Erdem, Şenyüz & Tatlıoğlu, *supra* n. 2, p. 205; Nadaroğlu, *supra* n. 2, p. 279; D. Özkök Çubukçu, A. Pınar, *Vergilendirme Süreçlerinde Vergi Kaçakçılığının Önlenmesi: Uluslararası Deneyimlerden Seçmeler*, Commemorative for M. Öncel (Ankara Üniversitesi 2009), p. 474; Pehlivan, *supra* n. 2, p. 163.

5. For example, *see* E. Pürsünlerli Çakar & F. Saraçoğlu, *Vergide Özgürlük İlkesi*, 18 Gazi Üni. Hukuk Fak. Dergisi No. 3-4 (2014), pp. 409 et seq.; *compare* E. Akçaoğlu, *ABD Vergi Hukukunda Özün Şekle Üstünlüğü*, Ankara Barosu Dergisi 2 (2012), pp. 171 et seq.; DE: BVerfG, 14 Apr. 1959, 1 BvL 23/57, 1 BvL 34/57, BVerfGE 9, p. 250, available at http://opinioiuris.de/entscheidung/1068 (accessed 1 Sept. 2015); J. Hey, *Steuerplanungssicherheit als Rechtsproblem* (R. Hüttemann, ed., Otto Schmidt 2002), p. 299; P. Kirchhof, *Legalität, Gestaltungsfreiheit und Belastungsgleichheit als Grundlagen der Besteuerung*, DStJG 33 (R. Hüttemann, ed., Otto Schmidt 2010), pp. 12 and 16; R. Seer, *Gestaltungsmissbrauch und Gestaltungsfreiheit im Steuerrecht – Einführung und Rechtfertigung des Themas* (R. Hüttemann, ed., Otto Schmidt 2010), DStJG 33, p. 1; K. Tipke, *Steuerrechtsordnung III* (Otto Schmidt 2012), pp. 1662 et seq.

6. *See and compare* the authors referred to in *supra* n. 4.

tax system to the extent that they are regarded as legitimate based on the principle(s) that the legislator places before the equality principle. The legislator strives to guide taxpayers by employing these tax incentives to attain other constitutional legitimate objectives (especially in the public interest). Therefore, tax immunity, exemption or reduction is included in an identified situation, where the taxpayer is exhibiting a behaviour that is precisely expected by the legislator.

Likewise, the legislator offers the possibility (or right) to the taxpayer to exercise his choice towards deducting certain expenses of the period directly or using, for example, depreciation, showing as revenue or keeping some of the revenue, such as a venture capital fund,[7] in liabilities for a certain time and thus only having it taxed after a period (utilizing tax deferment means), all of which are offered as rights of choice. Evidently, a person who exercises his right is not engaging in an illegal activity.

According to Turkish law, the legislator has clearly been entrusted with the task of imposing taxes, their amendment or abrogation. This task, which cannot be transferred to another organ, can be carried out by regulating all the subjects that limit fundamental rights and freedoms – along with other principles of the constitution such as equality and proportionality – in accordance with the principle of clarity and definiteness, while being aware that tax is an intervention in the fundamental rights and freedoms. Despite this fact, if the legislator left a lacuna in the law, whether this lacuna is *intra legem* or *extra legem*, the taxpayer would exhibit a behaviour that he can consider – under the current law system and praxis – to be *legal*, it cannot be expected of taxpayers to have their hands tied until the definitive sentence is passed by the judge. The economy cannot wait for the legal lacuna to be resolved.

7. TR: *Vergi Usul Kanunu* [Tax Procedural Law], 1961, (amended 2015), OG, 10 Jan. 1961, No. 10703, Art. 325/A I and II: “A venture capital fund can be set aside from the revenue of the relevant period or the declared revenue, in order to capitalize in the venture capital investment companies that have been established or will be established in Turkey as subject to the regulation and audit of the Capital Market Board or to purchase venture capital investment fund shares. This fund cannot exceed 10% of the profit of the company or the declared revenue or 20% of the equity capital. The amounts set aside for venture capital are kept in a transitory account in the liabilities.
If the taxpayers do not invest in the venture capital investment companies or the investment capital investment funds until the end of the year when the funds are set aside, the taxes that are not imputed in due time shall be collected with an interest for late payment”.

27.1.1.2. Tax rulings[8] and their impacts on tax avoidance

Tax rulings exist in Turkey. According to Art. 413 of the *Vergi Usul Kanunu* 1961[9] (VUK 1961), taxpayers can request written explanation from the Revenue Administration of Turkey or the authorized taxation agencies about the matters (concrete and not actualized transactions)[10] that cause ambiguity or hesitation for them in terms of their tax state and tax application. The administration may prefer to issue a private ruling for the taxpayer (binding commitment, *özelge*) or, if it deems necessary, to clarify the taxation subject for all taxpayers in the same situation, it may issue a circular. Both of these are considered to be administrative acts. The new – advance – ruling system in effect since 16 January 2010 aims to give accurate and clear answers to the taxpayers as soon as possible, to standardize the process and responses, to reduce bureaucracy, red tape and the cost of taxpayer compliance. There is no legal prohibition stating that the taxpayer cannot request written explanation regarding tax incentives.

Advance tax rulings, which provide legal security to taxpayers by allowing them to learn beforehand how the administration understands tax laws and implements them, can also be used in relation to legal regulations that would result in lower tax payments or no tax payments at all. Hence, in practice, the tax administration meets the advance ruling requests regarding the application of legal regulations. In this context, taxpayers may request a ruling on whether their transactions are in accordance with tax laws or not. For example, a revenue ruling may hold that taxpayers can deduct certain automobile expenses.

The tax administration cannot implement taxation different from the approach stated in the advance ruling, if the taxpayer fully and accurately describes the proposed transaction in his request and carries out the transaction as described in his petition. Accordingly, the advance ruling is only binding for the administration with respect to the taxpayer, who has filed an advance ruling request (it may not be relied on as a precedent by other

8. By the tax ruling concept, the administration provides certainty to taxpayers before the taxable event has taken place. Because the current reconciliation-praxis – especially before tax assessment – in Turkey ensures certainty to taxpayers, it can be said that both of them provide legal security to taxpayers. For reconciliation, please *see* sec. 27.1.1.3.

9. *See supra* n. 7.

10. Based on 395 *Sıra No'lu Vergisi Usul Kanunu Genel Tebliği*, Notice 2 ([The General Communiqué on Tax Procedural Law No. 395], OG, 16 Jan. 2010, No. 27464), the tax administration does not answer the information requests of the actualized transactions and subjects, although Art. 413 of the VUK 1961 ensure a broad right to request written explanations.

taxpayers). If the advance ruling is against the law, and the taxpayer is making a saving relying on the advance ruling, his trust in the administrative act shall be preserved by force of the legal security principle, within the scope of the "rightful expectation" concept.

Apart from the general advance ruling article, in Art. 13 V of the *Kurumlar Vergisi Kanunu*[11] 2006 (KVK 2006), which regulates hidden profit distribution by transfer pricing, taxpayers are allowed to reach advance pricing agreements with the tax administration. Art. 17 of the *Bakanlar Kurulu Kararı* 2007/12888[12] and *Transfer Fiyatlandırması Yoluyla Örtülü Kazanç Dağıtımı Hakkında Genel Tebliğ Seri* No. 1[13] clearly state all the procedures to be followed by the taxpayers, who require an agreement from the tax authority. Taxpayers are required to submit all relevant documents and data regarding transactions to the tax authorities. If necessary, the administration may request additional documents and information from the taxpayer. If documents and information concerned are written in other languages, they have to be submitted together with the original copies after being translated into Turkish. The taxpayers who signed an agreement with the tax administration are not obliged to prepare and submit an annual report for the transactions covered by the agreement.

Rulings are made public on the official website of the Revenue Administration, after all information that could identify the taxpayer to whom it was issued, Revenue personnel and tax professionals, has been removed (the tax secrecy principle). No private ruling has been published on the official site that would allow taxpayers to make transactions that would lead to avoiding taxation.

27.1.1.3. Non-judicial institutions/methods for tax disputes and tax avoidance

As for non-judicial institutions that can be used for tax disputes, there are the ombudsman institution, the compromise method and the reconciliation.

11. TR: *Kurumlar Vergisi Kanunu* [Corporate Tax Law], 2006 (amended 2015), OG, 21 June 2006, No. 26205.
12. TR: *2007/12888 sayılı Bakanlar Kurulu Kararı* [the Cabinet Decision 2007/12888], 2007, OG, 6 Dec. 2007, No. 26722.
13. TR: *Transfer Fiyatlandırması Yoluyla Örtülü Kazanç Dağıtımı Hakkında Genel Tebliğ Seri No. 1* [Transfer Pricing Communiqué No. 1], 2007, OG, 18 Nov. 2007, No. 26704.

Conciliation is a peaceful solution that can be applied only for the private law disputes in Turkey.[14]

The government auditing institution (ombudsman), established in 2013 based on Law No. 6328,[15] has legal personality with a separate budget. The institution is responsible for examining and investigating all kinds of acts and transactions of the administration together with its attitude and behaviour in terms of their legality and fairness upon the complaints concerning the operation of the administration within the framework of a sense of justice based on human rights, and making suggestions to the administration regarding these (Arts. 1 and 5 I of Law No. 6328). All real or legal persons, including those with foreign nationality, can apply to the institution without paying any fees (Art. 17 I of Law No. 6328). The application is required to contain a specific subject, not related to the disputes that are being heard at the judicial organs or that have been decided by the judicial organs, and not related to any disputes that have been finalized before (Art. 17 III of Law No. 6328). Before applying, the mandatory administrative application means stated in the private law and the administrative application means stipulated by the *İdari Yargılama Usulü Kanunu*[16] 1982 (İYUK 1982) should have been exhausted first. However, for cases that are irrecoverable or could possibly generate impossible losses, it is possible to apply even if the administrative application means are not exhausted (Art. 17 IV of Law No. 6328). In this context, if the administration does not respond to the application within sixty days of its notification, which is filed at the administrative authority for a transaction or action that can be the subject of an administrative proceeding to be realized, one can apply to the ombudsman institution within six months after this period expires. The application filed within the term of litigation stops the term of litigation in effect (Art. 17 VIII of Law No. 6328). The institution is obliged to finalize its examination and investigation within six months of the date of the application; otherwise, the term of litigation, which is stopped, shall continue from where it started (Arts. 20 I and 21 III of Law No. 6328). The institution shall notify the relevant agency or the applicant about its conclusions for the examination and investigation and its suggestions, if any (Art. 20 II, c.1 of Law No. 6328). The relevant agency is not obliged to establish an action in line with the suggestions of the institution or to perceive the solution suggested

14. TR: *Hukuk Uyuşmazlıklarında Arabuluculuk Kanunu* [Conciliation Law for Legal Disputes], 2012, Art. 2, OG, 22 June 2012, No. 28331.
15. TR: *Kamu Denetçiliği Kurumu Kanunu* [Law on The Ombudsman Institution], 2012, OG, 14 June 2012, No. 28338.
16. TR: *İdari Yargılama Usulü Kanunu* [Law on Administrative Trial Procedure], 1982 (amended 2015), OG, 20 Jan. 1982, No. 17580.

by the institution as applicable (Art. 20 III of Law No. 6328). If the relevant agency does not clearly accept the suggestion of the institution, or does not establish an action within thirty days or does not engage in any action, the term of litigation that has stopped shall continue from where it was stopped (Art. 21 II of Law No. 6328). If, among the decisions of the ombudsman institution there are decisions regarding taxation,[17] no decision regarding tax avoidance has been determined.

Compromise is another means that would indemnify the losses – apart from the judicial losses – of those who suffered due to an administrative transaction or action, provided that they would withdraw their lawsuit, which they would file against the administration due to the relevant administrative transaction or action (Arts. 3 and 12 I of KHK No. 659).[18] In this case, the dispute is not contextually resolved but only the parties are allowed to agree on the loss and its indemnification. The loss, in terms of tax law, shall occur with the collection of the tax or the administrative fine. The taxpayer or the person who has been fined can make the payment first and then file a lawsuit within the period of the term of litigation starting from the collection, instead of directly filing a lawsuit against the assessment based on the statement made over the declaration given for the mental reservation, or the additional or ex officio assessment made by the administration, or the administrative fine given. A similar situation prevails in terms of the taxes that have been paid through withholding, because in this case the collection is also carried out beforehand (the loss occurs) and then the taxpayer has the right to demand a tax refund (full remedy action) for the overpaid taxes within due time. Therefore, during the term of litigation one can choose to settle the dispute by peaceful means instead of filing a claim. The application for peaceful settlement must be made to the administration within the

17. For example, *see* the decisions that are dated 30/01/2014 and numbered 04.2013/1460; dated 12/03/2014 and numbered 04.2013/1860; dated 08/04/2014 and numbered 04.2013/1937; dated 22/01/2014 and numbered 04.2013/1370, available at http://www.ombudsman.gov.tr/.

18. TR: *659 Sayılı Genel Bütçe Kapsamındaki Kamu İdareleri ve Özel Bütçeli İdarelerde Hukuk Hizmetlerinin Yürütülmesine İlişkin Kanun Hükmünde Kararname* [Statutory Decree No. 659 regarding giving the legal services in the public administrations within the scope of general budget and the special budgeted administrations], 2011, OG, 2 Feb. 2011, No. 28103. Since both the Treasury and the Revenue Administration are public administrations within the scope of the general budget (*see* dated 10.12.2003 and numbered 5018, Public Finance Management and Control Law annex I Table, item nos. 13 and 47 (OG, 24 Dec. 2003, No. 25326), it is possible to apply for peaceful settlement of tax disputes. *See* F. Başaran Yavaşlar, *Vergi Uyuşmazlıklarında Sulh/659 sayılı KHK'yla Getirilen Barışçıl Çözüm Yolunun Vergi Hukuku Bakımından Değerlendirilmesi* (28.07.2012 tarihli Dünya Gazetesi), available at http://www.dunya.com/yorum-inceleme/vergi-uyusmazliklarinda-sulh-659-sayili-khkyla-getirilen-bariscil-coz-160975h.htm (accessed 10 Sept. 2015).

term of litigation and it should consist of a specific subject and a concrete demand (Arts. 12 I, c.1, IV and 11 II of KHK No. 659 and *see* Art. 9, b.c of KHK No. 178).[19] The application for peaceful settlement stops the term of litigation in effect until the application is concluded (Art. 12 II of KHK No. 659). It is obligatory to conclude the application, whether positive or negative, within sixty days (Art. 12 III, c.1 of KHK No. 659). Depending on the approval of the peaceful settlement, to be carried out between the administration and the applicant, if the parties settle on the "indemnity amount and the payment method", an official report shall be made and signed by the parties (Art. 12 I, c.1 of KHK No. 659). The amount agreed by the parties shall be paid to the administration budget according to the report of the verdict (Art. 12 VII of KHK No. 659). It is not possible to file a claim regarding the agreed subject or the amount (Art. 12 IX of KHK No. 659). No peaceful settlement decision is known for tax avoidance.

Reconciliation also – before or after assessment – is a method for resolving tax disputes. The subject of the reconciliation before assessment is the tax, which is to be assessed, and the penalty of tax loss, which is to be realized, whilst the subject of the reconciliation after assessment is the tax, the penalty of tax loss and the penalty of the minor infraction of rules, which are to be paid (add. Arts. 1 and 11 of the VUK 1961). Reconciliation binds both the administration and the taxpayer/the penalty addressee. The tax office must immediately fulfil the requirements of the finalized reconciliation protocol and the penalty addressee must pay the amount of penalty that had been agreed in due time. Parties cannot claim the invalidity of the reconciliation protocol, file a lawsuit for the issues that are determined in the protocol or file a complaint to any authority (add. Art. 6 II and 11 II of the VUK 1961).[20]

27.1.1.4. Repercussions of BEPS on the concept of tax avoidance

Because Turkey is one of the founding members of the OECD, it can be said that the latest tax legislation in KVK 2006 and *Gelir Vergisi Kanunu*[21] 1960 (GVK 1960) is influenced by the OECD soft laws and/or the international implementations of these rules. As a result of developments in the

19. TR: *Maliye Bakanlığının Teşkilat ve Görevleri Hakkında Kanun Hükmünde Kararname* [Statutory Decree Concerning Organization and Duties of the Revenue Administration], 1983 (amended 2015), OG, 14 Dec. 1983, No. 18251 (rep.).
20. For more information, please *see* F. Başaran Yavaşlar, *Turkey's National Report*, 5.4., EATLP Congress (2015).
21. TR: *Gelir Vergisi Kanunu* [Income Tax Law], 1960 (amended 2016), OG, 6 Jan. 1961, No. 10700.

Turkish economy and international taxation, for the first time new transfer pricing rules, thin capitalization rules and the controlled foreign company (CFC) regime were enacted in the new KVK 2006. All the regulations consequently are very much in line with OECD principles and guidelines. In the preamble to the KVK 2006,[22] the following considerations regarding transfer pricing and other regulations were clarified: "Taxation principles of resident corporate taxpayers towards their cross-border activities were considered and titles such as fight against controlled foreign companies and tax havens accordingly featured in the new draft. Similarly, in parallel with international implementations, the issue of transfer pricing, experienced as one of the most important problems, was also taken into the draft in conformity with reaching the equivalent capacity of other countries" (author's translation).

Legal regulations on hidden profit distribution by transfer pricing in the KVK 2006 were based on the OECD Transfer Pricing Guidelines and nothing else. In the preamble to Art. 13 of the KVK 2006, it is emphasized that the establishment of hidden profit distribution by transfer pricing is arranged in the light of international developments and especially the OECD's TPG. The meaning of arm's length principle and price, hidden profit distribution, related parties and transfer pricing methods, etc., which are indicated in the subparagraphs of Art. 13 of the KVK 2006, are in line with the TPG. Likewise, with No. 5 added to Art. 41 I of the GVK 1960 in 2007, the hidden profit distribution by transfer pricing is refused also in terms of the income tax and thus tax base erosion through transactions with the relevant people that are against the arm's length principle being prohibited.

BEPS has not made any direct impact on the meaning of tax avoidance in the Turkish tax system yet. However, there is great interest in BEPS, and many meetings and seminars are being organized regarding this subject along with numerous published articles. In this context, Revenue Administration has prepared a draft general ruling, which will be regarded in the context of Action 1 of the digital economy and BEPS. The draft imposes a duty on certain types of taxpayers to provide monthly information that could be as diverse as the names of intermediary companies that render services to those that deal with cross-border sales transactions between private consumers and foreign suppliers, cargo and logistic firms, banks and advertising companies. The main aim of the draft regulation is not only to collect information but also to help determine the nature of transactions; the goods

22. *Gelir İdaresi Başkanlığı*, available at http://www.gib.gov.tr/fileadmin/user_upload/Gerekceler/5520_Sayili_Kanun.pdf (accessed 20 June 2015).

or services are ordered by this method, via electronic commerce, and to tax the e-commerce or the intermediary companies' direct income and the VAT applied on the goods and services. Once implemented, the new regulation will facilitate the cross-border transactions to be subjected to taxation in Turkey, hence helping level the playing field between non-resident enterprises and domestic enterprises.

However, it is unreasonable to expect the BEPS action plan of the OECD, which functions as an international legislator, to be completely transferred to the domestic law, although it shall have some kind of impact. Since, as also stated by the doctrine,[23] it contains many problems such as matters that would not be easily accepted by the national legislators or the tax offices (for example, licence box regime, secret advance tax ruling), uncertainties regarding concepts (for example, location of the value creating activity), and implementation difficulties (for example, country-by-country report). The national courts shall not be affected by BEPS as long as it is not stated in the law. Hence, according to Art. 138 I of the *Türkiye Cumhuriyeti Anayasası* 1982 (AY 1982), "Judges, …; shall adjudicate according to their personal convictions in accordance with the constitution, law and legal system".

27.1.2. Concept of tax planning, abusive tax planning, aggressive tax planning and tax evasion in Turkish legal systems and the BEPS initiative

27.1.2.1. Concept of tax planning, abusive tax planning, aggressive tax planning and tax evasion

There is no legal definition of tax planning, abusive tax planning or aggressive tax planning in the Turkish tax system and there are also no published administrative regulations clarifying the meaning of the aforementioned concepts.

The concept of tax planning, even in business administration, which first stated this concept, was not used in Turkey until fifteen years ago, the terms "tax advantage" or similarly "tax saving" were preferred. Tax advantage/tax saving is, within the scope of the planning of the business administration

23. T. Ryding, *An Assesment of the G20/OECD BEPS outcomes: Failing to reach its objectives*, available at http://eurodad.org/BEPSfacts (accessed 10 Nov. 2015); W. Schön, *Ein grosser blinder Fleck*, 4 EY Tax&Justice (2015), pp. 24 et seq.; Tax Justice Network, *Major New Report on Global Corporate Tax Cheating*, available at http://www.taxjustice.net/tag/beps/ (accessed 13 Nov. 2015).

that perceives tax as a cost element and that wants to eliminate this cost, determining the behaviour that would create less tax burden or no tax burden at all by comparing different events/behaviour.[24] It can be said that the concept of (micro) tax planning has been used in the – public finance and tax law – doctrine by many authors in the last years what would correspond to as tax avoidance.[25] However, we should also point out that there are some views interpreting tax avoidance in a different and just way as an ultimate objective to be attained by tax planning.[26] According to this, tax planning is a strategic *process* aimed at reducing the tax load, removing it or extending it over a period of time and it can be performed by all kinds of taxpayers.[27]

As for the concept of abusive tax planning, it can be argued that it corresponds to "bypassing tax" in Turkish tax law.[28] We see this concept in conjunction with the "economic approach principle" mentioned in Sec. II below, and within this context in relation to tax veiling.[29] According to the

24. *Compare* G. Ergülen, H. Erdem, *Vergi Avantajları* (Yaklaşım 1999), pp. 9 et seq. and many authors referred to here; Y. Taşkın, *Vergi Planlaması Yöntemi Olarak Amortismanların Vergi Usul Kanunu ve Türkiye Muhasebe Standartları Usulü Bakımından Değerlendirilmesi*, Mali Çözüm (Kasım-Aralık 2012), p. 101; names the activities that cause tax planning as tax saving D. Gökbel, *Vergiden Kaçınmanın Önlenmesi* (Seçkin 2011), p. 33.

25. For example, *see* O. Eroğlu, Ö. Ö. Eftekin, *Vergi Planlaması Çerçevesinde Uzlaşma Kurumu*, 11 Ekonomik ve Sosyal Araştırmalar Dergisi 2, p. 240 et seq. (2015); C. İbiş, *İşletmelerde Vergi Planlaması*, Mali Çözüm 68, p. 73 (2004); Özkök Çubukçu, Pınar, *supra* n. 2, p. 474, footnote 5; B. Şişman, *İşletmelerde Vergi Planlaması Yöntemleri* (Yaklaşım 2003); Y. Taşkın, *supra* n. 24, p. 100; M. M. Yılmaz, *Agresif Vergi Planlaması: OECD ve Avrupa Birliği'nin Bakış Açısı*, 251 Yaklaşım, available at http://kasim20113.blogspot.com.tr/2015/08/agresif-vergi-planlamas-oecd-ve-avrupa.html (accessed 9 May 2017); *compare* Akdoğan, *supra* n. 2, p. 183. In turn, he differentiates between the evasion of taxes, which he refers to as "not establishing a relationship with the tax subject and thus foregoing the economic result", and tax planning, which he defines as "benefitting from the possibilities offered by the tax laws", *see* Akkaya, *supra* n. 1, p. 95. Likewise, she believes that despite great similarities, tax planning and tax evasion are two different things, *see* G. Yılmaz, *supra* n. 2, p.164. According to D. Gökbel, *supra* n. 24, pp. 36-37, tax planning reduces taxes by not committing any tax crimes and tax evasion remains outside the tax liability by not causing the event that generates taxes.

26. N. Coşkun Karadağ, *Hukuki Güvenlik İlkesinin Vergi Planlamasında Taşıdığı Anlam Üzerine Bir Değerlendirme*, Commemorative for Öncel (AÜHF 2009), p. 711.

27. Coşkun Karadağ, *supra* n. 26, pp. 716-717. The author divides tax planning into two as in broad sense, where "illegal means" can be used, and in the strict sense.

28. M. K. Oğuzman, *Medeni Hukuk Dersleri* (Filiz 1990), p. 175; K. Oğuzman & N. Barlas, *Medeni Hukuk* (Beta 2005), p. 200: "Attaining the same outcome by choosing legal ways in order to eliminate sanctions for acts against compulsory legal rules or legal transactions is called 'fraud against law' (*fraude a la lot, in fraudem legisagere, Gesetzesumgehung*). …Fraud against law is to circumvent the law and pass behind the law".

29. Akkaya, *supra* n. 1, pp. 96 et seq.; E. Yılmaz, *Kanuna Karşı Hilenin Vergi Hukukundaki Görünümü Olarak Peçeleme Kavramı ve Muvazaa İle Mukayesesi*, 17 Gazi Üni. Hukuk Fakütesi Dergisi 1-2 (2013), pp. 1757 et seq.

economic approach principle, although there are no regulations preventing taxpayers from establishing proper legal relationships that would bring tax advantages, *the use of the possibilities offered by the legal order contrary to their stipulated objectives* is considered to be illegal and is not protected.[30] Thus, different from tax avoidance, bypassing tax cannot be regarded to be within the scope of exercising fundamental freedoms; on the contrary, by violating the equality principle it corrupts the justice of taxation.[31] Since in almost all cases a tax loss also occurs, the infraction of tax loss is also committed (Arts. 344 I and 341 of the VUK 1961). Consequently, bypassing tax is a subject not only of tax law but also sanction law (administrative penalty law).

Hence, we are of the opinion that the reason why the subject "tax evasion" is paired with tax avoidance in the Turkish literature is probably due to sanction law coming into play. However, this does not mean that the concepts of tax avoidance and bypassing tax are identical because, according to the ruling conception in Turkey, tax evasion is committed when one engages in conduct in violation of tax law to pay less tax or to avoid taxes altogether, even though there was a clear tax liability.[32] For example, not registering the income for the sold product or service by not invoicing, making some accounting errors, showing the expenses higher than normal by providing a document indicating a higher amount than the actual payment are some examples that can be given of tax evasion. The first of these aforementioned examples is a tax infraction, the last example is a tax evasion crime and the second example is an infraction as well as tax evasion perhaps, depending on the circumstances of the incident. However, the prevailing idea in

30. TR: DVDDK [State Council Plenary Session of Tax Cases], 5 June 2009, 2007/696, 2009/244 (Opinion of the Investigation Judge).
31. D. Drüen, *Unternehmerfreiheit und Steuerumgehung*, StuW (2008), p. 158; for a critical perspective, *see* W. Schön, *Legalität, Gestaltungsfreiheit und Belastungsgleichheit als Grundlagen des Steuerrechts*, in DStJG 33 (R. Hüttemann, ed., Otto Schmidt 2010), p. 38.
32. Akdoğan, *supra* n. 2, p.165; Akgül Yılmaz, *supra* n. 2, pp. 164-165; H. Ay, Kamu Maliyesi (Seçkin 2014), pp. 161-162; Çelişikili ifadelerde de bulunmakla birlikte D. Gökmen, *supra* n. 24, p. 31; Nadaroğlu, *supra* n. 2, p. 280; D. Özkök Çubukçu & A. Pınar, *supra* n. 4, p. 474; Pehlivan, *supra* n. 2, p. 163; according to Erginay (*supra* n. 2, p. 160), tax evasion is considered a "fraud against the law".

Turkey[33] is that to speak of tax evasion, the existence of a criminal act is required.[34]

Aggressive tax planning, on the other hand, is a concept that has been in use in the last ten years for describing the international developments in the field of tax losses and tax avoidance. It is defined as "gaining tax advantages by using the discordant regulations or the inconsistencies between the tax systems", considering it a form of bypassing tax in Turkey.[35] However, when we take into consideration the abundance of works in the Turkish literature,[36] it would not be wrong to say that it is mostly used to denote abusive tax planning generally in the international field and specifically performed by multinational enterprises.

All these explanations show us that there are three established concepts in Turkish tax law in terms of taxpayer behaviour intended for underpaying tax or paying no taxes at all: *tax avoidance, bypassing tax* and *tax evasion*. Tax avoidance is a concept related only to tax law, bypassing tax both to tax law and sanction law (administrative penal law and, depending on the circumstances of the case, it can also be criminal law), and tax evasion is related to the penal code and in most cases also tax law. Within this context, it is not possible for an action/transaction to be a subject of tax avoidance and bypassing tax at the same time. However, depending on the circumstances of the case, an action/transaction can be a subject of both tax evasion and

33. Akdoğan, *supra* n. 2, p. 165; Akgül Yılmaz, *supra* n. 2, pp. 164-165; Ay, *supra* n. 32, p. 162; Bilici, *supra* n. 2, p. 161; Erginay, *supra* n. 2, pp. 160-161; Kumkale, *supra* n. 2; Nadaroğlu, *supra* n. 2, p. 280; Pehlivan, *supra* n. 2, p. 163; Akgül Yılmaz, *supra* n. 2, pp. 164-165. However, the actions such as "not giving invoices or underrating the taxes" that are provided as examples by Erginay, Pehlivan and Akgül Yılmaz are considered to be infractions but not crimes according to the applicable regulations. According to Erdem, Şenyüz and Tatlıoğlu, *supra* n. 2, to avoid taxes, the existence of crime is not necessarily required.

34. In comparative law, *see* i.e. W. Hoffman, D. Maloney, W. Raabe, J. Young, South-Western Federal Taxation 2016: Comprehensive, Part I, 2-4c (Cengage Learning 2015). The authors point out that tax evasion contains in itself the deceit and fraud as a means to pay less tax or no taxes at all.

35. For example, *see* Gülgün, *supra* n. 2, pp. 134-135; considering aggressive tax planning as tax evasion, O. Eroğlu, *Kurumlar Vergisinde Vergi Planlaması* (Seçkin 2014), p. 17.

36. For example, S. Acinöroğlu, *Vergiden Kaçınma ve Vergi Kaçakçılığıyla Mücadelede Avrupa Birliği'nin 1 Ocak 2013 Tarihli Son Eylem Planının Değerlendirilmesi*, Vergi Dünyası Dergisi 379 (2013), pp. 188 et seq.; Pürsünlerli Çakar, Saraçoğlu, *supra* n. 5 (2014), p. 416; PwC, *Dünya vergide neleri konuşuyor?*, available at https://www.pwc.com.tr/tr/microsite/transfer-pricing/yayinlar/2013/pages/dunya-vergide-neleri-konusuyor5.pdf (accessed 9 May 2017); M. M. Yılmaz, *supra* n. 25.

bypassing tax, although this is not required.[37] *Bypassing tax figures in the grey zone between tax avoidance and tax evasion*. The starting point of the pendulum ready to move on the clock is tax avoidance and the other tip is tax evasion, while the middle part is bypassing tax. The determination of the last one has been perhaps the toughest subject for both national and international tax law for a considerable time.

It is not possible to answer the question of at what point the pendulum enters the grey area, meaning "tax avoidance ends and bypassing tax starts" with a single formula that can be used for all concrete cases. Business administration and economics searched for various calculation formulas[38] and the jurisprudence searched for answers with principles and theories, and they all try to fight against this situation preventing just and transparent taxation.

27.1.2.2. Concept of bypassing tax[39]

According to the Turkish tax law, there are some definitions for bypassing tax – distinguishing it from collision – which is mostly referred as "tax

37. For example, *see* TR: DVDDK [State Council Plenary Session of Tax Cases], 7 May 2010, 2008/860, 2010/212. In the event, which is the subject matter of the case, it was determined that the company carried out an accounting fraud in its accounts and registries to hide the capital gains made by repo and reverse repo. Namely, in order to show the value of the security, which is subject to repo, higher than its original value, the securities, which are not subject to repo, were shown in the accounting records among the securities that are subject to repo, thus the cost value and the sale value of the securities subject to repo were equalized and the taxation of the positive earnings obtained from the repurchase promise of the security was prevented. The State Council assessed that presenting securities, which are not subject to repo, as if they were subject to repo was a fraud against law, and it was ruled that a threefold loss of tax penalty must be applied on the grounds that smuggling was committed by both in terms of ex officio tax assessment and accounting fraud.

38. For example, *see* J. Blouin, *Defining and Measuring Tax Planning Aggressiveness*, III, 67 National Tax Journal 4 (Dec. 2014), pp. 879 et seq. (According to the author, aggressive tax cannot be explained without tax risk. In other words, if there is tax risk, there is also aggressive tax planning. However, all the three principles that are generally used for determining when there is tax risk that are ((1) the cash effective tax rate (ETR); (2) the generally accepted accounting principles (GAAP) ETR; and (3) the FIN 48 reserve are open to discussion and they have weak points.

39. Although the "fraud against law" concept is predominantly used in judicial decisions and Turkish tax law, "bypassing tax" (please *see supra* n. 28) term is preferred in this study, taking into account that fraud against law is also bypassing law. Because, the term "fraud" is prone to misunderstanding in a way to refer crime, as mentioned above, however, tax crime does not exist in every case in which abusive/aggressive tax planning exist. Please *see* E. Alptürk, *Kanuna Karşı Hile, Muvazaa, Peçeleme Ve Vergi Planlaması Kavramları*, available at https://www.xing.com/communities/posts/kanuna-karsi-hile-muvazaa-peceleme-ve-vergi-planlamasi-kavramlari-1002155851 (accessed 10 Nov. 2015).

veiling":[40] "a private law transaction other than the normal and natural use, which is employed for achieving an economic result that would be achieved with a private law transaction that is the subject of taxation according to the tax law normally and naturally, for the purpose of rendering it not to be the subject of taxation according to the tax law",[41] "an act to prevent the occurrence of the event that would generate taxation although this is executed legally",[42] "presenting a concrete material event in a way befitting an abstract event, without foregoing its economic substance in order to benefit from a tax concession or to prevent any possible tax liability",[43] "the artificial transactions, which lack economic substance, put formality before others, cause tax losses, are not deemed as misdemeanour or crime according to the law but not also deemed as legitimate, realized by the taxpayers by making use of the legal regulations in a tax system, the conflicts between the legal regulations or the conflicts between the one or more tax systems in order to obtain a tax advantage that comply the letter of the law but are in conflict with the purpose and objective of the judicial organ";[44] "tax reducing activity by employing an adept use of the Civil law institutions or the contract types".[45] Most of these definitions were propounded by taking into consideration Art. 3 B-1 of the VUK 1961, which regulates the economic approach principle.

40. Akkaya, *supra* n. 1, pp. 94 et seq.; S. Acinöroğlu, *supra* n. 36, pp. 188 et seq.; Pürsünlerli Çakar & Saraçoğlu, *supra* n. 5, p. 416; S. Kaneti, *Vergi Hukukunda Ekonomik Yaklaşım İlkesi, Prof. Dr. Selim Kaneti Makaleler* (XII Levha 2011), p. 233; S. Kırbaş, *Vergi Hukuku, Temel Kavramlar, İlkeler ve Kurumlar* (Siyasal 2015), p. 59; *compare* K. Mutluer, *Vergi Genel Hukuku* (İstanbul Bilgi Üniversitesi 2006), p. 62; A. Oktar, *Vergi Hukuku ve Türk Vergi Sistemi* (Türkmen 2013), pp. 57-58; PwC, *Dünya vergide neleri konuşuyor?*, available at https://www.pwc.com.tr/tr/microsite/transfer-pricing/yayinlar/2013/pages/dunya-vergide-neleri-konusuyor5.pdf; M. M. Yılmaz, *supra* n. 25. However, we should point out that there is no unique agreement on the concept in terms of Turkish tax law. Hence, for example, M. Öncel, A. Kumrulu & N. Çağan, *Vergi Hukuku* (Turhan 2015), pp. 26 et seq., express that "if the aim is to evade taxes by employing private law types and institutions in a way other than their normal and natural purpose, these types of transactions shall be referred as tax-veiling contracts"; Y. Karakoç, *Genel Vergi Hukuku* (Yetkin 2014), p. 181, defines the transactions that are performed for the purpose of *tax evasion or tax avoidance* by employing private law types and institutions other than their normal use as tax veiling; E. Öner, *Vergi Hukuku* (Seçkin 2012), p. 44, footnote 6, accepts the abuse of the legal provisions in order to evade taxes as tax veiling; and finally, Ş. Kızılot, D. Şenyüz, M. Taş & R. Dönmez, *Vergi Hukuku* (Yaklaşım 2006), p.83, argues that the abuse of the private law types that cannot be regarded as natural and for the purpose of *tax evasion* as the tax veiling.
41. S. Kaneti, *supra* n. 40, p. 223.
42. Şenyüz, *supra* n. 1, p. 21.
43. Akkaya, *supra* n. 1, p. 95.
44. Gülgün, *supra* n. 2, p. 135.
45. Kırbaş, *supra* n. 40, p. 59.

We are of the opinion that by making use of the doctrine and criteria stated in Art. 3 B-1 of the VUK 1961 and comparative law, it is possible to state the characteristics of bypassing tax law as follows:
(1) a private law transaction that lacks economic substance;[46]
(2) this transaction being used for obtaining a tax benefit;[47]
(3) law not having the aim to attain such a tax benefit.

The presence of the first two characteristics together or the presence of the first and the last characteristics together should indicate that there is tax bypassing.

If we are to start with the absolute characteristics, the phrase "tax benefit" consists of a large range of situations from having tax immunity to postponing, reduction or even effacement of tax. However much the explanations in the doctrine are meant to imply that the transaction should serve the sole purpose of obtaining a tax benefit, we believe that this should not be the case. It would be sufficient for the principal aim to be such.[48] In other words, other objectives might be pursued with this transaction. If it can be argued in an objective way that even if this would not provide a tax benefit, this transaction would be performed, it should be accepted that the transaction is not aimed at obtaining a tax benefit anymore.

Regarding the first matter, "whether the legal transaction lacks economic substance" is a difficult matter to decide, especially when there are complex legal relationships. Generally speaking, it can be said that here we are talking about a transaction that lacks economic logic, rationality and which is artificial, extraordinary, against the natural course, suspicious, nonconforming, contradictory, not continuous, compulsory and/or complex.[49] By also

46. *See* sec. 27.2.; compare with economic substance doctrine (also called sham transaction doctrine) and *see* i.e. S. Schwarz & D. J. Lathrope, *Fundamentals of Corporate Taxation, Cases and Materials* (Foundation 2015), ch. 14, p. 620: "There is a lack of uniformity regarding the proper application of the economic substance doctrine. Some courts apply a conjunctive test that requires a taxpayer to establish the presence of both economic substance (i.e., the objective component) and business purpose (i.e., the subjective component) in order for transaction to survive judicial scrutiny. A narrower approach used by some courts is to conclude that either a business purpose or economic substance is sufficient to respect the transaction. A third approach regards economic substance and business purpose as 'simply more precise factors to consider' in determining whether a transaction has any practical economic effects other than the creation of tax benefits".
47. Tipke, *supra* n. 5, p. 1677; J. Englisch, *Steuerrecht*, ch. 5, Rz. 127 (K. Tipke, J. Lang and others, eds., Otto Schmidt 2015), p. 218.
48. *Compare* Akkaya, *supra* n. 1, p. 100; Tipke, *supra* n. 5, p. 1677; Schwarz & Lathrope, *supra* n. 46, ch. 14, pp. 610 et seq.
49. For example, *see* Akkaya, *supra* n. 1, p. 99; D. Drüen, *Abgabenordnung, Finanzgerichtsordnung*, Vor § 42, Tz. 19 (K. Tipke & H. W. Kruse, eds., Otto Schmidt

using the national court decisions, some of the criteria indicating lack of economic substance can be listed as follows:

(1) *Necessity criteria* (*whether the transaction is required in terms of economics*). Here, the important issue is whether there is a flaw in the economic process, if the transaction causing the tax advantage is not performed or removed from the chain. For example, if the goods are imported to the relevant person/company in the free zone/tax haven, then this relevant person/company adds profit and sends these goods to the purchasers or the affiliated company in Turkey.[50] Sending these goods to the company abroad will not have any economic substance/meaning, other than leaving some part of the tax of the profit in the free zone and eroding the tax base in Turkey. The fact that there is no distributor company in the free zone/tax haven does not cause a flaw in the economic process.

(2) *Conformity criteria* (*whether the transaction complies with the normal course of economic life*). The economic activities carried out by private persons in the free market regime have the sole final purpose of obtaining profits. Therefore, the purpose served by all the transactions, whether on their own or as parts of a chain, is exactly this. If no rational relationship can be established between the performed transaction and this principal purpose, this transaction is against the natural course of economic life.

   (a) Sometimes non-conformity originates from the "nature of the transaction/transactions" in the concrete case. For example, if a company has debt receivables from a bank, it would be against the natural course of the economic process if the company took a credit

2010); Hoffman, Maloney, Raabe & Young, *supra* n. 34, 2-4c; Kaneti, *supra* n. 40, p. 234.

50. *See* DVDDK [State Council Plenary Session of Tax Cases], 5 June 2009, 2007/696, 2009/244. In the case, which is the subject to non-conformity, the company, whose headquarter is in Turkey, sold its goods to its partner in which it had 95% ownership and that was founded in the free zone, and it was selling goods to that company at a price below the market value and in turn the partner was selling the fabrics it had purchased at a higher price to the domestic companies without further processing them, and the domestic buyers were interacting with the company in Turkey for sale-purchase transactions. The State Council focused on whether there was a conduct to decrease the tax basis in Turkey by keeping the earnings in the free zone – contrary to the founding principle of the free zone – by determining that the founding purpose of the free trade zone as "increasing investment and manufacturing for exporting, expediting the access to foreign capital and technology, providing economic input needs in a manner which is cheap and regular, benefitting further from external financing and trade opportunities".

from the bank instead of receiving its debt receivable directly.[51] Likewise, it is not a rational transaction that a company (A) making an advance payment to another company (C) at which it has 70% ownership for a real property it would purchase, and after that this company (A) is purchased by company (B), which owns 30% of company (C), by merging and accordingly causing its receivable rights to pass to the assignee company (B). The assignee company then abandons the purchase of the real property and requests the advance payment to be paid to itself, and company (C), which exchanged the advance to foreign currency and kept it in its accounts during these transactions, returns the money without paying any interest.[52] Because, even for the purchase of real property, it is against the natural course of economic life that a company would receive the money, which it gave as an advance payment to another company, after three years. The fact that the company making the advance payment (A) is transferred to company (B), which is the bigger owner of the company that wants to sell the real property – company (C) –, the bigger owner in all three companies being the same person, the non-existence of a decision of the board of directors or a general assembly resolution concerning the purchase of the real property, even if there is a contract between the two companies for the purchase of the real property, renders the advance payment transaction suspicious enough.

(b) Sometimes we see this non-conformity when we look at the economic results that cannot be associated with the final purpose (obtaining profit). Within this context, having losses over a long period and despite this not providing any solutions to solve this problem is against the natural course/logic of economic life. For example, if a Turkish resident company (A), which has a significant partnership share in a multinational enterprise (B) abroad, is incurring longstanding losses due to high commercial expenses in relation to its investment decision regarding the publicity, recognition and marketing of the global brand of the MNE (B) in Turkey and its financial situation becomes so bad to the point of declaring bankruptcy,

51. TR: DVDDK [State Council Plenary Session of Tax Cases], 31 Jan. 2003, 2002/422, 2003/11. The State Council reached the conclusion that the company reduced its tax basis by deducting the interest and the exhange difference paid to the bank as expenses.
52. TR: Dan. 3. D. [State Council, 3rd Division], 15 Sept. 2011, 2008/497, K.2011/4775. In this case, the claim of the tax administration of hidden gains distribution is accepted by the State Council on the grounds that "some parts of the earnings of the enterprise, which is deprived of the earnings arising from the lending transaction, was distributed by a large amount of cash sources letting be used unreturned".

and therefore a company (C) abroad, which is one of the five partners of the MNE (B), continuously sends money under "loss compensation fund" and "capital advance" – that would be added to the capital is not rational. Hence, constantly transferring funds to a company, whose financial situation worsens every day and the legally obligated institution to transfer this money to the capital reserve and profit reserve accounts is against the requirements of the economics and trade, in reality there is revenue earned in return for a service.[53] Namely, company (A) serves the purpose of adding Turkey to the global company chain of the MNE (B).

Likewise, it is contrary to the natural course of economic life that the transaction is not a transaction that belongs to the main activity area of the enterprise and/or does not serve the purpose of obtaining profits in economic terms. For example, if a Turkish resident company (A), whose main line of activity is journalism and publishing, does not use the credit it received from a foreign credit institution (B) in its line of activity and on the contrary buys stocks from company (C), which carries out its activities at the same address as company (B), enters into a 2-year forward agreement with foreign company (C), then puts up the stocks it purchased as collateral for foreign credit institution (B) from which it received the credit, while registering these stocks under the "Other Financial Fixed Assets" in its accounts, it is clearly unnatural that it does not earn any profits from these transactions and it shows us that company (A) carried out these transactions to decrease the risk and to be able to pay the taxes in the next period.[54]

However, in some cases enterprises could possibly content themselves with earning only revenues in a certain relationship with the

53. TR: DVDDK [State Council Plenary Session of Tax Cases], 17 June 2015, E.2015/245, K.2015/301 (unpublished). In the case, the plaintiff company is the sole seller of a global brand in Turkey; it may only sell products from this specific brand; it does not make any payments to the foreign company for brand, licensing and franchise; its rights have not been included in the inventory; the operating costs of the plaintiff company consist of "marketing, sales, distribution and general administrative expenses", there are no R&D expenses; the operating costs have been created in order to increase sales in Turkey; while the plaintiff company earns a gross income annually, it has also begun to make a loss due to the operating costs; conversely the multinational company abroad is making high quarterly profits and the global business plan of the company is being decided at the general headquarters; the money is regularly sent to the plaintiff company by the same partner of the multinational company; the interims sent were not regularly approved and the shareholders assembly and board of directors took decisions retroactively.

54. TR: Dan. 3. D. [State Council, 3rd Division], 30 Dec. 2004, 2004/1554, 2004/2655.

purpose/expectation to enter into a different legal relationship that would enable them to make profits (for example, meeting the non-rentable expectations of the customer to extend the customer portfolio and/or to develop economic relationships with the customer). If the scope of these transactions is meaningless in the bigger picture and there are some profit-earning transactions to balance these transactions or these transactions are not long term, they can be accepted as rational.

(c) We see non-conformity sometimes due to the complexity of the transaction and the economic purposelessness hidden behind this complexity. For example, when one of the companies affiliated to a holding company makes a donation to a university in which the holding company has 99.99% shares and the university transfers a big portion of this donation to the holding company as capital commitments payment and the holding company transfers almost the whole payment to the affiliated company as capital commitments payable, then these are chains of a transaction that has no meaning other than the money returning to where it came from under a different name. In the words of the tax administration, with these transactions "the money which has been transferred under the title of donation returns back to the company and with tax-veiling the returning amount is becoming nontaxable".[55]

(d) When determining whether a transaction is natural or not, the economic results generated by the transaction should be evaluated separately for both parties. For example, within the scope of the contracts made with company (A) abroad, if a Turkish resident company (B), which becomes a partner to the company (A) abroad by transferring some of the shares of company (A) and which needs to purchase some materials that will be used in production from company (A), cannot realize the import procedures due to an inability to complete the legal procedures and then purchases these aforementioned materials from another domestic company (C), which imports the goods, with which it has a partnership

55. TR: Dan. 4. D. [State Council, 4th Division], 29 June 2004, 2004/587, 2002/1591. However the State Council found the assessment illegal on the grounds that "the fact that the companies, which made the donation and the capital commitment payment, belong to the same structure does not necessarily indicate that both of the transactions should be associated to each other in absolute terms, even than there is no regulation that prohibits this process, the matters stated in the investigation report and the findings are hypothetical".

relationship, over a price that is higher than that for similar products, it does not necessarily indicate the presence of a hidden gain transfer by transfer pricing. The decision needs to be given based on whether there is a gain transferred to the relevant company by the plaintiff and, if there is a transferred gain, whether this gain was transferred to the related company (C) in compliance with the arm's length principle and not in a non-conforming value or price.[56] Likewise, to decide whether a Turkish resident company is reducing its tax basis in Turkey by purchasing goods at a higher price from a company in the free zone on whose management and inspection it has authority, it has to be determined at which price this institution purchased the same good in the previous years and the expenses of the firms engaging in similar activities.[57]

The last criterion required for recognition as bypassing tax concerns "the law not intending to attain such tax benefit with such an action" and whether the transaction/transactions serve the purpose stipulated by the law. This last provision, which we observe *especially in relation to tax exemption, tax privilege and tax reduction*, requires first the manifestation of the purpose of the relevant norm and then an examination of whether a typical relationship is established between the transaction and the norm. For example, the sole purpose of a company buying four real estate properties from another company – that belongs to the same group or with which it has a close relationship – and then selling these four properties within a month with a value thirty-five times their original values to another company, adding the profit on the sale to its capital, issuing registered share certificates and having them listed in the stock exchange, is to benefit from the tax exemption offered by the law. However, the law provided this exemption for the purpose of providing the opportunity "to enable the legally obligated institutions to bring in the enterprise the values gained by the immovable in their assets and the inactive dependent values such as participation stocks in an inflationary environment, thus enabling the institutions to use the sources obtained by the sale of their participation stocks and their immovable in their commercial activities and therefore continuing their activities with their equities without borrowing and strengthening their financial structures. Adding the sale profits obtained from the immovable, which is sold 26 days after

56. TR: DVDDK [State Council Plenary Session of Tax Cases], 30 Dec. 2014, E.2014/953, K.2014/1369.
57. TR: Dan. 4. D. [State Council, 4th Division], 20 Jan. 2003, 2002/1783, K.2003/129.

> its purchase, to the capital, … does (not) necessarily mean that the funds are created by turning the asset of the enterprise into cash".[58]

In conclusion, we have to state that no matter how much the desire to pay less taxes or no taxes at all befits the homo economicus, *the legislator expects taxpayers to carry out their transactions without thinking about the taxes* and by almost presenting a "hypothetical transaction" (presumption) – that would be determined according to the conditions of the concrete incident – accepts the transaction(s) contrary to this hypothetical transaction/presumption as bypassing tax.[59] In fact, this approach finds its legitimate grounds on the one hand in the public benefit, which materializes in the state "receiving tax revenue" and thus fulfilling the obligations given to the state by the constitution, and on the other hand in the equality principle. Everyone should pay their taxes, in proportion to their financial power, and contribute to covering the public expenses. Bypassing tax not only prevents the equal distribution of the tax burden by causing distortions in the financial power, but also hinders the equality in competition (unfair competition).[60]

27.1.2.3. Tax rulings and non-judicial institutions/methods for tax disputes

The explanations above in sections 27.1.1.2. and 27.1.1.3. are also valid for bypassing tax (abusive tax planning and aggressive tax planning). However, regarding abusive tax planning and aggressive tax planning, it should be remembered that the administration should remain within constitutional principles, especially the boundaries of the principle of legality, while passing advance rulings.[61] Therefore, it is not only that the administration cannot interpret any legal regulation inconsistent with the constitution, but also it cannot engage in an application that does not appear in the law or is not allowed by the law or elucidate that it shall implement something that is prohibited by the law. Therefore, since the tax administration cannot interpret the law in such a way that allows taxpayers to perform abusive tax planning

58. TR: DVDDK [State Council Plenary Session of Tax Cases], 6 Dec.1996, 1996/269, 1996/407.
59. *Compare* Englisch, *supra* n. 47, p. 215.
60. *See supra* n. 31 and also B. Dirk, *Steuerrecht*, Rz.343 (C. F. Müller 2015), p. 107.
61. TR: *Türkiye Cumhuriyeti Anayasası* [Constitution of Turkish Republic], 1982, (amended 2011), OG, 9 Nov. 1982, No. 17863 (rep.), Art. 8: "The executive power is used and exercised by the President of the Republic and the Cabinet in accordance with the Constitution and the laws".
Art. 11 I: "The provisions of the Constitution are the fundamental legal rules that are binding for the legislative, executive and judicial organs, administrative authorities and other institutions and persons".

or aggressive tax planning, it is unacceptable for a taxpayer to abuse the information given by the administration to facilitate bypassing tax law.

27.1.2.4. Influences on the meaning of tax planning, abusive tax planning or aggressive tax planning by their meaning in other jurisdictions or OECD soft law

Since there are no express definitions of tax planning, abusive tax planning or aggressive tax planning in the law, administrative regulations or judications in Turkey, we cannot speak of a direct impact of comparative law on this subject.

As for the indirect impact, there are two different types:

(1) The three significant tax laws (tax procedure law, income tax law and corporate tax law) were prepared by taking German laws towards the end of the 1940s as models. Although there have been significant changes to the fundamental laws of both countries, their basic structures are quite similar and for some concepts and principles, German tax law forms the basis. One of these concepts is tax veiling.[62] Consequently, it is observed that the explanations for tax veiling stated in the tax law doctrine in the past years were based mainly on the German doctrine.

(2) Turkey is a member of the OECD and a candidate country for the European Union. Within this scope, it is affected by the studies in the OECD and the European Union.[63] Especially in recent years, in the publications of academics and mostly pragmatists, the discourse has mainly been on tax planning, abusive tax planning or aggressive tax planning within the frame of the OECD and EU studies.[64] However, these studies have not had any impact on the legislator or the tax office

62. One of the principles is the economic approach principle (or substance-over-form principle).

63. Chapter 16: Taxation is in negotiation process since 30 June 2009. *See* T. C. AB Bakanlığı, *Katılı Müzakerelerinde Mevcut Durum*, available at http://www.ab.gov.tr/index.php?l=1&p=65 (accessed 5 Sept. 2015).

64. For example, *see* Acinöroğlu, *supra* n. 36; O. Günay, *OECD Yaklaşımı Çerçevesinde Vergi Kaçırma Ve Vergiden Kaçınma*, Vergi Sorunları Dergisi 312 (2007), available at http://www.vergidunyasi.com.tr/dergiler.php?id=4760 (accessed 14 Sept.2015); Gökbel, *supra* n. 24; Gülgün, *supra* n. 2; M. M. Yılmaz, *supra* n. 24; E. Tayfur, *Avrupa Birliği'nin Vergi Kaçakçılığı ve Vergi Kaçırma Faaliyetlerine Karşı Mücadelesi*, Vergi Sorunları Dergisi 374 (2012), available at http://www.vmhk.org.tr/avrupa-birliginin-vergi-kacakciligi-ve-vergi-kacirma-faaliyetlerine-karsi-mucadelesi/ (accessed 14 Sept. 2015).

or the judicial organ in relation to "tax planning, abusive tax planning or aggressive tax planning".

27.1.2.5. Repercussions of BEPS

BEPS have not made any impact on the meaning of the mentioned concepts in the Turkish tax system yet. But it may be considered that some regulations in tax codes can be implemented in compliance with the BEPS concept.

For instance, Action 12 of BEPS called for recommendations for participant states regarding the design of mandatory disclosure rules for aggressive or abusive transactions, arrangements, or structures. Art. 148 of the VUK 1961 states that all kinds of state agencies and institutions, taxpayers and both individuals and legal persons who transact with the taxpayer are obliged to provide information to the Finance Ministry or the person who has tax audit authority, when it is required by them. Furthermore, Art. 149 of the VUK 1961 states that the mentioned persons can be obliged by the Ministry or by the Tax Office to disclose continuous information at regular intervals, generally a monthly basis. The Finance Ministry has used this authority on various issues by issuing a general regulation. The Revenue Administration has intensified its effort to curb the underground economy and held workshops in May 2015 on increasing awareness and voluntary tax compliance. The Finance Ministry *may* consider using its authority within the context of Action 12 of BEPS and impose a disclosure obligation on both the promoter and the taxpayer, or impose the primary obligation to disclose on either the promoter or the taxpayer.

27.2. The reaction to avoidance and aggressive tax planning in the BEPS context – Domestic GAARs

Turkey has a GAAR that relies on the substance-over-form principle. This principle allows the tax authorities to disregard the form of a transaction when it is obvious that the taxpayer is attempting to avoid tax. The substance-over-form principle was introduced and became effective in the tax legislation on 30 Dec. 1980 (Art. 3 B-1 of the VUK 1961).

The provision in Art. 3 B-1 of the VUK 1961 reads as follows: "True nature of taxable events and related transactions shall be taken into account in taxation". In the preamble to this amendment, it is mentioned that, in cases

related to taxation, the actual aspect of the transactions should be taken into account rather than the appearance (legal form) of them. Additionally, it is stated that some taxpayers may conceal their incomes by abusing loopholes or "tolerant" provisions in the law and it is the tax administration's duty to reveal these concealed incomes.

The aforementioned substance-over-form principle is also called "economic approach", which denotes that along with the legal form and names of taxable events, economic meanings and contents (economic substance) should be taken into account by tax authorities and other parties. In case there is a contradiction between the legal form and economic substance, the latter shall be paid regard. In other words, if the tax administration concludes that the actual nature of the transaction(s) is different than the form, that is to say the economic substance is concealed by the parties to avoid taxes, the transaction is recharacterized or disregarded and tax benefits are eliminated. Additionally, tax loss penalty and interest are imposed.

Consequently, the substance-over-form principle was included in the Turkish tax code to restrain taxpayers from utilizing/abusing private law transactions with the aim of avoiding taxes and to assure the ability to pay principle of taxation. Even before the enactment of the law, the economic approach principle was adopted by both the tax administration and tax courts. *Danıştay* (Court of Appeals for administrative and tax courts) had well-established case law on this principle in the 1970s. For instance, *Danıştay* considered the sale with reservation of title as a firm sale in terms of tax law in one of its decisions in 1970.[65] Codification of this principle, however, has solidified the implementation.

In addition to Art. 3 B-1 of the VUK 1961, another provision about the substance-over-form principle exists in a subparagraph of Art. 8 of the VUK 1961. Subparagraph 3 states that special contracts made by taxpayers related to tax liability or tax responsibility are not binding for tax offices, with the exception of conditions accepted by tax codes. Put differently, tax liabilities and tax responsibilities cannot be changed with contracts made between private parties so that tax cannot be handed over to anybody else.

Aside from the VUK 1961, there is a provision stipulating that taxation must be based not on the legal form but the actual nature of the documents set forth in Art. 4 of the *Damga Vergisi Kanunu*.[66]

65. TR: Dan. 4. D. [State Council, 4th Division 1970], 1970/6217.
66. TR: *Damga Vergisi Kanunu* [Stamp Duty Law], 1964 (amended 2008), OG, 11 July 1964, No. 11751.

Having read the EC Recommendation, one can conclude that there are three components that need to be taken into consideration. The first one is "action", i.e. some transaction(s) are carried out or arrangement(s) made, and the second one is "abuse", i.e. by making artificial arrangements, private law is abused, meaning that apparent transactions do not reflect the real will of parties, which is actually to avoid taxes. The last component is "benefit", meaning that parties should get a tax benefit from these arrangements. The Recommendation states that national authorities shall treat these arrangements according to their economic substance.

The well-established substance-over-form principle in Turkish tax law, "economic approach" as it is widely used in domestic literature, mostly complies with the EC Recommendation regarding GAAR. The Recommendation underscores the substance-over-form principle by saying "…shall treat these arrangements for tax purposes by reference to their economic substance" as well, as it is included in the Turkish tax code. Though the term "economic substance" is not explicitly mentioned in the Turkish provision, the words "true nature" are interpreted with the exact same meaning by all parties.

There are some concerns, however, regarding the ambiguity of the substance-over-form principle in the tax code. The principle was codified in 1980 only as a short sentence and there have been no amendments or improvements since then. The tax administration has not created any official or unofficial document containing definitions or analyses of the principle. A secondary regulation was published after the enactment of the Law in 1980 containing no explanations other than the aim of the provision, which was implied as prevention of avoidance. Additionally, "main objective test, the obtaining of a tax advantage as the essential aim of the transactions concerned, complementary business purpose test or the genuine economic activity test (under EU law), subjective element, consisting of the intention to obtain a tax advantage, and the principle of proportionality" are not defined or even mentioned in official documents of the tax administration or decisions of tax courts. There is no official test to be conducted in GAAR implementation in Turkey. It is a generally accepted rule, though not officially formulated, that the reassessment of taxes by authorities should include the test elements of the main objective test and the obtaining of a tax advantage as the essential aim of the transactions concerned. Sometimes in addition to the main objective test some tax audit reports also contain a subjective element, the intention to obtain a tax advantage. In general, a GAAR comes into operation when the course of action taken by the taxpayer aims to achieve a favourable tax result that lawmakers did not anticipate while introducing the tax rules in question and where that course of action cannot

be regarded as reasonable or in other words can be regarded as an abusive arrangement. In Turkey, however, procedures to establish whether arrangements are abusive are not formally defined.

In short, the economic approach in the interpretation of tax rules along with the determination and qualification of taxable events has not been systematized. In some cases, there are concerns that the principle is overused against the core principles of law, such as the legality of taxes and legal security. There is consensus amongst commentators on the principle that the provision should not be used arbitrarily and in a manner inconsistent with the rule of law. An important deficiency in regard to the economic approach is the lack of objective criteria for the implementation of the principle.

Regarding the Turkish national system, the Turkish tax administration utilizes the substance-over-form principle frequently and its approach is founded on two important concepts of civil law, namely simulation and bypassing the law. In a tax context, tax veiling is considered as a specific type of bypassing the law. While simulation is defined in the *Türk Borçlar Kanunu*[67] 2011, tax veiling is not a codified term. There is not an official description of this term in tax regulations. Tax authorities, courts and doctrine, however, use this term very often. As a matter of fact, a definition of tax veiling was made in a *Danıştay* decision: "If taxpayers aim to avoid taxes by abusing private law forms and institutions, contracts made with this purpose are called tax-veiling contracts".[68] The doctrine gives us the definition as "taxpayers' abuse of private law forms in order to avoid taxes" or "unnatural usage of an untaxed private law transaction instead of another private law transaction economic content of which is taxed".[69]

The tax law doctrine gives the essentials of tax veiling and simulation in tax law as follows:

> In tax-veiling, the economic result is left out of the scope of taxation through a different legal appellation; the law is sought to be circumvented in this way, with a solely tax-related motive. In tax-veiling, the form of the actual event is altered with intent to circumvent tax, although the result of the actual event is not changed. There never are two separate acts (in the form of apparent act and covert act) in tax-veiling; the apparent legal form is desired by the parties, it is valid in civil law, but it does not correspond with the economic context of the

67. TR: *Türk Borçlar Kanunu* [Turkish Code of Obligations], 2011 (amended 2013), OG, 4 Feb. 2011, No. 27836.
68. TR: DVDDK [State Council Plenary Session of Tax Cases], 6 Dec. 1996, 1996/320, 1996/410.
69. Akkaya, *supra* n. 1, p. 96.

> actual event. Therefore, in terms of "actuality" stipulated in Article 3B of the Tax Procedure Law, in tax-veiling the legal form does not correspond to the economic context.
>
> On the other hand, in simulation, there are two acts, namely the apparent act and the actual act. The covert act, which is hidden under the apparent act, is the act of which the parties desire the economic results, and this act is directly subject to tax according to the tax laws. In tax simulation, the act which taxpayers do not want to perform but perform nonetheless as cover is invalid, while the actual act which taxpayers desire to perform and perform according to the conditions of validity is valid. Therefore, in terms of "actuality" stipulated in Article 3B of the Tax Procedure Law, simulation of the "legal appearance" does not correspond to the "legal actuality".[70]

In light of this information, the economic approach (substance-over-form principle) can be deemed as mostly similar to the GAAR proposed by the EC. All taxpayer classes are included in the scope of the Turkish GAAR.

As already mentioned, along with the tax administration, tax courts have also adopted the substance-over-form principle in Turkey. This adoption is reflected in numerous *Danıştay* decisions. In a well-known decision that reflects the general view of the *Danıştay* on the substance-over-form principle, it is stated that "the economic substance is critical in tax law, adhering to strict requirements as to form of civil law do not comply with principles of tax law".[71]

To give some concrete examples from court decisions, "while acquisition of immovable property depends on registration in the land registry according to the civil law, taxable event in property transfer takes place when the seller leaves the right of disposition to the buyer, even if the formal registration is not made".[72] In another case, the Court rejected the assertion of a person who bought immovable property and registered it in his son's name, who was a minor. The person made a small down payment and rest would be paid in instalments over five years. Though the apparent transaction was a purchase of a property by a minor, the court interpreted it as a donation by the father and stated that the motivation was avoiding inheritance and transfer tax.[73] As another example, the Court accepted an assessment of the tax authority based on the idea that lending money without getting any interest

70. Z. Gündüz, *General Abuse Prevention Provision: Practice In Turkish Tax Law*, available at http://www.mondaq.com/turkey/x/241912/sales+taxes+VAT+GST/General+Abuse+Prevention+Provision+Practice+In+Turkish+Tax+Law (accessed 1 Nov. 2015).
71. TR: Dan. 4. D. [State Council, 4th Division], 10 Jan. 1987, 1196/7.
72. TR: Dan. 4. D. [State Council, 4th Division], 12 Mar. 1970, 4119/1258.
73. TR: Dan. 7. D. [State Council, 7th Division], 2 July 1985, 3975/1531.

is against the economic reality and that repayments should be considered as consisting of capital and interest. As a final example, in a decision about a corporation that has a subsidiary (with a 95% share) in a free trade zone in Turkey, the Council of State rejected the view that there was not a simulation in the corporation's sale of goods to its subsidiary from a price lower than that of the domestic market and subsidiary's sale to domestic firms by adding a considerable mark-up, although adding no value to the goods or incurring no additional costs related to the sale. Whole organization was made and all risks were taken by the corporation. The Council of State asserted that the real motivation was to shift the profit to the free trade zone where the firms enjoyed huge tax advantages. It would not be possible to shift to deem all profit to the subsidiary normal and in line with the commercial requirements and approve the assessment made by tax inspectors.[74]

On the other hand, the Council of State has rejected the tax authority's assessments regarding the substance-over-form principle in some cases. In an example, the Council of State did not agree with the tax inspector's view that, a holding company that transferred a loan to a sister company with no additional fee or interest is actually carrying out transfer pricing. To sum up, the substance-over-form principle in Turkey's legislation is commonly applied by the tax administration and tax courts in general.

Though the tests (main objective test, the obtaining of a tax advantage as the essential aim of the transactions concerned, complementary business purpose test or the genuine economic activity test (under EU law), subjective element, consisting of the intention to obtain a tax advantage) are not defined in our legal system, tax inspectors do not assess taxes without analysing the transaction(s) of taxpayers by using similar methods. The fundamental issue on the substance-over-form principle in Turkey is burden of proof. According to Art. 3 of the VUK 1961, the burden of proof is shared between the taxpayer and the authority. But, if either party claims the existence of a situation that is inconsistent with economic, commercial and technical norms or that is abnormal and unusual due to its nature, the burden of proof of such existence falls upon the party asserting such a claim.

With reference to this rule, tax inspectors generally analyse the transactions of taxpayers, in other words evaluate the way they conduct businesses, and if they come to the conclusion that taxpayers opted for an "abnormal" way resulting in a tax benefit compared to a "normal" one, they may assess

74. TR: DVDDK [State Council Plenary Session of Tax Cases], 5 June 2009, 2007/696, 2009/244.

additional taxes. They try to determine whether the taxpayer's real purpose is to attain certain economic goals, in other words whether transactions have economic substance. When there is a "reasonable" connection between the economic result and the way to attain that, the burden of proof falls upon the tax inspector and it would be difficult to qualify that case as tax avoidance. On the other hand, if a reasonable connection does not exist, the taxpayer should prove that he/she is not trying to avoid taxes. There are complaints that tax inspectors may go too far while evaluating the criteria of conformity to economic, commercial and technical norms.[75]

The tax administration has to prove that the tax return does not show the true taxable income or that the transactions are sham. Thus, the onus of proof lies with the administration. Tax audits are used as the main tools to check the status of taxpayers and to cope with tax avoidance schemes and tax evasion. The tax adjustments/reassessments made in the tax audit reports should not be arbitrary and capricious and tax auditors must prove that the taxpayer's tax return of the transactions are not in accordance with the economic, commercial or technical requirements as suggested by the taxpayer. To win the case, the taxpayer has to prove that the findings of the audit reports are incorrect and his arguments must be supported by evidence so that the transactions are in accordance with the economic, commercial or technical requirements.

While it is correct to say that the aforesaid tests are not mentioned in national legislation or regulations, it is also correct to state that in addition to tax inspectors, courts often take into consideration some principles inherent in those tests. Three related *Danıştay* decisions will be reported in this context.

The first case is about a company that had no business transactions in 1993 other than selling immovable properties registered in its balance sheet and had taken over seven firms, all of which were at a complete loss.[76] Those seven companies were all inactive, having no equity and de facto bankrupt. The company assumed all losses and financial expenses of those seven companies. Additionally, income derived from the sale of immovable properties was transferred to the holding company that owned shares of the company of interest.

75. In Turkey, tax inspectors carry out tax inspections/audits under the Tax Audit Board, which is directly attached to the Minister of Finance and is a separate unit from the tax administration. On the other hand, the tax administration is in charge of creating tax regulations.

76. TR: DVDDK [State Council Plenary Session of Tax Cases], 11 June 1999, 1998/404, 1999/334.

Regarding the transactions of the acquisition of seven companies as fictive, the tax authority asserted that the company was aiming to avoid taxes resulting from the profit of sales by assuming the losses and expenses of acquired firms. Taxes and penalties were assessed. The real motivation was not doing business but not paying taxes. The first instance court also regarded the transactions in the same way as tax authority did and the taxpayer (plaintiff) lost the case.

When the company filed an appeal, the division in the *Danıştay* overturned the decision. The view was that, the acquisition of firms were all in compliance with commercial law and corporate income tax law. The division declared that acquisition transactions could not be deemed as fictive based on assumptions about tax avoidance.

When the first instance court insisted on its decision, the case was sent to plenary session of tax cases in the *Danıştay*. Adhering to the economic substance, not the form, the plenary session upheld the first instance court's decision. According to the decision of the plenary session, the purpose of the parliament in putting provisions on mergers and acquisitions in the tax law is to strengthen equities of firms. The main objective of a firm in doing business is to make profit and lawmakers decided not to tax profits arising from mergers and acquisitions to create an incentive for these sorts of transactions. On the other hand, the acquisition of multiple firms that are inactive and a complete loss by a company that itself had no business other than selling immovables could not be deemed as part of this incentive. Even if the legal form was completely in compliance with the law, the essence was totally different. The plenary session stated that there was no business purpose in the case. The purpose was to avoid taxes by cancelling out the profit with assumed losses.

In summary, the *Danıştay* took into account the business purpose doctrine, and came to the conclusion that transactions with no reasonable business purpose other than creating tax benefits, cannot benefit from the advantages put in the law with a different objective.

The second case was about a provisional article in the corporate income tax act providing a tax advantage for those capitalizing the profit generated by sales of immovable properties.[77] The purpose of the clause was to strengthen the equity of firms and to prevent taxpayers from excessive profits caused

77. TR: DVDDK [State Council Plenary Session of Tax Cases], 6 Dec. 1996, 1996/320, 1996/410.

by high inflation. Due to high inflation at the time, the values of properties were increasing rapidly and huge amounts of profits were being generated in sales.

A company bought multiple properties in November 1989 and sold these 26 days later. Profit was capitalized in the same year. The company's field of activity was not in the trading of immovable properties. So, from a formal perspective, everything seemed to be in compliance with the law. The huge profit seemed to be exempted from corporate tax. The court, however, approved assessment of tax authority, stating that 31 times increase in value of properties was not reasonable in only 26 days. The *Danıştay* considered the sales contract as a tax veiling contract and rejected the tax benefit.

Though the taxpayer was strictly compliant to the form of the legislation, the *Danıştay* declared that the law cannot tolerate bypassing tax. While the purpose of the provisional article was to liquidate idle capital and make possible the effective use of resources in business activities, in this case the relevant taxpayer aimed to avoid taxes by abusing legal forms of private law (sale and buying contracts). So the *Danıştay* utilized the business purpose doctrine and genuine economic activity test.

The final case is about a father who transferred his own shares in a non-limited liability company to his son. While the tax authority considered this transaction to be tax veiling aiming to reduce personal income tax liabilities, the *Danıştay* asserted that transferring shares of a company to the next generation is common and normal. Additionally, the transfer of shares was real in the sense that sold shares were registered in the name of the son. Taxpayers do abuse private law to avoid taxes, but this bad faith should be proven soundly. The court stated that, in the case of interest, tax authorities could not establish firmly that the sole purpose of the transfer of shares was to avoid taxes. It was plausible that transfer took place for normal reasons, which would make it impossible to implement the economic approach and assess tax and penalties.[78]

In short, the business purpose test and other aforementioned elements are not formally defined in the regulations and judicial decisions but are partially utilized by both the tax administration and courts informally. This informal utilization, however, causes lack of objectivity and uniformity in the implementation of the general anti-avoidance rule.

78. TR: Dan. 4. D. [State Council, 4th Division], 24 Dec. 1982, 1982/3668, 1982/4803

There is a Draft Tax Procedural Code under discussion currently. The provision regarding the substance-over-form principle is being changed according to the draft. In summary, it is possible to say that the new provision more explicitly states that taxpayers' acts aiming to avoid taxes will be disregarded even if they are in line with law formally. In this respect, new wording of the provision can be considered to be more in line with the EC Recommendation. The translation of the new provision is as follows: Disguisement and alteration of the true nature of the taxable event with methods of circumventing the law, staying out of tax liability, tax planning to create effects in favour of the taxpayer are disregarded even if the transaction is valid in law, is recorded in a registry or is subject to an official form.

The draft is open to the public and the Ministry of Finance is receiving comments on it. There is not an announced calendar, but it is anticipated to be sent to the parliament by early summer this year.

27.3. TP rules, GAARs, SAARs and linking rules

27.3.1. National transfer pricing rules as a tool against tax avoidance

KVK 2006 has transfer pricing rules that are specially designed to prevent tax avoidance. As a result of developments in the Turkish economy and international taxation, the new transfer pricing rules were introduced in Art. 13 of the KVK 2006. Below, Art. 13 and its application are summarized from the symposium report book and then explained how the rules used as a tool against tax avoidance.[79]

Legal regulations on hidden profit distribution by transfer pricing in the KVK 2006 were based on the TPG. TP rules are applicable for both domestic and cross-border related-party transactions and also related personal income taxpayers. The subparagraphs of the article clearly define issues in detail, such as: the legislative meaning of hidden profit distribution via transfer pricing, the arm's length price principle, related parties and transfer pricing methods. In all legislative intentions, OECD standards, methods and guidelines are referred to in the TPG. There exist two Decrees of Council of Ministers on transfer pricing regulations, containing general statements and

79. N. K. Uyanık, *Turkish Transfer Pricing Regulations*, in *Transfer Pricing in International Discussion* (F. B. Yavaşlar, ed., Marmara University Press 2013), pp. 99 et seq.

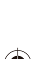
the formulas for the calculation of gross profit mark ups. Additionally, there are two Transfer Pricing General Communiqués, the Communiqué on the Hidden Profit Distribution by Transfer Pricing No. 1 (hereinafter referred to as Transfer Pricing Communiqué No. 1) the one in which the most comprehensive explanations are made. It includes examples of certain issues and explains the application of methods. In Transfer Pricing Communiqué No. 2, additional regulation statements on related parties, advance pricing agreements and documentation are made. However, statements concerning the loss of tax revenue to the national treasury under hidden profit distribution by transfer pricing were arranged in Corporate Tax Law Communiqué No. 3.

Table 27.1. below shows the chronological order of regulations on transfer pricing by publication dates in the Official Gazette.

Table 27.1. Chronological order of regulations on transfer pricing by publication dates in the Official Gazette

No.	Regulation	Date of Official Gazette	Number of Law/ Communiqué
1.	Corporate Tax Law	21.06.2006	5520
2.	Cabinet Decision	23.07.2006	2006/10731
3.	Cabinet Decision	30.12.2006	2006/11447
4.	Corporate Tax Law Communiqué	03.04.2007	No. 1
5.	Communiqué on Hidden Profit Distribution by Transfer Pricing	18.11.2007	No. 1
6.	Cabinet Decision on Hidden Profit Distribution by Transfer Pricing	06.12.2007	2007/12888
7.	Cabinet Decision on Hidden Profit Distribution by Transfer Pricing	13.04.2008	2008/13490
8.	Communiqué on Hidden Profit Distribution by Transfer Pricing	22.04.2008	No. 2
9.	Corporate Tax Law Communiqué	20.11.2008	No. 3
10.	Cabinet Decision on Hidden Profit Distribution by Transfer Pricing	03.02.2009	2009/14593
11.	Cabinet Decision on Hidden Profit Distribution by Transfer Pricing	03.02.2009	2009/14594

In Transfer Pricing Communiqué No. 1, it is explained that the arm's length price represents the market price that independent parties agreed on under comparable transactions and comparable conditions and the price determined in this manner is the ideal price determined objectively without any influence by the parties to the transaction. As the price for transactions between unrelated parties is determined by market conditions, the same



conditions should also be valid for related-party transactions. The arm's length principle in the KVK 2006 is in keeping with the arm's length principle of TPG.

Transfer Pricing Communiqué No. 1 states that a comparable uncontrolled transaction is a transaction between two independent parties that is comparable to the controlled transaction under examination. It can either be a comparable transaction between one party to the controlled transaction and an independent party or between two independent parties, neither of which is a party to the controlled transaction. If internal comparables do not exist, external comparables should be applied. The availability of internal comparables in transactions of multinational enterprises where unique intangibles exist is generally difficult. Therefore, prices applied in related-party transactions will be regarded against the arm's length principle in case these prices do not confirm with the comparables. Since the main purpose of transfer pricing regulations is to determine the price, which would be established in an uncontrolled transaction by comparing transactions of uncontrolled parties with transactions of controlled parties, in some cases and in the practical application of the methods, for instance in transactional profit methods, priority must be given to the external information.

Related parties are broadly defined in Art. 13 of the KVK 2006. A general definition is given in paragraph 1. The company's own shareholders, individuals and entities associated with the shareholders, individuals and entities attached to the company directly or indirectly in the management, supervision or capital or under the control of the company comprise related parties. In the second sentence, safeguarding that the regulation applies to domestic transactions and individuals, the shareholder's spouse and any of the relatives of the shareholder or the spouse including lineage with a third degree relationship by blood or marriage are considered likewise as related parties. The third sentence is a determination based on the foreign country tax system, and cross-border transactions will be regarded as related-party transactions if performed between other parties in foreign jurisdictions or regions.

In line with the TPG, the main factors used in the determination of comparability are mentioned in Transfer Pricing Communiqué No. 1, and these are the characteristics of goods or services, functional analysis, contractual terms, economic circumstances and business strategies. Comparability analysis is defined in Transfer Pricing Communiqué No. 1 and, shortly after this, clarifications are revealed on characteristics of goods or services, functional analysis, economic circumstances and business strategies. However,

no special clarifications are made on contractual terms. It is believed that clarifications on business strategies are not sufficient, even though comparability analysis and methods are based on the TPG, clarifications on comparability analysis and transfer pricing methods are especially inadequate specifically after changes made in TPG in the year 2010.

The Turkish Tax Inspection Board (*Vergi Denetim Kurulu Başkanlığı*) has the authority and duties to plan and execute tax audits in Turkey by Statutory Decree No. 646.[80] According to Art. 20 of the Statutory Decree, the board consists of four groups, one of which is established in order to fight against transfer pricing, thin capitalization and controlled foreign companies. Experienced tax inspectors are assigned to this special unit.

In recent years, the Turkish Tax Audit Board significantly increased its number of transfer pricing audits, with particular emphasis on the methods applied in related-party transactions (intragroup or holding activities) and services, the actions MNE's take to minimize their tax liabilities, the companies that invest and operate in low tax rate jurisdictions, borrowings from related parties, tax planning activities and transfer pricing, and payments to tax havens.[81] It is expected that companies will face different levels of tax audits under the subject of transfer pricing in the coming years as TP seems to become a trendy subject to tax inspectors.

27.3.2. Application of TP rules by the judiciary

There are many tax litigation cases before tax courts and *Danıştay* in Turkey. The former TP rule was promulgated in a very compact fashion in the first subparagraph of Art. 17 of the repealed *Kurumlar Vergisi Kanunu* 1950 (KVK 1950).[82] The first subparagraph[83] set the complete rules for TP without any secondary regulations. It should be mentioned here that

80. TR: 646 *Sayılı Vergi Denetim Kurulu Başkanlığının Kurulması Amacıyla Bazı Kanun ve Kanun Hükmünde Kararnamelerde Değişiklik Yapılmasına Dair Kanun Hükmünde Kararname*, OG, 10 July 2011, No. 27990.
81. *Vergi Denetim Kurulu Yıllık Rapor* 2014, (Annual Report of Tax Audit Board 2014), 15-16, 2015.
82. TR: *Kurumlar Vergisi Kanunu* [Corporate Tax Law], OG, 10 June 1949, No. 7229.
83. "1. If a company's buying, selling, manufacturing, building transactions and service relations with the company's own shareholders, individuals and entities associated with the shareholders, individuals and entities related to the company directly or indirectly in the management, supervision or capital or under the control of the company have been made *higher or lower prices or values on a conspicuous degree* (*prominently*) from the arm's length parties prices or free of charge" (emphasis supplied).

somehow the Courts mainly followed and applied the TPG and OECD Model in these cases. Important decisions about the former transfer pricing rules had been published by the *Danıştay*. These decisions clearly state that "price increases does not necessarily mean that there is a disguised profit distribution between related parties", unless other factors have been proved. Furthermore, tax court decisions state that controlled prices must be remarkably higher or lower than uncontrolled prices and the nature and scope of the business activities undertaken, the comparability of prices, and the factors effecting the formation of prices should also be taken into consideration. When this is the case, if necessary, then some adjustments will be appropriate. Some of the examples of these kinds of decisions, which favour the taxpayer, may be mentioned here can be found at the Appeal Court's official website.[84]

As mentioned above, most of the TP decisions strongly stress that the prices must be compared to the arm's length prices for determining the existence and the amount of the profit distribution. Tax audit reports lacking in this feature and not proving disguised profit shifting and tax evasion clearly but mainly relying on Art. 30 of the VUK 1961, which grants a broad regulatory authority to reassess the tax deficiency and very broad discretionary powers to tax inspectors, would not be acceptable by courts. The decisions contrary to this mainstream opinion were accepted as against both the wording and the spirit of tax law and Art. 73 of the *Anayasa* 1982. The main paragraphs of the DVDDK decision[85] clearly express the logic:

> The comparability analysis must display the circumstances of the case and must take into account the comparable companies' business volumes, profitability, assets used, quickness and stability in development, the impact of demonstration activities on product sales, the characteristics of the scope and quality of the services they render.
>
> There is not any study (research) in the dossier that shows the selected three entities belong to which group, what is the relationship between these holdings and companies, whether the services they provide could be taken as an arm's length comparable, whether they provide the same services with the same efficiency, whether exhibiting activities submitted with the same creativity, whether the service affect the sale of group products and to what extent, thereto, there is no study that shows whether the lower prices charged by the companies that

84. TR: DVDDK [State Council Plenary Session of Tax Cases], 1995/418, 1997/8; Dan. 4. D. [State Council, 4th Division], 2008/8030, 2010/6595; Dan. 4. D. [State Council, 4th Division], 2003/245, 2004/59; Dan. 3. D. [State Council, 3rd Division], 2009/2352, 2011/7637.

85. TR: DVDDK [State Council Plenary Session of Tax Cases], 17 Jan. 1997, 1995/418, 1997/8.

> they accused of rendering lower priced services constitute a disguised profit distribution, the conclusion was reached and calculation has been made by assuming that the products displayed in the exhibition hall will be given free so that the price paid for the exhibition and presentation (introduction) is higher than the arm's length prices.

In another case the taxpayer, the plaintiff, had a subsidiary abroad and owned 99.99% of its paid capital. Pursuant to an audit, the tax audit reallocated the company's payments and expenditures to the subsidiary's damage compensation fund, thereby increasing its taxable profits. The court found that there should be a direct relationship between items of gross income and expenses related thereto.[86] The specific question presented in this case involved the interpretation of articles of the KVK 2006 that governs the deductible and non-deductible expenses and transfer pricing rules. The appeal court held that the relevant statutory text does not support the taxpayer's argument and thereby rejected the payments and favoured the tax administration. The decision was that the payments must be included in the taxable profit of the petitioner company. Dissenting opinion states that the tax administration has not proved its claim clearly; it has to investigate whether the payments to the subsidiary for damage compensation fund and company's loss under the audit year meet commercial requirements. This was not proven by the administration and an additional tax assessment has been suggested on the revenue obtained from the estimates.

It must be expressed that there are many tax court decisions delivered about the application of new transfer pricing rules, mostly favouring taxpayers. But it will take time to reach the published Appeal Court's decisions for TP cases, due to the very long appeal procedure.

27.3.3. LOB rules in Turkey's DTCs

Turkey has 82 income tax treaties with other states[87] and only eight of them, Brazil, Israel, Kazakhstan, Lebanon, Malta, Qatar, Singapore and the United States, include "limitation on benefits" (LOB) provisions. However, the rest of the income tax treaties include and emphasize beneficial ownership provisions for the clauses of dividend, interest and royalty payments. The

86. TR: DVDDK [State Council Plenary Session of Tax Cases], 17 June 2015, 2015/245, 2015/301.
87. Available at gib.gov.tr/sites/default/files/uluslararasi_mevzuat/VERGIANLASMALIST.htm, as is 21.01.2016 (accessed 8 Nov. 2015).

Turkey-US DTC[88] has the most detailed and comprehensive rules on the LOB and the rules of other conventions are very similar to this agreement. According to Art. 22 of the DTC, the main elements are summarized below:

Paragraph 1 describes persons who are eligible for the LOB. A person (other than an individual) who is a resident of a Contracting State and derives income from the other Contracting State shall not be entitled under this Agreement to relief from taxation in that other Contracting State unless (a) more than 50% of the beneficial interest in such person is owned, directly or indirectly, by one or more individual residents of one of the Contracting States or citizens of the United States, or by persons entitled to the benefits of this Agreement under the provisions of paragraphs 3, 4 or 5; and (b) the income of such person is not used in substantial part, directly or indirectly, to meet liabilities to persons who are neither residents of one of the Contracting States or citizens of the United States, nor persons entitled to the benefits of this Agreement under the provisions of paragraphs 3, 4 or 5.

Paragraph 2 describes the exceptions to the provisions of paragraph 1. The provisions of paragraph 1 shall not apply if the income derived from the other Contracting State is derived in connection with, or is incidental to, the active conduct by such person of a trade or business in the first-mentioned Contracting State and, in the case of income derived in connection with the active trade or business, the trade or business is substantial in relation to the activity carried on in the other Contracting State giving rise to the income in respect of which treaty benefits are being claimed in that other Contracting State.

According to paragraph 3, the provisions of paragraph 1 shall not apply if the person deriving the income is either a company that is a resident of a Contracting State in whose principal class of shares there is a substantial and regular trading on a recognized stock exchange; or a company that is wholly owned, directly or indirectly, by a company referred to in subparagraph a), provided that each company in the chain of ownership used to satisfy the control requirement of this subparagraph is a resident of a Contracting State. According to paragraph 5, the provisions of paragraph 1 shall not apply if the income derived from the other Contracting State is derived by a not-for-profit organization that, by virtue of that status, is generally exempt from income taxation in its Contracting State of residence, provided that more than half of its annual support is expended for the benefit

88. The Convention was signed on 30 July 1996 and the general effective date under Art. 28 is 1 Jan. 1998.

of qualified persons; or more than half of its annual support is derived from qualified persons.

27.3.4. CFC rules

Turkish CFC rules were enacted in 2006 for the first time, effective from 1 January 2006. Art. 7 of the KVK 2006 sets out all these rules. The CFC rules must be applied where Turkish residents, real persons and corporations control, directly or indirectly, at least 50% of the share capital, dividends or voting power of a foreign entity and the following conditions are satisfied:

(a) definition of CFC and income: 25% or more of the gross income of the CFC is comprised of passive income, such as dividends, interest, rent, licence fees or gains from the sale of securities that are outside the scope of commercial, agricultural or professional income;
(b) attribution and computation of income: The CFC is subject to an effective tax rate lower than 10% in its country of residence; and
(c) *de minimis* threshold: The annual total gross revenue of the CFC exceeds the foreign currency equivalent of YTL 100,000 for a year.

If the above requirements are met, the profits of the CFC will be included in the profits of the Turkish company, regardless of whether such profits are distributed, and will be taxed at the current year at the Turkish corporation tax rate of 20%. But, to eliminate double taxation, Art. 33 of the KVK 2006 allows a credit for foreign taxes actually paid.

Turkey has not introduced linking rules as recommended in the BEPS Action Plan yet and there has been no information publicly available about the prospective plans of the tax administration of Turkey.

27.3.5. Limits on the deduction of interest

The new thin capitalization rule of Turkey, a fixed ratio rule, is rearranged under Art. 12 of the KVK 2006. According to Art. 12 of the KVK 2006, if the ratio of the borrowings from related persons (shareholders or from persons related to the shareholders) exceeds three times the shareholder's equity (that is, shareholder equity measured as per the statutory accounts opening balance sheet of the period concerned) of the borrower company at any time within the taxable year, the exceeding portion of the debt will be re-characterized as disguised equity. The scope of the term "related parties" consists of shareholders and persons who are related to shareholders

that own 10% or more of the shares, voting rights or right to receive dividends of the company. If the company has negative shareholder's equity at the beginning of the year, then all borrowings from related parties will be considered as thin capital.[89]

If thin capitalization exists, the interest paid or accrued, foreign exchange losses and other similar expenses calculated over the loans considered as thin capital are treated as non-deductible for KVK 2006 purposes. The interest actually paid on the disguised equity is re-characterized as disguised dividends and subject to dividend withholding tax at 15%, unless reduced by a double taxation treaty. An injection of equity or reserves to the company within a period does not help to overcome the thin capitalization status for the current period, because the shareholder equity is measured as of the opening balance sheet, but it may help for subsequent periods. When debt is obtained from an external bank against cash guarantees provided by the shareholders, thin capitalization rules still apply. Some borrowings will not be considered within the scope of the rules: loans received from third parties based on non-cash guarantees provided by the shareholders or persons related to the shareholders; loans obtained by related parties from banks, financial institutions or from capital markets and loans transferred wholly or partially in the same conditions; loans obtained by banks from other banks and loans obtained by leasing, factoring, finance and mortgage companies from their shareholders or related banks.

Moreover, the interest rate of the related-party borrowings must be determined as an arm's length rate according to the TP rules.

27.3.6. Other SAARs

Art. 30, paragraph 7 of the KVK 2006 makes provision for all kinds of payments made to entities, including permanent establishments of Turkish resident companies in the relevant countries, regardless of whether the said payments are in the scope of tax or not and the entity that receives the payments is a taxpayer or not, that are established or operating in the countries which are announced by the Council of Ministers, to be subject to withholding tax at a rate of 30%. The Council of Ministers determines these countries, taking into account whether the taxation capabilities of these countries are equal to the taxation capacity of Turkey or not and by considering the issue

89. N. K. Uyanık, *Transfer Fiyatlandırması ve Örtülü Sermaye Düzenlemelerine Göre Vade Farklarının Ortadan Kaldırılmasına Yönelik Öneriler*, Yaklaşım 207 (2010).

of exchange of information. This paragraph also applies to certain kinds of transactions in the context of transfer pricing, namely payments for goods and shares purchased from related parties at arm's length prices, leasing of sea and air transport vehicles, transit and port fees paid to related parties. The Council of Ministers has the authority to amend the above-mentioned rate within certain limits and might use its authority for each sort of payment or for each line of activity and sector separately. On the other hand, the Council of Ministers has not determined a list of countries yet, meaning that this provision is not in practice currently.

27.4. Application of GAARs, TP rules and SAARs

There are no formal linking rules about GAARs, TP rules, SAARs in the Turkish legal system. Transfer pricing rules are considered as SAARs, and in case of detection of transfer pricing, principally TP rules are applied to the case.

In addition, there is no formal hierarchy, coordination or overlapping of measures mentioned in the questionnaire. However, as mentioned in the previous paragraph, in specific cases such as transfer pricing, thin capitalization or controlled foreign company earnings, SAARs are always applied first. GAARs are applied in non-specific cases. No regulation or procedural rules exist about the application of the GAAR, TP rules and/or SAARs.

Chapter 28

United Kingdom

Sandra Eden

28.1. The meaning of tax avoidance and tax planning in the United Kingdom

28.1.1. Introduction

The development of a useful definition of tax avoidance and its counterpart, tax planning (a term assumed to indicate acceptable tax-driven behaviour) is a task that many have attempted. Most have concluded that there are limitations to every attempted definition. There is no doubt that there is a continuum between, on the one hand, taking advantage of tax breaks that are offered by the legislation and, on the other, engaging in a series of artificial and (usually) self-cancelling steps that have no economic purposes other than to generate a tax advantage. One end of this continuum is acceptable – perhaps being described as tax planning or tax mitigation; at the other is unacceptable tax avoidance. It is not possible to indicate precisely where the line should be drawn between these two extremes and there are many arrangements which might be labelled tax mitigation by one group and tax avoidance by another, depending on perspective. Graham Aaronson, the author of the UK GAAR, preferred not to use the term tax avoidance, regarding it as an emotive expression. He preferred to use the term tax planning in relation to such arrangements:

> You can call that tax planning because it is planning. Whether it is good planning or bad planning, whether it is abusive planning or innocent planning, it is planning. Tax avoidance is a very dangerous expression to use if you want to have a serious debate because one person's avoidance is another person's perfectly reasonable planning.[1]

28.1.2. The approach of the courts to tax avoidance

Not very many decades ago, a UK judge would be unlikely to concern himself with the content of the term "tax avoidance" as it would have very little

1. Evidence to the Lords Economic Affairs Committee, January 2013: *The Finance Bill: Oral & Written Evidence,* Mar. 2013 pp. 12-13 (Q10).

relevance to the judicial function. It was not a term used in UK legislation and, in the words of Lord Oliver,[2] "it was not … a matter of concern, much less of moral censure, that the citizen should seek to preserve his individual economic well-being by what one might have thought was … an obvious fiddle".[3] He was speaking about the case of *Duke of Westminster v. CIR,*[4] decided in 1935, which is usually cited in support of the principle that it is the citizen's right to avoid tax in a legal manner; there is no morality about tax.

Chinks in this view of tax avoidance began to appear in the mid-1970s. Whilst judges had long taken a good look at the facts in order to ascertain whether the taxpayer had brought himself within the terms of some legislative relief or exemption,[5] this is not an anti-avoidance approach or even a tax principle, simply the application of the law to the facts. For example, where a relief is attached to a "trade", there is a close analysis of the facts in order to see if they lead to the conclusion that a trade is being carried out.[6] Where the parties put a label on a thing which its characteristics cannot support, this is in UK law referred to as a "sham" (and is a different thing entirely to the sham doctrine in US law). A more significant change in the judicial attitude was heralded with the unanimous decision of the House of Lords in *Ramsay* in 1981,[7] in which the word "loss" in the statute was given a meaning that accorded with reality, thus denying the relief for the technical loss which it had been argued was generated by the contrived scheme in that case. Other cases at the highest level followed over the next few years, all confirming one thing – that the judges were adopting a more vigorous approach to tax avoidance.[8] Pinning down exactly on what basis was more difficult. There was a brief sniff, no more, of an emergence of a free-floating judicial anti-avoidance doctrine[9] – a notion that sits uncomfortably with the United Kingdom's constitutional position that tax is a creature

2. A member of the House of Lords who sat in many tax avoidance cases in the 1980s and 90s.
3. Lord Oliver, *Judicial Approaches to Revenue Law* in Gammie and Shipwright (eds), *Striking the Balance: Tax Administration, Enforcement and Compliance in the 1990s*, Institute for Fiscal Studies 1996 at 175-176.
4. (1935) 19 TC 490.
5. *Snook v. London & West Riding Investments* [1967] 2 QB 786 at 801 (Diplock LJ); *Dickenson v. Gross* (1927) 11 TC 614.
6. For example, *Samarkand Film Partnership No 3 and others v. HMRC* [2015] UKUT 211 (TCC).
7. *W.T. Ramsay Ltd v. IRC, Eilbeck (Inspector of Taxes) v. Rawling* [1982] AC 300.
8. *MacNiven v. Westmoreland Investments Ltd* [2001] UKHL 6.
9. For example, *Furniss v. Dawson* [1984] AC 474 per Lord Scarman: "Whatever a statute may provide, it has to be interpreted and applied by the courts: and ultimately it will prove to be in this area of judge-made law that our elusive journey's end will be found."

of statute alone. There were stronger suggestions that the courts were adopting something like the "step" approach (the composite transaction), or the business purpose test. However, in 2004, after more than 23 years of judicial uncertainty, the House of Lords in *Barclays Mercantile Business Finance Ltd v. Mawson* (*BMBF)*[10] confirmed that, all along, the judges had not been developing a judicial anti-avoidance rule but had simply been doing what judges do – interpreting legislation. However, the correct approach to statutory interpretation was purposive rather than literal, and the facts must be viewed "realistically".[11] This is not a principle that applies to tax alone, although it might have arrived rather later in the tax world than in other areas of law. John Tiley described the result of *BMBF* as "less chaos, more uncertainty"[12] as the House of Lords finally confirmed the intellectual basis of the judicial approach to tax avoidance, which has remained consistent since.[13]

This means, ultimately, that it is not "tax avoidance" per se that will deny a scheme efficacy. The question is rather whether the facts, including, where relevant, the artificial nature of any scheme under consideration, fall within purposively construed legislation. So, for example, a circular "payment" made to gain a tax advantage was found to qualify for relief on the basis that the purpose of the payer or the source of the funds was not relevant in the determination of whether a "payment" was made.[14] On the other hand, payments to employees through the medium of "restricted securities" designed to achieve a tax advantage were denied relief by the Supreme Court in *UBS AG and Deutsche Bank Group Services (UK) Limited v. HMRC*.[15] Lord Reed noted in that case that the function of the relevant legislation was to counter avoidance. He commented that this function "self-evidently makes

10. *Barclays Mercantile Business Finance Ltd v. Mawson (Inspector of Taxes)* [2004] UKHL 51. This neat retrospective analysis of what the courts had been doing from *Ramsay* onwards was not entirely convincing, but the line of the judges since 2004 has been consistent with the *BMBF* analysis in the sense that what they are searching for is the meaning of the statute.

11. The decision of the Court of Final Appeal in Hong Kong in the *Collector of Stamp Revenue v. Arrowtown Assets Limited* [2003] HK CFA 46 was cited with approval in *BMBF*, and has been referred to many times since.

12. J. Tiley, *Barclays and Scottish Provident: Avoidance and Highest Courts: Less Chaos but More Uncertainty* [2005] BTR 273.

13. For example, the Supreme Court decisions in *Tower M Cashback LLP 1 v. HMRC* [2011] UKSC 19; *UBS AG and Deutsche Bank Group Services (UK) Limited v. HMRC* [2016] UKSC 13 and the Court of Appeal decision of *Astall v. HMRC* [2009] EWCA 1010.

14. *MacNiven v. Westmoreland Investments Ltd* [2001] UKHL 6; *UBS AG and Deutsche Bank Group Services (UK) Limited v. HMRC* [2016] UKSC 13 at [77].

15. *UBS AG and Deutsche Bank Group Services (UK) Limited v. HMRC* [2016] UKSC 13.

it difficult to attribute to Parliament an intention that it should apply to schemes which were carefully crafted to fall within its scope, purely for the purposes of tax avoidance".[16]

In the cases after 2004, tax avoidance cases challenged under the *Ramsay* principle that have been lost by HMRC have generally fallen under two categories. First, the legislative framework is so detailed and technical that it is impossible to interpret it using a purposive approach.[17] Alternatively, the term used in the legislation is a specific word, for example "payment" that it is not possible to construe purposively.[18]

In relation to VAT, the judiciary have approached avoidance through the prism of the European Court of Justice's decision in *Halifax* (Case C-255/02),[19] which was that EU law cannot be relied upon for abusive ends.[20] In *Pendragon v. HMRC*,[21] the Supreme Court found the use of a rather contrived scheme to be abusive. According to the Supreme Court, the two *Halifax* tests were satisfied as the scheme was (i) contrary to the purpose of the legislation and (ii) the essential aim of the scheme was a tax advantage. The Supreme Court noted in *Pendragon*:

> National VAT regimes fall to be applied not just according to the letter of the national law, but in accordance with a number of general principles of EU law whose origin is the jurisprudence of the Union rather than the constitutive treaties or legislation made under them. These include the principle of respect for fundamental rights, the principle of proportionality, the principle of legal certainty with its concomitant doctrines of legitimate expectation and good faith, and the principle of abuse of law. Their application is not excluded because some particular feature of the national legal regime applying an EU tax has its origin in a domestic legislative choice rather than in a member state's obligation to implement a Directive.[22]

However, despite a reference to the principle of abuse of law in the direct tax case of *Cadbury Schweppes* (Case C-196/04)[23] in the ECJ, domestic UK courts have not applied the principle outside the arena of VAT.

16. Id., at [77].
17. *HMRC v. Mayes* [2011] EWCA Civ 407.
18. *Tower Radio Ltd and another v. HMRC* [2015] UKUT 60 (TCC).
19. UK: ECJ Case C-255/02 *Halifax plc and others v. Customs and Excise Commissioners* [2006] ECR I-1609.
20. *WHA Limited and another v. HMRC* [2013] UKSC 24.
21. *HMRC v. Pendragon* [2015] UKSC 37. This has been followed by *University of Huddersfield Higher Education Corporation v. HMRC* [2016] EWCA Civ 440.
22. Id., at [27].
23. UK: ECJ Case C-196/04, *Cadbury Schweppes plc and Cadbury Schweppes Overseas Ltd v. Commissioners of Inland Revenue* [2006] ECR I-7995.

28.1.3. Legislative definition

UK tax legislation is, on the whole, lengthy and detailed, based on rules rather than principles. Until recently, the United Kingdom had no GAAR, instead preferring to counter tax avoidance through targeted legislation on a piecemeal basis, often after the tax authorities had become aware of a particular arrangement. A wide variety of targeted anti-avoidance rules (TAARs) are found in UK legislation.[24] Sometimes these are very narrow, simply denying relief to a specific variant of a transaction that would otherwise have received relief.[25] Frequently the legislation incorporates a "main purpose" test or similar, denying the relief where the "main purpose or one of the main purposes" is a tax advantage or a tax reduction. So, for example, a certain type of loss relief is denied where "the loss arises directly or indirectly in consequence of, or otherwise in connection with, relevant tax avoidance arrangements", defined as arrangements where "the main purpose, or one of the main purposes, of which is to obtain a reduction in tax liability by means of loss relief".[26] Similarly, certain provisions on distributions of share capital are disapplied, where the main purposes of one of the main purposes is the avoidance or reduction of tax.[27] Part of the United Kingdom's diverted profits tax refers to a "tax avoidance condition": "The tax avoidance condition is that, in connection with the supplies of services, goods or other property ….. arrangements are in place the main purpose or one of the main purposes of which is to avoid or reduce a charge to corporation tax".[28]

Since the introduction of the GAAR in 2013, "tax advantage" is commonly defined by reference to the definition of this term contained in the GAAR itself, which is as follows.

> A "tax advantage" includes—
> a) a relief or increased relief from tax,
> b) repayment or increased repayment of tax,
> c) avoidance or reduction of a charge to tax or an assessment to tax,
> d) avoidance of a possible assessment to tax,
> e) deferral of a payment of tax or advancement of a repayment of tax, and
> f) avoidance of an obligation to deduct or account for tax.[29]

24. *See* the examples given in T. Bowler, *Countering Tax Avoidance in the UK: Which Way Forward*? (2009) Institute for Fiscal Studies, TLRC discussion paper No. 7. A selection of the more international orientated TAARs is mentioned towards the end of this report.
25. For example, the closure of the "*Eversden*" scheme in Finance Act 2003 sec. 185 inserting sec. 102(5A) into Finance Act 1986.
26. Income Tax Act 2007 (ITA) sec. 152.
27. Income (Taxation of Other Income) Act 2005 (ITTOIA) sec. 396B.
28. Finance Act 2015 sec. 86.
29. Finance Act 2013 sec. 208. This is replicated, for example, in ITA sec. 517K.

Sometimes a definition along these lines forms the basis of the meaning of "tax advantage", which is then more finely tuned for that particular transaction.[30]

Closing the stable doors after the horses have bolted takes time and, in order to enable counteracting measures to be taken more quickly, the Disclosure of Tax Avoidance Schemes (DOTAS) rules were introduced in 2004, applying initially to two particular types of schemes but since then rolled out over a much wider range of activities and taxes.[31] The DOTAS regime requires those who promote or participate in tax arrangements[32] with relevant hallmarks[33] to notify HMRC[34] of the schemes. There are specific rules promulgated in statutory instruments, but a key element is "tax advantage". This is defined in similar terms to the GAAR, although omitting (d)-(f).[35]

The DOTAS scheme has been claimed as a success by HMRC, although hard evidence is difficult to come by.[36]

28.1.4. Tax rulings

There is no general right in the United Kingdom to request a tax ruling, although in practice HMRC will give a non-statutory ruling where, for example, there is a genuine uncertainty about the application of the law to a particular transaction and, for a business, where the issue is commercially

30. For example, Corporation Tax Act 2009 (CTA 2009) sec. 698C; Corporation Tax Act 2010 (CTA 2010) sec. 1139.
31. HMRC Guidance on the DOTA scheme as it applies to Income Tax, Corporation Tax, Capital Gains Tax, National Insurance contributions (NICs), Stamp Duty Land Tax (SDLT), Annual Tax on Enveloped Dwellings (ATED) and Inheritance Tax (IHT) is available here: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/560047/dotas-guidance.pdf.
Guidance on the VAT DOTAS is available here:
https://www.gov.uk/government/publications/vat-notice-7008-disclosure-of-vat-avoidance-schemes.
32. A tax arrangement is generally defined in the DOTAS rules as one where a tax advantage is, or might be expected to be, the main benefit or one of the main benefits of the arrangement.
33. The hallmark rules are complicated and vary according to tax, but include arrangements about confidentiality and premium fees.
34. Notification must be within 5 days of certain trigger events.
35. Finance Act 2004 sec. 318.
36. M. Devereux et al., *The Disclosure of Tax Avoidance Schemes Regime*, December 2012, Oxford University Centre for Business Taxation, available at http://www.sbs.ox.ac.uk/sites/default/files/Business_Taxation/Docs/Publications/Reports/DOTAS_3_12_12.pdf. (Site accessed 4 Jan 2017)

significant. HMRC will *not* give either formal or informal clearances where the relevant arrangements constitute what it believes to be tax avoidance, including the application of the GAAR.[37]

There are a number of statutory provisions for clearances in relation to particular transactions.[38] For example, deferral of capital gains tax on reorganization or exchange of shares may be available, but only where the transaction is "effected for bona fide commercial reasons and does not form part of a scheme or arrangements of which the main purpose, or one of the main purpose, is avoidance of liability" to tax.[39] A similar provision limits certain capital gains tax reliefs that would otherwise apply on the transfer of assets to a non-resident company.[40] In both cases, the taxpayer is given a statutory route for clearance in advance that the limitations do not apply.[41]

28.1.5. External influences

Apart from the adoption of the civil law principle of abuse of law via the CJEU in relation to VAT, the meaning of tax avoidance from the judicial perspective appears to have developed in recent years with little reference to external factors, including, so far at least, BEPS. This is perhaps in contrast to the first court decision in the development of a judicial anti-avoidance

37. HMRC Guidance on non-statutory clearances is provided here: https://www.gov.uk/guidance/non-statutory-clearance-service-guidance.
38. Some examples of statutory clearances: qualifying life assurance policies (Income and Corporation Tax Act 1998 (ICTA) sch. 15), transactions in shares or debentures (ICTA secs. 765 and 765A), share exchanges (Taxation of Chargeable Gains Act 1992 (TCGA) sec. 138(1)), reconstruction involving the transfer of a business (TCGA sec. 139(5)), Collective Investment Schemes: Exchanges, Mergers and Schemes of Reconstruction (TCGA sec. 103K), transfer of a UK trade between EU Member States (TCGA secs. 140B and 140D), purchase of own shares by unquoted trading companies (CTA 2010 sec. 1044), demergers (CTA 2010 sec. 1091), EIS shares (acquisition by new company) (ITA sec. 247(1)(f)), company reorganizations involving intangible fixed assets (CTA 2009 sec. 831), transactions in securities (CTA 2010 sec. 748 and ITA sec. 701), transactions in land (CTA 2010 sec. 831 and ITA sec. 770), loan relationships (CTA 2009 secs. 426, 427 and 437), derivative contracts (CTA 2009 secs. 677 and 686), converting income into capital (TCGA secs. 184G and 184H), cross-border transfer of a loan relationship, derivative contract or intangible fixed assets (Taxation (International and Other Provisions) Act 2010 (TIOPA) sec. 117(4)), continuity of seed enterprise investment scheme relief (ITA sec. 257HB).
39. TCGA sec. 137.
40. Id., sec. 140A.
41. Id., secs. 138 and 140B, respectively.

approach in which several cases from the United States were brought to the attention of the House of Lords.[42]

However, the United Kingdom has been required to change some of its legislative anti-avoidance provisions in response to challenges from the European Commission. In *Cadbury Schweppes*,[43] the ECJ held that whilst the prevention of tax avoidance could be a justification to a restriction, this was only the case where the arrangements affected were "wholly artificial"[44] and the UK courts were tasked with determining whether the United Kingdom's CFC rules could be restricted to such arrangements. Subsequently, in *Vodafone 2*,[45] the Court of Appeal inserted an additional exception[46] into the regime in order to give a conforming interpretation. The CFC regime was amended in 2007[47] but the Commission issued a reasoned opinion,[48] indicating that the rules still cast too broad a net and they were revised again in 2012.[49]

It is not easy to say whether the most recent set of rules is compliant. They are discussed more fully below, but they certainly do not expressly use the words "wholly artificial".

The United Kingdom's anti-avoidance legislation has been the subject of the Commission's attention in relation to two other matters: the "transfer of assets abroad" legislation,[50] and the attribution of foreign corporate

42. *Ramsay,* op cit, n. 7. It might also be noted that what might be regarded as the modern statement of purposive interpretation in tax cases comes from the Hong Kong Court of Final Appeal : *Arrowtown,* op cit, n. 11.
43. *Cadbury Schweppes* (C-196/04).
44. Id.
45. *Vodafone 2 v. HMRC* [2010] 2 WLR 288.
46. *Vodafone 2*, op cit, n. 45: the exception added was, "if the CFC is, in that accounting period, actually established in another member state of the EEA and carries on genuine economic activities there".
47. Finance Act 2007. The effectiveness of the 2007 changes were discussed in detail by D. Taylor and L. Sykes, *Controlled Foreign Companies and Foreign Profits,* [2007] BTR 609. The authors considered the regime vulnerable to further challenge.
48. *Commission requests UK to further amend its treatment of controlled foreign corporations (CFCs),* Case No. 2009/4105, IP/11/606 of 19/05/2011.
49. The controlled foreign company (CFC) regime was enacted in Finance Act 2012 and codified in TIOPA part 9A, with effect on accounting periods beginning on or after 1 January 2013. They have been subject to further revisions in Finance Act 2013 and Finance (No 2) Act 2015, but these are not relevant for current purposes.
50. ITA secs. 714-751 potentially impose income tax liabilities when income arises to a person abroad as a result of a transfer of assets. Indeed these were held by a UK court to be incompatible with EU law in *Fisher v. HMRC* [2014] UKFTT 804 (TC).

capital gains to UK participators.[51] Both these provisions were amended from 2012 - 2013 in an attempt to make them EU compatible. The transfer of assets abroad rules already had exemptions for transactions not motivated by tax avoidance[52] but these were replaced by an exemption for genuine transactions,[53] which requires the satisfaction of conditions A and B. Condition A is that, on the assumption that the transaction is a genuine transaction, to tax the person would be an unjustified and disproportionate restriction in contravention of the TFEU or the EEA. Condition B is that the transaction is a genuine transaction. In order for a business transaction to be genuine, particular consideration must be given to the amount and competence of staff, the use of premises and equipment and the addition of economic value.

In relation to the attribution of foreign gains, two new exemptions were introduced with effect from 2012-13. Gains on assets used for the purposes of "economically significant activities" carried on by the company wholly or mainly outside the United Kingdom are excluded.[54] This is assessed on similar grounds as "genuine transactions" in the revised transfer of assets abroad rules.[55] Further, there is no charge where a UK tax avoidance motive was neither the main purpose nor one of the main purposes for the acquisition, holding or disposal of the asset.[56]

It is not entirely clear whether these reformulated exemptions are sufficient to protect all transactions other than the wholly artificial.[57]

So certainly the exemptions have been broadened in these areas in response to CJEU jurisprudence, but, without a decision on whether the tests meet the stringent *Cadbury Schweppes* principles, it is necessary to await further judgments.

51. TGCA sec. 13. This was the subject of a successful challenge by the Commission in ECJ, Case C-112/14 *European Commission v. UK* [2014] All ER (D) 146 (Nov.) but the United Kingdom had already amended its legislation by the date of the decision.
52. ITA secs. 737 and 739.
53. Id., sec. 742A.
54. TCGA sec. 13(5)(ca).
55. Id., sec. 13A(4).
56. Id., sec. 13(5)(cb). Economically significant activities are defined as the provision of goods or services to others on a commercial basis, involving the use of staff (defined as employees, agents or contractors), premises and equipment, and the addition of economic value commensurate with the size and nature of the activities.
57. *See* P. Cussons, *Does TCGA 1992 s 13 Still Breach EU Laws?* Tax Journal, 13 Dec. 2014.

In relation to BEPS 15 Actions, the United Kingdom's response to each point is attached to this report as an appendix.

28.2. EU Recommendation C(2012) 8806

28.2.1. The UK GAAR[58]

Following an earlier abortive attempt to introduce a GAAR in the late 1990s,[59] legislation was eventually enacted in 2013.[60] Whilst the robust approach to statutory interpretation developed by the courts was able to counteract many tax avoidance schemes, and some might suggest that the judges used this approach beyond its limits, there were still arrangements that the normal rules of interpretation could not tackle.[61]The UK GAAR is based in large part on the recommendations of a study group headed by Graham Aaronson QC.[62] It is designed with a narrow focus, intended to catch only the most abusive arrangements. Indeed, it is designated a general anti-*abuse* rather than anti-*avoidance* rule. It applies to the main direct taxes[63] but not to VAT, which was omitted in order to avoid the layering of the GAAR on top of the *Halifax* principle and thus remove the potential for conflict. It is relevant to note in this context that it is not aimed at much of the international profit shifting which has been catching the headlines of

58. *See further* J. Freedman, *General Anti-Avoidance Rules (GAARs) – A Key Element of Tax Systems in the Post-BEPS Tax World? The UK GAAR*, in M. Lang, J. Owens, P. Pistone, A. Rust, J. Schuch and C. Staringer (eds) *GAARs – A Key Element of Tax Systems in the Post-BEPS World* (IBFD, 2016).
59. A consultation document was issued in 1998 (Inland Revenue, *A General Anti-Avoidance Rule for Direct Taxes*, Oct. 1998). This differed in significant respects from an earlier proposal from the Institute for Fiscal Studies (IFS, *Tax Avoidance: A Report by the TLRC*, Nov. 1997), which received little support from those responding and was abandoned in 1999.
60. Finance Act 2013 sec. 206 et seq.
61. *HMRC v. Mayes* [2011] EWCA Civ 407.
62. G. Aaronson, *GAAR Study: A study to consider whether a general anti-avoidance rule should be introduced into the UK tax system,* (London: Nov. 2011) Available at http://webarchive.nationalarchives.gov.uk/20130605083650/http:/www.hm-treasury.gov.uk/d/gaar_final_report_111111.pdf (accessed 22 Dec. 2016).
HMRC, *A General Anti-Abuse Rule (GAAR) – consultation document*, June 2012.
63. Finance Act 2013 sec. 206: specifically, income tax, capital gains tax, inheritance tax, corporation tax (and any amount chargeable as if it were corporation tax, e.g. a CFC charge), petroleum revenue tax, stamp duty land tax and the annual tax on enveloped dwellings. It was extended to national insurance contributions by the National Insurance Contributions Act 2014 sec. 1.

late.[64] It is only where these arrangements are abusive (and are not caught by a targeted anti-avoidance rule) that the GAAR may come into play.

The GAAR permits the counteraction of "tax arrangements" that are "abusive". "Tax arrangements" are arrangements[65] in relation to which it would be reasonable to conclude that the obtaining of a tax advantage was the main purpose or one of the main purposes of the arrangements.[66] The phrase "reasonable to conclude" makes it clear the subjective intention of the taxpayer must be judged by reference to objective factors. It does not matter what the actual motive of the taxpayer is – it is what objectively can be assumed to be the profit motive that is important. Tax advantage is similarly rather broadly defined.[67] However, it is the definition of "abusive" that is intended to narrow down the application of the rule. The test of an "abusive" arrangement is one which "the entering into or carrying out of which cannot reasonably be regarded as a reasonable course of action, having regard to all the circumstances".[68] This is the "double reasonableness" test, again importing an objective assessment of the arrangement. It is not what the observer personally regarded as reasonable, it is what that person assesses a reasonable observer would conclude. To what extent judges might regard their personal conclusion as unreasonable remains to be seen. The legislation provides that the circumstances to which the court must have regard here include:

(a) whether the substantive results of the arrangements are consistent with any principles on which those provisions are based (whether express or implied) and the policy objectives of those provisions,
(b) whether the means of achieving those results involves one or more contrived or abnormal steps, and
(c) whether the arrangements are intended to exploit any shortcomings in those provisions.[69]

The legislation continues:[70]

> Each of the following is an example of something which might indicate that tax arrangements are abusive—

64. HMRC, *GAAR Guidance* para B5.2. *See* n. 73, *infra*.
65. "Arrangement" includes any agreement, understanding, scheme, transaction or series of transactions (whether or not legally enforceable): Finance Act 2013 sec. 214.
66. Finance Act 2013 sec. 207(1).
67. Id., sec. 208. Tax advantage is defined as including a relief or increased relief from tax, repayment or increased repayment of tax, avoidance or reduction of a charge to tax or an assessment to tax, avoidance of a possible assessment to tax, deferral or a payment of tax or advancement of a repayment of tax, and avoidance of an obligation to deduct or account for tax".
68. Id., sec. 207(2).
69. Id., sec. 207(2).
70. Id., sec. 207(4).

(a) the arrangements result in an amount of income, profits or gains for tax purposes that is significantly less than the amount for economic purposes,

(b) the arrangements result in deductions or losses of an amount for tax purposes that is significantly greater than the amount for economic purposes, and

(c) the arrangements result in a claim for the repayment or crediting of tax (including foreign tax) that has not been, and is unlikely to be, paid, but in each case only if it is reasonable to assume that such a result was not the anticipated result when the relevant tax provisions were enacted.

Further taxpayer protections include the "established practice" defence,[71] the placing of the burden of proof on HMRC[72] and the establishment of the independent advisory panel. The independent panel has two important functions. First, in an attempt to contribute some certainty to inherently uncertain legislation, extensive guidance has been provided and, whilst drafted by HMRC, this requires the approval of the panel and must be taken into account by the courts in any GAAR case.[73] Second, as part of the process of triggering the GAAR, the opinion of the panel on the reasonableness of the arrangement must be sought by HMRC.[74] The opinion is not binding on HMRC who may still proceed to a court or tribunal but, in this event, the opinion must also be taken into account by the court or tribunal.[75]

The procedures to be followed by HMRC are laid down in Schedule 43 of the Finance Act 2013, but before the first statutory step of serving a counteraction notice is taken, there are various internal HMRC processes that will ensure approval at a senior level. The notice will explain what is regarded as abusive, and why, and give the taxpayer a chance to make representations. If, after receiving representations, HMRC wishes to continue, the case is referred to the GAAR panel and, again, the taxpayer is given the chance to make representations, and the panel can invite further information. Once it

71. Id., sec. 207(5). This is that reasonableness is to be judged in the light of established practice, and the fact that HMRC accepted a practice is evidence of something which might indicate that the arrangements are not abusive.

72. Id., sec. 211.The burden of proof is the civil standard of balance of probabilities.

73. The GAAR guidance is available in three documents – Parts A-C, Part D and Part E (Part E had not received panel approval at the time of writing).
https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/399270/2__HMRC_GAAR_Guidance_Parts_A-C_with_effect_from_30_January_2015_AD_V6.pdf
https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/399271/3__HMRC_GAAR_Guidance_Part_D_with_effect_from_XX_November_2014_chm_171214v2.pdf, https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/399273/4__HMRC_GAAR_Guidance_Part_E_with_effect_from_XX_November_2014.pdf (site accessed 22 Dec. 2016).

74. Finance Act 2013 sch. 43.

75. Id., sec. 211(2)(b).

has considered the matter, the panel must give a reasoned opinion to the parties, although it is binding on neither. If the case is subsequently considered by the tax tribunal, it is required to take into account the opinion, as well as HMRC guidance on the GAAR. Unusually, the tribunal is also required to take into account (a) guidance, statements or other material (whether of HMRC, a Minister of the Crown or anyone else) that was in the public domain at the time the arrangements were entered into, and (b) evidence of established practice at that time.[76] This is considerably wider than the range of material that courts are usually permitted to consider when interpreting legislation.

To these rules were added in 2016 the right of HMRC to issue provisional counteraction notice without going through the full Schedule 43 procedures in order to keep within assessment time limits.[77]

The UK GAAR was followed in 2014 by the Scottish GAAR, which applies specifically to taxes within the jurisdiction of the Scottish Parliament.[78] This is deliberately intended to be broader than the UK GAAR, and is drafted in terms of "avoidance" rather than "abuse". Its drafting bears some resemblance to the European Commission's Recommendation C(2012) 8806 on aggressive tax planning.[79] The Scottish GAAR is addressed to "tax avoidance arrangements" if they are "artificial".[80] An arrangement is a "tax avoidance arrangement" if it would "be reasonable to conclude that obtaining a tax advantage is the main purpose, or one of the main purposes, of the arrangement".[81] This is in similar terms to the UK GAAR, but stronger than the Commission's Recommendation, which suggests the counteraction of a transaction where avoiding taxation is an "essential" purpose.[82] An arrangement is "artificial" if, broadly, it is designed to defeat the principles or policy of existing tax provisions or lacks economic or commercial substance.[83] There is then a list of features that may indicate a lack of economic or commercial substance.[84] The double reasonableness test is absent and

76. Id., sec. 211(3).
77. Id., sec. 156.
78. These are, in 2016-17, the Scottish Landfill Tax and the Land and Buildings Transaction Tax, to which will be added Air Passenger Duty in 2018 and, subject to current legal challenge, the Aggregates Levy. The Scottish GAAR can be found in the Revenue Scotland and Tax Powers Act 2014 (RSTPA) secs. 62-72.
79. EC Recommendation C(2012) 8806 of 6.12.2012 on aggressive tax planning (Recommendation 8806).
80. RSTPA sec. 62.
81. Id., sec. 63.
82. Recommendation 8806, op cit, n. 79, para. 4.2.
83. RSTPA sec. 64(2) and (3).
84. Id., sec. 64(4).

there is no independent panel. Although there is some guidance published by Revenue Scotland, so far this is not nearly as extensive as the guidance provided relative to the UK GAAR – in particular it lacks practical examples. Moreover, of course, the guidance is not approved by an independent panel, which will give more weight to the interpretation of the tax authorities, since this interpretation may not be entirely unbiased. Given the limited extent of Scottish tax powers, the EU Anti-Tax Avoidance Directive (ATAD)[85] is not relevant to Scotland as it only applies to corporation tax, not yet devolved. Furthermore, it is unlikely that at present the Scottish GAAR will be operative in the arena of international tax planning, although in the event that further tax powers are devolved, e.g. corporation tax (sought by the present Scottish Government), it could come into play.

Given that the GAAR is still very new (and has not yet been considered by the courts), there are no plans at present to amend it along the lines of either the Recommendation or the ATAD.

Are the UK and Scottish GAARs in line with the Council's Recommendation 8806 and is the UK GAAR compliant with article 6 of the ATAD? In terms of the substantive content, this is an extremely difficult call to make given that the terms of both the Recommendation and the Directive are rather broad, and there is still no evidence of how the UK courts will interpret the domestic GAARs. However, it is suggested that a comparison of each of the four relevant provisions implies that the GAARs are indeed in line with EU principles.

Each of the UK GAARs makes reference to the taxpayer's purpose. Whilst the Recommendation applies where a transaction has the "essential" purpose of obtaining a tax advantage, the Directive and the UK GAARs merely require that "the main purpose or one of the main purposes of a transaction" is to obtain a tax advantage.

Both the UK GAARs incorporate the notion of tax benefit or advantage – included in the Recommendation and the ATAD. The ATAD requires a tax advantage to "defeat the object or purpose of applicable tax law",[86] a notion which is incorporated into each of the UK GAARs in different ways, as noted above.

85. Council Directive (EU) 2016/1164 of 12 July 2016 laying down rules against tax avoidance practices that directly affect the functioning of the internal market.
86. Directive 2016/1164 art. 6.1.

The final element to be considered is the notion of artificiality. The Recommendation relates to an "artificial arrangement", the ATAD to transactions that are not "genuine". Transactions are not genuine "to the extent that they are not put into place for valid commercial reasons which reflect economic reality." The Scottish GAAR would appear to incorporate this element, applying as it does to artificial transactions, which includes transactions lacking economic substance. On the other hand, the UK GAAR does not expressly provide a safe haven for genuine transactions, although there are elements that strongly suggest that a genuine transaction would be excluded: in particular, the reference to "contrived or abnormal steps" as a characteristic of an abusive transaction, and the double reasonableness test itself. The Guidance of course is not law, but there are references throughout to matters such as "genuine economic consequences"[87] or presence or lack of a commercial purpose or to an uncommercial transaction.[88] But until the UK courts start to interpret the GAAR, it is hard to make an overall judgment at to its compatibility with the ATAD.[89]

28.2.2. "Subject to tax" in UK double taxation treaties

The other part of the European Commission Recommendation 8806 states that double taxation conventions of Member States should contain a subject-to-tax provision in order to avoid double non-taxation. Such a clause provides an exemption from taxation in one state *only* where that income is subject to tax in the other. If the income is not subject to tax in the other state, the first state withdraws the exemption. Despite this recommendation, the United Kingdom's treaties have not contained such a general provision for many years. There are still several old treaties that contain subject-to-tax clauses in relation to the exemption of particular types of income, most commonly, pension income. Indeed, one of the rare cases in the United Kingdom on the interpretation of tax treaties, *Paul Weiser v. HMRC*, concerned a subject-to-tax clause in the UK-Israel double taxation treaty.[90] Article XI of this treaty provides that UK source pensions will not be subject to UK tax where they are received by a resident of Israel and subject to Israel tax in respect thereof. However under Israeli tax rules, UK pension income is excluded from tax in Israel during the first 10 years of residence. The issue was whether this income was "subject to tax" or simply "liable to tax" there.

87. HMRC Guidance, op cit, n. 73, para. D 2.5.4.
88. Id., para. D 2.6.1. *See also* para. D 5.6.1, referring to a lack of a commercial purpose.
89. *See* A. Cédelle, *The EU Anti-Tax Avoidance Directive: A UK Perspective,* [2016] BTR 490 at p. 502.
90. *Paul Weiser v. HMRC* [2012] UKFTT 501(TC).

In accordance with the internationally accepted dividing line, it was held that "subject to tax" meant, generally, actually taxed, in contrast to "liable to tax" which denotes a more abstract liability to tax by that state.

In addition, there are subject-to-tax clauses in relation to remitted income in some of the UK's more recent treaties.[91] It is relevant to recall that, on the whole, despite a shift to the territorial system for active business income and foreign dividends,[92] the United Kingdom adopts worldwide taxation with credit, which reduces the need for subject-to-tax clauses. However, a non-UK-domiciled individual resident in the United Kingdom may only be subject to UK tax on foreign income if it is remitted to the United Kingdom. In relation to remitted income, treaties often provide that the state of source need only apply relief to the extent that the income (or gains) is remitted to the United Kingdom.

28.3. Transfer pricing rules, GAARs, TAARs and linking rules

28.3.1. Introduction

Before moving to describe some of the United Kingdom's other anti-avoidance rules in this section, it is interesting to note the change in the rate at which progress has been made by the tax authorities in recent years. At least part of this can be explained by the change in public attitudes towards tax avoidance following increased press attention. Graham Aaronson, the architect of the GAAR, in a reflection of the shift in attitudes towards tax avoidance over recent years, described the Treasury's response to the increase in public intolerance as "like a surf-boarder riding a giant wave off Hawaii",[93] as it successfully moved to introduce a succession of anti-avoidance measures.

91. For example, UK-Netherlands Treaty (2008) art 22 (The Double Taxation Relief and International Tax Enforcement (Taxes on Income and Capital) (Netherlands) Order 2009 SI 2009 No. 227); UK-Bulgaria (2015) art 22 (The Double Taxation Relief (Bulgaria) Order 2015 SI 2015 No. 1890).
92. In 2008, the taxation of foreign dividends in the hands of a UK parent was shifted from a credit to an exemption system. In 2011, UK companies with a permanent establishment abroad can opt into an exemption system in relation to foreign branch profits. The UK CFC rules have been extended to branches in order to afford the same treatment to branches as to foreign subsidiaries.
93. G. Aaronson, *The swing of the pendulum: tax avoidance in modern times*, Tax Journal, 29 Sept. 2016.

28.3.2. Transfer pricing

28.3.2.1. Introduction

The UK transfer pricing rules are found in the Taxation (International and Other Provisions) Act 2010 (TIOPA) Part 4, which applies the arm's length principle. The legislation expressly provides that it is to be interpreted in accordance with OECD principles.[94] Extensive guidance is provided by HMRC on the operation of these rules.[95]

The determination of a transfer price is in principle simply a technical task to determine the correct attribution of income and expenses to particular jurisdictions. It only becomes relevant in the context of anti-avoidance when such an attribution is not achieved by the tax authorities, for example as a result of complexity, lack of information or lack of resources. Since 2012, the public profile of the role of transfer pricing in the allocation of profits between jurisdictions has increased dramatically and it has become linked in the public mind with international tax avoidance.

The Public Accounts Committee (PAC)[96] engaged in high-profile questioning of senior executives of Starbucks, Amazon and Google as part of its review of HMRC's accounts for 2011-12.[97] The PAC concluded that HMRC should be "more aggressive in policing and prosecuting companies that paid too little tax" and should "be seen to challenge practices to prevent the abuse of transfer pricing, royalty payments, intellectual property pricing and interest payments".[98] In 2013, the PAC investigated the tax affairs of Google[99] and transfer pricing was included in the issues raised. Following a

94. TIOPA sec. 164. Legislation on secondary adjustments is likely to be passed in 2017.
95. HMRC, *International Manual* INTM 410000 et seq.
96. The PAC "scrutinises the value for money - the economy, efficiency and effectiveness - of public spending and generally holds the government and its civil servants to account for the delivery of public services." http://www.parliament.uk/business/committees/committees-a-z/commons-select/public-accounts-committee/role/. Site accessed 28 Dec. 2016.
97. PAC 19th Report – HM Revenue and Customs: Annual Report and Accounts 2011-12 (2 Dec. 2012). http://www.publications.parliament.uk/pa/cm201213/cmselect/cmpubacc/716/71603.htm. Site accessed 28 Dec. 2016.
98. Further PAC comments on transfer pricing in the 19th report include: "For example, it is perplexing that, on transfer pricing HMRC consider a royalty fee of 6% or 4.7% can be competitive when the company involved consistently makes a loss. We expect HMRC to prosecute multinational companies who do not pay the tax due in the UK."
99. PAC, *Tax Avoidance – Google,* 9th Report of Session 2013-14, (10 June 2013). http://www.publications.parliament.uk/pa/cm201314/cmselect/cmpubacc/112/112.pdf. Site accessed 28 Dec. 2016.

6-year investigation by HMRC, in 2016, Google agreed to pay an additional GBP 130 million in corporation tax, covering the previous 10 years. Much of this payment was for the settlement of a dispute over the transfer pricing.

The extent to which this has changed the general approach of HMRC is difficult to determine, given the issue of taxpayer confidentiality. Against a backdrop of significant cuts in the number of staff employed by HMRC in recent years,[100] an additional GBP 29 million was invested in 2012 in challenging abusive practices by MNEs, including the increase in the numbers employed in HMRC's specialist transfer pricing team by 25%.[101] Recognizing the resource-heavy nature of transfer pricing disputes, stringent procedures have to be followed before a transfer price enquiry is opened.[102]

In recent years, HMRC has adopted a more risk-based approach and its internal guidance provides a list of issues that might indicate a transfer pricing risk. At the same time, it has tried to adopt a less adversarial relationship with large business, with each large business being allocated a customer relationship manager who is supposed to develop a more open engagement, with issues being dealt with at an earlier stage. Approaching the issue of tax-driven behaviour from the perspective of prevention rather than a post-event challenge is part of the overall ambition of HMRC's strategy towards large businesses. In 2016, several measures were introduced that will improve transparency and cooperation. Large businesses will be required to publish their tax strategy, a framework for co-operative compliance is likely to appear next year, and a series of "special measures" designed to discourage persistently high-risk behaviour has been introduced.[103]

Despite the obvious importance of the topic, there have been very few occasions for the courts to consider the issue, as noted below, suggesting that HMRC is rather more concerned to reach a negotiated settlement or to use alternative dispute mechanisms than to litigate.[104] It may well be that the court is not the best place to resolve these disputes, given their complexity and fact-heavy nature. At least to date, if there is a toughening-up in the

100. Staffing levels were 56,000 in 2016 as compared with 91,000 in 2005: 2016 figure from HMRC *Working for HMRC* https://www.gov.uk/government/organisations/hm-revenue-customs/about/recruitment, earlier figure from HMRC *Business Plan 2014-16* https://www.gov.uk/government/organisations/hm-revenue-customs/about/recruitment.
101. HM Treasury, *Business Tax Roadmap,* Mar. 2016 para. 1.18.
102. HMRC International Manual INTM481030 et seq. The approval of the Transfer Pricing Panel is required before a transfer pricing enquiry is opened.
103. These special measures are discussed below.
104. *See* E. Baistrocchi and I. Roxan, *Resolving Transfer Pricing Disputes A Global Analysis,* Cambridge tax law series, Cambridge University Press, (2012) ch. 8.

position of HMRC in the context of transfer pricing, it is not yet reaching the stage of litigation.

28.3.2.2. Transfer pricing case law

There were some early cases establishing the arm's length principle in relation to disposals between related persons in a domestic environment[105] and three cases on specific issues raised by now repealed legislation (each at the lowest level of court).[106] The first (and, to date, only) substantive transfer pricing case is *DSG Retail and others v. HMRC*,[107] decided in 2009, which, although again a first instance decision, raised some important issues about transfer pricing methodologies and the OECD Transfer Pricing Guidelines. The facts of the case were rather complex but, in brief, they concerned a large UK retailer of electrical goods (DSG). Customers were offered a service contract at the point of sale. These service contracts were offered by an agent of an independent company who reinsured them with an offshore subsidiary of DSG, DISL. The profits therefore built up offshore and the dispute concerned the level of commission received by DSG from DISL. The Commissioners decided that there was something to price between DSG and DISL despite there being no direct contractual relationship and the question was how this was to be priced. The benefit conferred upon DISL was determined to fall within the meaning of a "provision" or a "facility" in terms of the legislation,[108] as it was extremely profitable as a result of the arrangements entered into between DSL and the independent company. DISL should have paid a fee to DSG, which would have been substantial given the low risks undertaken and functions performed by DISL. Applying arm's length terms, the DSG group would have required payment from an independent party to enter into the same arrangement.

105. For example, *Sharkey v. Wernher* (1955) 36 TC 275.
106. *Ametalco UK v. IRC* [1996] STC (SCD) 399 in which notional interest on an interest-free loan by a UK parent was taxed on the parent – interest-free loans were within the scope of "the giving of business facilities of whatever kind in ICTA 1988 sec. 773(4). *Glaxo Group Ltd v. IRC* [1996] STC 191, which concerned whether an original assessment could be increased in a situation where a new assessment would have been out of time – the decision was that it could. *Waterloo plc v. IRC* [2002] STC (SCD) 95, which again concerned "business facilities" in the context of interest-free loans to a trustee to fund a share option scheme for employees of non-UK subsidiaries.
107. *DSG Retail Ltd and others v. HMRC* [2009] UKFTT 31 (TC).
108. TIOPA sec. 147 provides that one of the pre-conditions of the legislation is that "provision … has been made or imposed as between any two persons … by means of a transaction or series of transactions." The more recent words under dispute were governed by ICTA sch. 28 AA which used the same word, "provision" and the earlier years by ICTA sec. 770, which used the term "facility".

The Commissioners proceeded to consider how the price should be determined. The use of the CUP method was rejected by the court on the basis that the six "comparable" contracts put forward by the taxpayer were not actually comparable for a variety of reasons, including failing to reflect the unusual bargaining position of DSL, who provided the facility to enter into these contracts at the point of sale. It also rejected the transactional net margin (TNMM) approach, again on the basis that the comparable put forward did not reflect the lack of bargaining power of DISL. The Commissioners therefore supported the use of a profit-split formula, based on the capital asset pricing model, as argued for by HMRC, thereby validating the profit split method where appropriate comparables cannot be found.

28.3.2.3. Advance pricing agreements (APAs)

The United Kingdom has been entering into APAs since the 1990s. In 2014, there were 88 APAs in existence[109] and although, so far, the United Kingdom has not been the subject of attention of the European Commission, the APA with Microsoft has been criticized recently in the UK's national press.[110]

28.3.3. Limitation of benefit rules and other anti-shopping devices

The only UK double taxation treaty in which a comprehensive limitation of benefit clause is found is in the UK-US treaty,[111] reflecting the US treaty practice of inserting such clauses in its treaties.

Article 23 of this treaty limits access to treaty benefits to "qualified persons",[112] of which there are several categories:[113] individuals, qualified government entities, publicly traded US or UK corporations (including a 50% subsidiary of five or fewer publicly traded companies that are listed in the United Kingdom or United States); a publicly traded trust listed in the United Kingdom or United States (or a trust more than 50% owned by publicly traded companies or by publicly traded trusts listed in the United Kingdom or United States), tax-exempt organizations, legal entities meeting

109. EU Joint Transfer Pricing Forum, *Statistics on APAs in the EU at the End of 2014*.
110. *Taxman backs £100m Microsoft wheeze*, Sunday Times, 19 June 2016.
111. *Double Taxation Relief (Taxes on Income) (The United States of America) Order* 2002/2848.
112. UK-US Treaty art. 23 para. 1.
113. Id., para. 2.

the ownership test and base erosion test,[114] a trust, or trustee of a trust in their capacity as such, if the trust is more than 50% owned by certain "qualified persons" or by "equivalent beneficiaries" provided it satisfies a "base erosion" test.

A resident who does not come within the definition of qualified person may still be entitled to benefits under the "derivative benefits test",[115] the "active conduct of a trade or business" test[116] or at the discretion of the competent authority of the country that is giving up its taxation right under the treaty.[117]

A more specific LOB clause, applying only in relation to a particular article, is occasionally included in UK treaties, for example UK-Japan.[118]

Apart from the LOB clause, the UK treaties frequently adopt other anti-shopping devices, such as beneficial ownership,[119] found in almost every UK treaty.

Most recent UK treaties include a "principal purpose" test in relation to particular articles that has the effect of removing relief (e.g. from withholding taxes) where there is a tax avoidance purpose.[120]

114. Id., para. 6.
115. Id., para. 3.
116. Id., para. 4.
117. Id., para. 6.
118. Art. 22. *Double Taxation Relief (Taxes on Income) (Japan) Order* 2006/1924.
119. *Indofood International Finance Ltd v. JP Morgan Chase Bank NA* [2006] STC 1195. In this case, the Court of Appeal interpreted the term through its international meaning rather than its domestic meaning. It held that the term should be interpreted in the context of the purposes of the DTC, which included the prevention of fiscal evasion and avoidance. *See further* P. Baker, *Beneficial ownership after Indofood* 2007 GITC Review Vol. VI No. 1 p. 15.
120. For example, UK-Finland Treaty (*Double Taxation Relief (Taxes on Income) (Finland) Order* 1970/153 as amended by *Double Taxation Relief (Taxes on Income) (Finland) Order* 1991/2878)). Art. 13 para. 6 provides, "The provisions of this Article shall not apply if the right or property giving rise to the royalties was created or assigned mainly for the purpose of taking advantage of this Article and not for bona fide commercial reasons." The UK-Germany Treaty art. 12 para. 5 (*Double Taxation Relief and International Tax Enforcement (Federal Republic of Germany) Order* 2010/2975) provides, "No relief shall be available under this Article if it was the main purpose or one of the main purposes of any person concerned with the creation or assignment of the rights in respect of which the royalties are paid to take advantage of this Article by means of that creation or assignment."

28.3.4. UK CFC rules

28.3.4.1. Introduction

Following the decision of the European Court of Justice in *Cadbury Schweppes*[121] and as part of its drive to provide a more friendly business regime, the United Kingdom radically overhauled its CFC rules with effect for accounting periods starting on or after 1 January 2013.[122] The new rules are in line with the OECD's recommendations in BEPS Action 3, although predating the BEPS conclusions. The new regime incorporates OECD concepts such as "significant people functions" and "key entrepreneurial risk taking functions". Whilst the new approach is more targeted than the old, it is still ferociously complex, despite the avoidance of complexity being a stated policy ambition of the government in relation to businesses.[123]

28.3.4.2. Entities affected

A non-UK resident company is a CFC if it is controlled by a UK company. Control is determined by reference to four separate factors: legal control, economic control, a joint venture test or accounting standards. The profits of the CFC are apportioned and taxed on any UK resident company with a 25% interest in the CFC if none of the entity-level exemptions apply, none of the specific exemptions apply and the profits fall within the gateway provisions.

If the entity-level exemptions apply, the entire income of the company is exempt from charge. These are broadly to prevent the charge arising where the CFC is a normal trading company with mostly trading income or which otherwise imposes a low risk to the UK's tax base. The entity-level exemptions are:

– Temporary exempt period exemption – no CFC charge for the first 12 months of the new ownership by the UK parent;
– Excluded territories exemption – CFCs in specified territories[124] with a headline tax rate of more than 75% of the UK tax rate) will be exempt, subject to further conditions relating to the amount of income that is subject to exemption or reduced rate of tax, or where significant

121. *Cadbury Schweppes* C-196/04.
122. The CFC legislation can be found in TIOPA part 9A.
123. HM Treasury, *Business Tax Roadmap,* Mar. 2016, para. 1.1.
124. *The Controlled Foreign Companies (Excluded Territories) Regulations* 2012, SI 2012 No. 3024.

intellectual property has been transferred from the United Kingdom within the last 6 years;

- Low-profits exemption – a CFC will be exempt if its accounting profits do not exceed GBP 50,000 in an accounting period, or if its accounting profits do not exceed GBP 500,000 and its non-trading income does not exceed GBP 50,000;
- Low-profit-margin exemption – a CFC will be exempt provided its accounting profits do not exceed 10% of its relevant operating expenditure; and
- Low level of tax exemption – a CFC is exempt if it has paid local tax of at least 75% of the corresponding UK tax that would have been payable.

The specific exemptions apply to particular types of profit:

- capital gains;
- property business profits;
- business profits – except those passing through the CFC charge gateway;
- trading finance profits – except those passing through the CFC charge gateway;
- non-trading finance profits – ¾ exempt if tax election or claim made;
- incidental (less than 5%) non-trading finance income; and
- group treasury company finance profits – ¾ exempt if elect to be treated as non-trading and elect for partial exemption.

28.3.4.3. Gateways

In relation to any income coming through the gateways, a transfer pricing analysis will be necessary in order to determine the extent to which the profits are apportioned to the UK parent.

As regards *business profits*, these will only pass through the gateway where one of the following conditions is met:

- if UK tax reduction is a main purpose of the arrangements and the CFC expects its business profits to be higher as a consequence or it is expected that a person's UK or foreign tax liability will be reduced or eliminated as a consequence of the arrangements;
- if the control and management of the CFC's assets or risks is carried on to a significant extent in the United Kingdom; and
- if the CFC has UK-managed assets or risks and it could not manage them itself or outsource the management to a third party.

Even so, all profits are excluded where UK activities are a minority of the total activities, or the separation of assets or risks from activities does not give rise to substantial non-tax value, or similar arrangements would be put in place if the UK's significant people functions were replaced by independent companies.

Furthermore, all *trading* profits are excluded where the following conditions are satisfied:

- the CFC has business premises in its territory of residence that are occupied with a reasonable degree of permanence for the purposes of the CFC's activities;
- no more than 20% of the CFC's income is derived from the United Kingdom;
- no more than 20% of the CFC's management expenditure is incurred in the United Kingdom;
- the CFC does not exploit IP that has been transferred to in the last 6 years; and
- no more than 20% of the CFC's trading income arises from goods exported from the United Kingdom.

As regards *trading finance profits*, a CFC with funds derived directly or indirectly from UK-connected capital contributions will find that its trading finance profits pass the CFC charge gateway and are potentially within the scope of a CFC apportionment. If the "free capital" of the CFC (contributed by UK-connected capital contributions) does not exceed arm's length "free capital", the profits of the CFC are excluded from the CFC regime.

As regards the *non-trading finance profits* of a CFC, these are within the regime to the extent that they are attributable to a UK special purpose vehicle, or they arise from the investment of capital from a UK-connected company. In addition, the regime applies if the profits arise from an arrangement with a UK company (e.g. loan) or are bought through a finance lease with a UK company rather than being bought outright and, in either case, a main reason from the arrangements is a tax liability. There are further rules to exclude incidental non-trading finance profits.

Captive insurance companies are within the CFC regime, unless, in the event that the CFC is in the EEA, there is a significant non-tax motive for entering into the contract.

"Solo-consolidated" companies[125] with a UK resident-regulated financial company are within the regime to the extent that its profits exceed the amount that would have been attributed to it had it been a foreign PE.

The effect of the CFC rules applying is that the relevant profits of the CFC, computed according to UK rules, are taxed on the UK parent, subject to credit for the foreign tax and to any relevant UK reliefs.

In addition to controlled foreign companies, similar anti-diversion rules apply to the profits of foreign permanent establishments of UK companies.[126] These may also be subject to the diverted profits tax, discussed below.

28.3.5. Special provisions relating to the deduction of interest

Generally, interest paid by a business is deductible in the computation of its profits. There are three special rules in the United Kingdom that may restrict deductibility.

28.3.5.1. Thin capitalization

The United Kingdom's thin capitalization rules were brought into its transfer pricing rules in 2004.[127] The thin capitalization regime applies to transactions between associated "persons", which includes companies, trusts and individuals. It applies to intra-UK transactions as well as to transactions between the United Kingdom and foreign entities. The rules apply the normal arm's length principle to determine what would be an acceptable amount of debt in relation to the company's arm's length borrowing capacity. If the amount of debt is excessive, some of the interest may be disallowed as a deduction. Where the *rate* of interest is excessive, the same result occurs. The duration of lending and terms of repayment may also be taken into account. There is no safe harbour provision that lays down a fixed debt-to-equity ratio as being an acceptable limit.

125. The solo consolidation rules permit a subsidiary of a regulated enterprise to be treated as a branch of that enterprise under a waiver granted by the Financial Conduct Authority.
126. CTA 2009 part 2 ch. 3A, inserted by Finance Act 2012.
127. They are now in TIOPA part 4.

28.3.5.2. The worldwide debt cap

With respect to the current regime, in 2009 the UK government introduced a "worldwide debt cap", which applies to all accounting periods beginning on or after 1 January 2010.[128] This applies in addition to the thin capitalization rules, but, unlike those rules, the relationship between the company making the payment and the payee is unimportant – it is only the overall position of the payer that is relevant. The rules apply only to "large" groups,[129] meaning those where at least one member has 250 or more employees, annual turnover of EUR 50 million or an annual balance sheet of EUR 43 million or more. Qualifying financial services businesses and certain other bodies are excluded from the rules. The rules also have a "gateway test": the debt cap rules only apply if the UK debt of the worldwide group exceeds 75% of the worldwide debt of that group.

The current rules will be replaced in 2017 by new provisions that are designed to be in line with the BEPS outcomes.[130]

The key elements of the new rules will be:[131]
- a fixed-ratio rule, limiting corporate tax deductions for net interest expense to 30% of a group's UK EBITDA;
- a group-ratio rule, based on the EBITDA ratio (external net interest to earnings before interest, tax, depreciation and amortization for the worldwide group) (which will replace the current worldwide debt cap regime with a more limited net interest cap);
- a *de minimis* group threshold of GBP 2 million net UK interest expense;
- rules to ensure that the restriction does not impede the provision of private finance for certain public infrastructure projects in the United Kingdom; and
- rules addressing volatility in earnings and interest.

128. TIOPA part 7.
129. "Large" is defined by defined by reference to the Annex to the European Commission Recommendation concerning the definition of micro, small and medium-sized enterprises 2003/361/EC of 6 May 2003.
130. The Government has engaged in consultations on these proposals in 2015 and 2016. The outcome of these consultations was published in December 2016 and is available here: https://www.gov.uk/government/consultations/tax-deductibility-of-corporate-interest-expense/tax-deductibility-of-corporate-interest-expense-consultation (site accessed 3 Jan. 2017).
131. The information is taken from the second more detailed consultation available here https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/525923/tax_deductibility_second_consultation_v2.pdf (site accessed 3 Jan. 2017). However, changes could be made prior to the enactment of the Finance Act 2017.

The rules apply to UK companies and corporate groups with net interest expenses in excess of GBP 2 million. There is a carve-out for banking and insurance businesses.

28.3.5.3. Interest treated as distribution

The UK legislation contains extensive provisions that treat value transferred out of a company as a distribution.[132] Included here are certain payments of interest, for example to the extent to which they exceed a reasonable commercial return on the loan[133] or where the payments relate to "special securities",[134] for example where the interest on a loan to a company is dependent on the business results of the company or the value of its assets. Where either rule applies, the borrowing company will not be entitled to a tax deduction for any amount recharacterized as a distribution.

28.3.6. Other TAARs

A full account of UK TAARs is outside the scope of this chapter. The following are a selection of those that apply in a cross-border situation.

28.3.6.1. Diverted profits tax

The United Kingdom introduced the diverted profits tax (DPT) in 2015.[135] It is a tax separate from corporation tax (thus avoiding any complications with double taxation treaties) that is designed to counter tax avoidance by large companies by imposing a higher charge to tax than the normal corporate tax rates on the diverted profits plus interest.[136] It applies in two separate situations.

The first situation is where either a UK company or a foreign company with a UK PE uses arrangements or entities that have insufficient economic

132. CTA 2010 part 23.
133. Id., secs. 1000 and 1005.
134. Id., secs. 1000 and 1015.
135. The legislation is in Finance Act 2015, applying to profits arising after 1 Apr. 2015.
136. The DPT rate is 25%, compared with the current main rate of UK corporate tax of 20%, or 33% on banking profits which are subject to an 8% surcharge after 1 Jan. 2016. Oil profits are subject to a 55% charge under the DPT and 30% under the main ring-fenced rate. The UK main corporate tax rate is expected to decrease to 18% by 2020: HMRC policy paper, *Corporation Tax: main rate,* July 2015.

substance and which exploit tax mismatches.[137] An example might be the transfer of IP to a related foreign entity by a UK company, where the entity is entitled to receive royalty payments from the UK company although it does not have the capacity to exploit the IP. Any arm's length prices can be overridden where it is reasonable to assume that the arrangements would not have been made in the absence of a mismatch. Profits will be allocated to the United Kingdom on the basis of the relevant "alternative provision".[138] The "alternative provision" is an arrangement that would have been assumed to have been made if tax on income had not been a relevant consideration for any person at any time.

This rule only applies where both the non-UK company and its UK resident customer are not small or medium-sized companies.[139] There is also an exemption where the mismatch arises as a result of an exemption due to the person being a charity, a pension scheme or having sovereign immunity.

The second situation in which the DPT may apply is where a non-UK resident supplies goods and services to customers in the United Kingdom, using arrangements designed to avoid the creation of a UK taxable presence and the main purpose, or one of the main purposes, is the avoidance of UK tax.[140] This is a radical step, taxing non-resident companies with no traditional UK taxable presence. This is likely to affect several large companies that have an extensive customer base in the United Kingdom but which use strategies to avoid the establishment of a UK PE. There is an exemption where the sales revenue to UK customers does not exceed GBP 10 million or its UK-related expenses do not exceed GBP 1 million in any 12-month accounting period. Neither does this rule apply unless the avoided PE and the foreign company fall outside the definition of a small or medium-sized enterprise.[141] The amount that will be taxed by the United Kingdom is the amount that it is just and reasonable to assume would be the chargeable profits using OECD principles of profit attribution.

137. Finance Act 2015 sec. 80 (UK companies) and sec. 81 (non-UK companies with a UK PE). An effective tax mismatch arises, broadly, where the tax is less than 80% of the tax that would have been paid on the UK profits on the basis of an "alternative provision", broadly, had a non-tax avoiding arrangement been used.
138. Id., sec. 85.
139. TIOPA sec. 172.
140. Finance Act 2015 sec. 86.
141. TIOPA sec. 172.

28.3.6.2. Taxation of immoveable property in the United Kingdom

The general position is that there is no capital gains tax on the disposal of assets in the United Kingdom by a non-UK resident.[142] This was changed in relation to residential property in order to prevent avoidance by UK residents owning UK property through non-resident entities.[143] There are various exclusions: property that is the owner's main residence is excluded, as are what might be regarded as multiple occupancy residences, such as student accommodation and nursing homes.[144]

The charge is not designed to attract a charge on business enterprises, so there is no charge on a disposal of such assets by a "diversely held" company – this is, broadly, a company controlled by five or fewer participators.[145] However, if there are "arrangements" in place, the main purpose of which is to avoid CGT being charged by escaping the definition of diversely held, these arrangements are to be ignored for the purposes of the definition.[146]

From 6 April 2017, all UK residential property held indirectly through an offshore structure or trust is chargeable to inheritance tax.

28.3.6.3. Anti-hybrid rules

New rules were introduced in 2016 in order to implement the best-practice recommendations in Action 2 of the OECD's Final Report on base erosion and profit shifting (BEPS).[147] These are wider in scope than the previous regime. Hybrid mismatches are defined as cases where an amount is deductible in one jurisdiction but not taxed in any other (a deduction/non-inclusion mismatch), or where an amount is deductible more than once (double deduction mismatches). They are not restricted to financial transactions and are also seen, for example, in respect of payments relating to intellectual property.

The new rules apply to hybrid instruments, hybrid transfer arrangements and hybrid entities. They apply to transactions between related entities, dual residents and between a UK company and its PE, but will also exceptionally

142. Except gains on the disposal of assets in the UK used by a UK permanent establishment: TCGA sec. 10.
143. Finance Act 2015 sch. 7 amending TCGA.
144. TCGA sch. B1 para. 4.
145. Id., sec. 14F.
146. Id., sec. 14H.
147. Finance Act 2016 sec. 66 and sch. 10, inserting TIOPA 2010 secs. 259A-259NF.

apply to transactions between unrelated parties where it is reasonable to suppose that there is a "structured arrangement" designed to attract a hybrid mismatch, including timing mismatches.

In the event of the provisions applying, a "reasonable" adjustment will be made by increasing taxable income or by denying a claimed deduction. Where the *payer* is within the charge to UK corporation tax, deduction will be denied. Where the *payee* is within the charge to UK corporation tax, the amount equal to the mismatch is treated as income unless counteracted by equivalent anti-hybrid rules in another jurisdiction.

The rules do not contain a "purpose" test unlike the provisions they replace, but there are several exemptions: payments to a country that only adopts territorial taxation, payments to exempt entities, and certain regulatory capital securities and repos and stock loans entered into as part of a financial trade.

28.3.6.4. Royalty withholding tax

In 2016, legislation was introduced to widen the circumstances in which withholding tax must be deducted from payments of royalties to persons not resident in the United Kingdom and to counter the use of contrived arrangements involving double taxation treaties to obtain relief from withholding taxes on royalties.[148]

Under the pre-existing rules, withholding tax broadly only had to be withheld from royalties relating to certain IP rights but not from royalties relating to others, including trademarks and trade names and copyright in film and video recordings. In addition, the obligation to withhold was often excluded by a double taxation treaty or the Interest and Royalties Directive.[149]

There are three aspects to the changes:

First, the range of IP royalties subject to UK withholding tax is extended so that it now covers all payments that are treated as royalties in the OECD Model Treaty.[150]

148. Finance Act 2016 secs. 40 and 41.
149. Council Directive 2003/49/EC of 3 June 2003 on a common system of taxation applicable to interest and royalty payments made between associated companies of different Member States.
150. ITA secs. 906 and 907.

Second, a new targeted domestic anti-abuse rule is introduced that will apply to royalty payments between connected parties, which will override any applicable tax treaty. It applies to "DTA avoidance arrangements", meaning an arrangement where it is reasonable to conclude that the main purpose, or one of the main purposes of the arrangements is to obtain a tax advantage (widely defined) by virtue of any provisions of a double taxation arrangement and obtaining that tax advantage is contrary to the object and purpose of those arrangements.[151]

Third, there is a clearer definition of the circumstances in which IP royalties "arise in the UK" that augment the vague UK "source" rules. It is now provided that the royalty will have a UK source where (1) the non-resident carries on a trade in the United Kingdom through a permanent establishment in the United Kingdom; and (2) the payment (or part of the payment) is made "in connection" with the trade of the non-resident carried on through that UK permanent establishment.[152]

28.3.6.5. Attribution of gains of non-resident companies to UK residents

The anti-avoidance provisions that are designed to prevent avoidance of tax on capital gains by sheltering them in a closely controlled overseas company[153] were amended in 2013, following intervention from the European Commission in 2011.[154] These apply to gains on which UK resident individuals or companies would otherwise be taxed had they disposed of the asset and realized the gain themselves.

The provisions operate by attributing gains realised by a non-UK resident closed controlled company to UK resident participators in proportion to their interests. There is no attribution unless that participator has an interest of over 25% in the company (previously 10%), and gains from genuine business activities are excluded. A chargeable gain accruing to the company on a disposal of an asset is also excluded where it is shown that neither the disposal nor the acquisition or holding of the asset by the company formed

151. Id., sec. 917A.
152. ITTOIA sec. 577A.
153. TCGA sec. 13.
154. The Commission addressed a reasoned opinion to the United Kingdom in 2011, but the United Kingdom took no immediate action so proceedings were initiated. The decision was that the provisions were contrary to the TFEU and EEA agreement: UK: CJEU Case C-112/14 *Commission v. United Kingdom*. The offending legislation had been amended before the decision of the CJEU.

part of a scheme or arrangements of which the main purpose, or one of the main purposes, was the avoidance of liability to capital gains tax or corporation tax.[155]

28.3.6.6. Transfer of assets abroad (TAA)

Alongside the "attribution of gains" rules, discussed above, the TAA legislation was another anti-avoidance provision that was amended following the European Commission's interest.[156] These provisions are designed to counteract the use of offshore structures by individuals who aim to avoid income tax by transferring assets to a person outside the United Kingdom, whilst retaining the power to enjoy that income. Whilst there were already exemptions in place to exclude the TAA (transfers where there is no UK tax avoidance purpose to the transfer or associated operations or the transactions are genuine commercial transactions and any UK tax avoidance purpose is incidental), the new rules provide for an exemption where two conditions are met. Section 742A of ITA provides:[157]

> (3) Condition A is that-
> (a) were, viewed objectively, the transaction to be considered to be a genuine transaction having regard to any arrangements under which it is effected and any other relevant circumstances, and
> (b) were the individual to be liable to tax under this Chapter by reference to the transaction, the individual's liability to tax would, in contravention of Title II or IV of the Treaty on the Functioning of the European Union, constitute an unjustified and disproportionate restriction on a freedom protected under that Title.
>
> …
>
> (5) Condition B is that the individual satisfies an officer of Revenue and Customs that, viewed objectively, the transaction must be considered to be a genuine transaction having regard to any arrangements under which it is effected and any other relevant circumstances.

The reference to the treaty freedoms in Condition A(b) is of course simply a procedural change as taxpayers can already rely on EU treaty freedoms!

155. TCGA sec. 13A.
156. The legislation, as amended by Finance Act 2013, is in ITA, part 13, ch 2.
157. Inserted by FA 2013 sch. 10.

28.3.6.7. Offshore employment intermediaries

Provisions were introduced in 2014 to restrict the use of offshore employment intermediaries to avoid employment taxes.[158]

28.3.6.8. Exit charges on accrued capital gains

The United Kingdom imposes an exit charge on assets held by a company on the occasion of the company ceasing to be non-UK resident.[159] The tax charge can either be paid in instalments or deferred following amendments in 2013 in order to achieve compliance with EU law.

Rather unusually, the United Kingdom does not impose an exit charge where an individual becomes non-UK resident. Instead, there is only a charge to gains tax where that individual subsequently re-acquires UK residence, broadly within 6 years.[160] The gain is charged as a gain of the year of return.

28.3.6.9. Other anti-avoidance provisions

Whilst not TAARs, it is worth noting some recently introduced provisions designed to bolster the tax authority's tools to detect and deter tax avoidance.

Country-by-country reporting

Country-by-country (CbC) reporting has been introduced in the United Kingdom with effect from accounting periods starting on or after 1 January 2016.[161] The reporting requirements affect UK-headed MNEs where the group has a consolidated group revenue of EUR 750 million or more in the accounting period.[162] They also affect UK subsidiaries or PEs of foreign companies, if the foreign company is not required to file in its own territory.

158. Finance Act 2014 sec. 20, amending Income Tax (Employment and Pensions) Act 2003 sec. 689.
159. TCGA sec. 185.
160. Id., sec. 10A.
161. Finance Act 2015 sec. 22 and the *Taxes (Base Erosion and Profit Shifting) (Country-by-Country Reporting) Regulations 2016* SI 2016 No. 237.
162. HMRC estimate there are about 300 UK-headquartered entities that will be required to report, and 100 UK-resident subsidiaries or PEs of non-UK headed entities: HMRC policy paper, *Country by country reporting*, Feb. 2016.

Large-business tax strategies

Legislation was introduced in 2016 to require large businesses[163] to publish their tax strategy on the Internet, viewable free of charge, as it relates to or affects UK taxation.

The strategy will cover the businesses' approach to risk management and governance arrangements in relation to UK taxation, its attitude towards tax planning (insofar as it affects UK taxation), the level of risk in relation to UK taxation it is prepared to accept and its approach towards its dealings with HMRC. There are penalties for non-compliance.

Large business: Special measures regime

Also new in 2016 was the introduction of the special measures regime, which applies where a large business (as defined for the purposes of the large business tax strategy, above) has broadly been "persistently uncooperative"[164] in relation to its dealings with the tax authority. Warning notice will be given, and this may be followed after 12 months by a special measures notice. Potential sanctions include removing the defence of "reasonable care" for the purpose of penalties in respect of inaccurate returns and power for HMRC to publish the name and address and any other identifying information in relation to the business and the fact that it is subject to the special measures regime. Sanctions could also include the removal of access to non-statutory clearances.[165]

Penalties for application of the GAAR

The United Kingdom has hitherto never applied penalties for tax avoidance, as opposed to evasion. For the first time, from 2016, penalties may be applied to tax avoiders to whom the GAAR has been successfully applied.[166] The penalty is 60% of the "counteracted advantage", broadly the extra tax

163. Finance Act 2016 sec. 161 and sch. 19. It applies to UK groups and subgroups where the UK group/subgroup's aggregated turnover is more than GBP 200 million or its balance sheet total more than GBP 2 billion in the previous financial year, and other UK groups and subgroups in respect of which there is a mandatory reporting requirement under the UK country-by-country reporting regulations (or would be if headed by a UK resident company). It also applies to partnerships that meet the above thresholds.
164. Defined in the Finance Act 2016, sch. 19, paras. 35-40.
165. HMRC policy paper, *Tax administration: large business special measures regime,* Dec. 2015: https://www.gov.uk/government/publications/tax-administration-large-business-special-measures-regime/tax-administration-large-business-special-measures-regime. Site accessed 3 Jan. 2017.
166. Finance Act 2016 sec. 158, introducing new sec. 212A and sch. 43A into Finance Act 2013.

payable as a result of the application of the GAAR. This is likely to encourage taxpayers to concede their position to the tax authorities before the case is referred to the panel.

Serial tax avoiders

Coming into effect in 2017 are also sanctions for "serial tax avoiders".[167] A person who has suffered a "relevant defeat" may receive a warning notice from HMRC, which sets a 5-year clock running. A relevant defeat is broadly a successful challenge under the GAAR, the counteracted use of a DOTAS arrangement, or the use of disclosable VAT arrangements. Further defeated tax avoidance attempts within that period gives rise to a sanction of up to 60% of the understated tax, as well as resetting the clock. Three defeats within the period (as extended) mean that HMRC may publish details identifying the taxpayer and may deny him further specified reliefs.

The accelerated payments regime

In 2014, a new regime was introduced requiring disputed tax to be paid up front in arrangements covered by the disclosure of tax avoidance schemes (DOTAS) rules or by the GAAR.[168]

Follower notices

Where HMRC have already successfully challenged a particular scheme in the courts, it may serve a follower notice in any case that concerns essentially the same arrangement.[169] If the taxpayer does not settle its dispute after receiving such a notice, it may be liable to a penalty.

Enablers of abusive tax avoidance

Legislation is expected in 2017 to enable penalties to be applied to those who essentially provide access to abusive tax avoidance schemes. Consultation has been taking place and as a result the proposals have been amended. As they currently stand, a person who has enabled abusive tax arrangements is potentially liable to a penalty when those arrangements are defeated. An enabler is, in relation to the scheme, a designer, a manager, a marketer, an enabler (someone who was essential to the arrangements and knew what they were doing) or a financial enabler. A tax arrangement is abusive if it

167. Id., sec. 159 and sch. 18.
168. Finance Act 2014 part 4 ch. 1.
169. Id., part 4 ch. 2.

would fall within the GAAR and the opinion of the GAAR panel may be sought here.

The penalty is 100% of the fee received.

28.4. Relationship between GAARs, TAARs and transfer pricing rules

If one assumes that the transfer pricing rules are simply technical rules designed to allocate appropriate value to transfers between two entities, they constitute a set of fact-finding rules rather than an anti-avoidance provision (whilst the effect may be of countering avoidance). In this sense, there is no relationship between transfer pricing and anti-avoidance rules.

The GAAR is independent of other anti-avoidance rules and overrides them.[170] In the event that an arrangement successfully circumvents a TAAR by, for example, falling a day outside a time limit or artificially satisfying the conditions for an exemption, the GAAR may come into play in appropriate circumstances. Equally, there may be cases which fall outside the GAAR, which may still be challenged by TAARs. Under UK law, an arrangement may be challenged simultaneously under more than one provision and this may well be the case in relation to certain arrangements which may be caught by a TAAR and/or the GAAR. However, the GAAR guidance makes it clear that there may be some arrangements that are so "blatantly abusive" that HMRC may simply proceed under the GAAR alone.[171]

In terms of procedural matters, the unusual role of the GAAR advisory panel has been discussed in section 28.2.1., as have the special rules about evidence.

170. HMRC, *GAAR Guidance,* para. B 7.2.
171. Id., para. B 6.2.

Appendix: The UK's response to the BEPS Actions

Action 1 Digital economy

There is limited tangible evidence of specific action here. The Treasury says "work to update the threshold at which a company becomes taxable in a foreign country and updates to the transfer pricing guidelines to take into account technological advances will address many of the tax challenges with the digital economy. However, in the context of the rapid development of new digital technologies and business models, the government will continue to work with international partners to determine whether any supplementary rules to tackle specific tax challenges are necessary and participate in future work at the OECD".[172]

Action 2 Hybrids

Following consultation, the United Kingdom enacted legislation to deal with hybrid mismatches in 2016.[173] It will come into effect on 1 January 2017 and supersedes the previous rules on tax arbitrage.[174] The new legislation is largely based on the OECD Final Report.

The new rules apply to hybrid instruments, hybrid transfer arrangements and hybrid entities. It applies to transactions between related entities, dual residents and between a UK company and its PE, but will also exceptionally apply to transactions between unrelated parties where it is reasonable to suppose that there is a "structured arrangement" designed to attract a hybrid mismatch. These include timing mismatches. In the event of the provisions applying, a "reasonable" adjustment will be made by increasing taxable income or denying a claimed deduction. Where the payer is within the charge to UK corporation tax, deduction will be denied. Where the payee is within the charge to UK corporation tax, the amount equal to the mismatch is treated as income unless counteracted by equivalent anti-hybrid rules in another jurisdiction. The rules do not contain a "purpose" test.

Action 3 CFC rules

The United Kingdom has in place a CFC regime which is largely consistent with the OECD's recommendations.

172. HM Treasury, *Business Tax Roadmap,* Mar. 2016, Box 2.B, *UK activity in response to the BEPS actions.*
173. Finance Act 2016 sec. 66 and sch. 10, inserting TIOPA 2010 secs. 259A-259NF.
174. TIOPA 2010 part 6.

Action 4 Interest deductions

Legislation is expected to come into effect on 1 April 2017, at which point the existing debt cap regime[175] will be repealed and replaced in a strengthened form within the new regime. The current draft legislation largely follows the recommendations in Action 4. So far, it is proposed that the new rules apply only to corporation tax although they may be extended to income tax in the future.

The cap will apply to groups with an excess of GBP 2 million net UK interest expense per annum.

The maximum amount of UK relief for interest for such groups is calculated by whichever of two calculations, the fixed-ratio rule and the group-ratio rule, gives rise to the highest figure. The fixed- ratio rule restricts relief to 30% of taxable earnings in the United Kingdom, before interest, depreciation and amortization (EBITDA). The group-ratio rule, which may be helpful for highly geared groups, is based on the net interest to EBITDA ratio for the worldwide group.

The restriction will apply to all amounts of interest, other financing costs that are economically equivalent to interest, and expenses incurred in connection with the raising of finance. Rules for groups in the banking and insurance sectors are also being developed.

Action 5 Harmful tax practices

Recent legislation has amended the UK's patent box regime to bring it in line with the OECD recommendations.[176] The method of calculating the income subject to the special 10% rate of tax is being changed.[177] The new approach applies to new entrants to the regime from 1 July 2016, with existing patents moving to the new regime, broadly, by 30 June 2021.

175. The debt cap regime was introduced in 2009 as a counterpart to the exemption from corporation tax of overseas dividends. Restrictions to deduction of debt may apply where the UK debt exceeds 75% of the worldwide debt of the group. The debt cap currently potentially applies to "large" groups – at least one member has at least 250 members of staff, an annual turnover of at least EUR 50 million, and/or a balance sheet total (gross assets) of at least EUR 43 million.

176. The patent box regime is in CTA 2010 secs. 357A-GE. It is amended by Finance Act 2016 sec. 64.

177. The proportional profit split option is being removed, and in all cases the "streaming approach" is to be used.

Action 6 Treaty abuse

In 2016, legislation was introduced to counter abusive use of royalty payments. The United Kingdom imposes withholding tax (WHT) on royalties but this is frequently reduced or removed by treaty. One of the measures relating to royalties[178] denies treaty benefits when such payments are routed through a connected company in a treaty jurisdiction to gain a tax advantage. The new rule adopts a principal purpose test, which is modelled closely on the OECD's recommendations in Action 6.

The other two measures extend the scope of the WHT regime for royalties and bring the United Kingdom more in line with practice elsewhere. The definition of royalty is extended to include payments made in respect of intangible assets – such as trademarks and brand names – and the regime will also apply to royalty payments that are connected with the activities of a UK PE of an overseas company (even if the payment does not have a UK source).

Action 7 Permanent establishment status

Pre-empting, according to some, the BEPS Final Reports, the United Kingdom introduced the diverted profits tax (DPT) with effect from 1 April 2015. It is a tax separate from corporation tax, and applies at a higher rate (25% rather than the current corporation tax rate of 20%, being reduced to 19% in 2017).

The DPT applies to UK resident companies where profits are considered to have been diverted from the United Kingdom through arrangements or entities lacking economic substance.

In relation to non-UK resident companies, it applies where profits are considered to have been diverted from the United Kingdom by avoiding a UK PE.

Actions 8-10 Transfer pricing

UK legislation already incorporated the OECD's Transfer Pricing Guidelines[179] and this was amended in 2016 to incorporate recent amendments made to OECD's 2010 Transfer Pricing Guidelines and Final Report

178. Finance Act 2016 inserting new sec. 917A into the ITA.
179. TIOPA sec. 164 requires that the UK legislation on transfer pricing is to be interpreted to secure consistency with the OECD's Transfer Pricing Guidelines.

in relation to Actions 8 to 10.[180] There is also power to make further changes by secondary legislation.

The amendment applies to companies in relation to accounting periods beginning on or after 1 April 2016 and for income tax purposes from the tax year 2016/17.

There are no specific rules relating to master file and local file (as included in Action 13) and thus no legal requirement for UK taxpayers to adopt the master file/local file approach to transfer pricing documentation, although this may be brought in by way of secondary legislation.

Action 11 BEPS data analysis

Again, there is relatively little hard evidence here. The Treasury simply says that this action “will improve access to new and existing data to allow countries better to analyse risks. Data will be presented in an internationally consistent way, while still maintaining taxpayer confidentiality”.[181]

Action 12 Disclosure of aggressive tax planning

The United Kingdom has had rules in place since 2004 that require the early disclosure of tax planning. These are the various Disclosure of Tax Avoidance Schemes (DOTAS), which cover virtually all taxes in the United Kingdom and require notification to HMRC within 5 days of a scheme being made available or implemented.[182]

Action 13 Transfer pricing documentation

Country-by-country (CbC) reporting was introduced to the United Kingdom with effect from accounting periods starting on or after 1 January 2016.[183] The reporting requirements affect UK-headed MNEs where the group has consolidated group revenue of EUR 750 million or more in the accounting

180. Finance Act 2016 sec. 75, adding to TIOPA sec. 164, “as revised by the report, Aligning Transfer Pricing Outcomes with Value Creation, Actions 8-10 - 2015 Final Reports, published by the OECD on 5 October 2015”.
181. HM Treasury, *Business Tax Roadmap,* Mar. 2016, Box 2.B, *UK activity in response to the BEPS actions.*.
182. The regimes for direct taxes are the subject of a 166-page publication by HMRC: *“Guidance – Disclosure of Tax Avoidance Schemes (DOTAS)”* (most recent version issued 2016).
183. Finance Act 2015 sec. 22 and the *Taxes (Base Erosion and Profit Shifting) (Country-by-Country Reporting) Regulations 2016* SI 2016 No. 237.

period.[184] They also affect UK subsidiaries or PEs of foreign companies, if the foreign company is not required to file in its own territory (or HMRC does not expect to receive the report from that tax authority). Regulations are expected to extend the requirements to partnerships.

The regulations require information on the amount of profit and tax paid in each jurisdiction, as well as total employment, capital retained earnings and tangible assets. At the moment, it is unclear as to whether these reports will be made public. The Finance Act 2016 gives the Treasury the power to make regulations to require the CbC reports to be included in the group tax strategy.[185] Unless and until this is done, the reports will not be made public.

Action 14 Dispute resolution

The United Kingdom has started to include binding arbitration clauses in some of its more recent tax treaties.[186] The Treasury states that "the UK has committed to adopt and implement mandatory binding arbitration as a way to resolve disputes, along with 19 other countries. The UK is now working with these countries to develop a mandatory binding arbitration provision as part of the negotiation of the multilateral instrument, as well as implementing other dispute resolution changes in the multilateral instrument (see action 15)".[187]

The United Kingdom is one of the countries in the first batch of peer reviews to be carried out under the OECD's Forum on Tax Administration, starting in December 2016.

Action 15 Multilateral instrument

The United Kingdom chaired a group of over 90 countries that developed a multilateral instrument that will allow countries' tax treaties to be updated quickly and efficiently with the BEPS changes. This instrument was published by the OECD in November 2016. The United Kingdom is expected to sign it in 2017, and will publish consolidated versions of all UK treaties as amended, agreed with the treaty partners as far as possible before publication.

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184. HMRC estimate there are about 300 UK-headquartered entities that will be required to report, and 100 UK-resident subsidiaries or PEs of non-UK headed entities: HMRC policy paper, *Country by country reporting* Feb. 2016.
185. Finance Act 2016 sch. 19 paras. 17(6) and (7).
186. For example, in the Protocol with Japan (2014) amending the 2006 Treaty (*Double Taxation Relief (Taxes on Income) (Japan) Order* 2006/1924).
187. HM Treasury, *Business Tax Roadmap,* Mar. 2016, Box 2.B, *UK activity in response to the BEPS actions.*

Chapter 29

United States

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29.1. The meaning of avoidance and aggressive tax planning and the BEPS initiative

29.1.1. The meaning of tax avoidance in national legal systems

Tax avoidance has not been developed as an independent legal concept in the United States as much as it has in most European countries. The general philosophy of the Internal Revenue Code (IRC) is to prefer rules to standards, and to avoid general concepts that may lead to a vast array of interpretations and reduce certainty of the law. Complementarily, the United States does not employ general anti-abuse rules (GAARs), a policy stance further explored below.

The IRC mentions the term "avoidance" in quite a few provisions, yet in none of them is it defined. Similarly, the use of the term "evasion" is not defined, and is often used together (with no specific distinction) with the term avoidance, albeit with some lower frequency. To the best of my knowledge, Congress has never bothered to define the term, consistent with its general policy regarding the drafting of tax laws.

The most common use of the terms avoidance and evasion occurs in code sections explicitly permitting the promulgation of Treasury Regulations (hereinafter referred to as the "regulations") to combat more or less specific anticipated circumventions of the rules that contain such permissions.[1] Such

1. The delegation is sometimes general (*see*, for example, IRC secs. 42(n)(3) (regarding the low income housing credit); 72(e)(12)(B) (Annuities; certain proceeds of endowment and life insurance contracts);163(i)(5)(B), 163(j)(9)(A) & 163(l)(7) (regarding interest deduction); 170(f)(10)(I) (regarding non-deductibility of certain payments in the charitable contribution context); 172(g)(5)(B) (regarding certain net operating losses); 197(g) (regarding the amortization of intangibles); 280G(e)(2)(C)(ii)(III) (regarding golden parachute payments); 367(b)(1) (regarding certain transfers from foreign corporations); 409(p)(7)(B) (regarding tax credit employee stock ownership plans); 411(b)(5)(B)(v)(III) (regarding minimum vesting standards); 414(o) (regarding employee benefits); 444(g) (regarding special tax year elections); 504(b) (regarding loss of charity status); 512(b)(13)

circumvention is often referred to as tax avoidance, yet again only in the specific, limited context. Regulations promulgated pursuant to these code provisions similarly follow the pattern of specific targeting and describing of undesirable actions or consequences, largely avoiding generalizations and relevant definitions.

In other code sections, power is otherwise (i.e. not in the form of an authority to prescribe regulations) given to the Secretary (the executive branch, or the Internal Revenue Service (IRS)) to counter abuse.[2] Section 1274(b)(3) includes a unique construct where the IRC denies a tax benefit (in the context of debt exchanged for property) to "potentially abusive situations",

(F) (regarding unrelated business income of exempt organizations); 643(a)(7) (regarding the taxation of trusts and estates); 731(c)(7) (regarding non-recognition of partnership distributions); 860G(b) (RIC and REIT rules); 864(d)(8) (regarding related person factoring income); 871(h)(4)(A)(ii) (regarding denial of the portfolio interest exemption for certain contingent interest); 877(d)(4)(D), 877(f) & 877(g)(2)(A)(ii) (regarding expatriations to avoid tax); 953(c)(8) (insurance income as Subpart F income); 956(e) (regarding investment of CFC earnings in US property); 904(i) (regarding the use of consolidation to avoid FTC limitations); 1474(f) (regarding avoidance of rules on foreign accounts); 1502 (general authority to regulate the taxation of affiliated corporations); 4261(e)(3)(C) (regarding an air transportation excise tax); 7701(f) & (l) provide authority to prescribe anti avoidance regulations for abusive uses of related party transactions, pass-thru entities and conduit arrangements without defining avoidance or abuse, albeit in the "definitions" section of the code; 7874(g) (regarding inversions), and sometimes more specific about the potential abuse anticipated (*see*, for example, secs. 45R(i) (regarding employee health insurance expenses of small employers); 149(g)(5) (regarding the treatment of hedge bonds); 167(e)(6) (regarding the non-depreciation of certain term interests); 361(b)(3) (regarding transfers to creditors and reorganizations); 382(m)(3) (regarding limitations on net operating loss carryforwards and certain built-in losses following ownership change); 469(g)(1)(C) (regarding passive activity losses); 706(b)(4)(B) (regarding partnerships' tax years); 846(e)(4)(B) (regarding cherry picking by insurance companies); 897(e)(2) (regarding coordination of FIRPTA with non-recognition provisions); 936(a)(4)(B)(iii)(III) (regarding the Puerto Rico and Possessions tax credit election in the context of affiliated groups); 965(b)(3) (regarding the temporary dividend received deduction rules); 1022(g)(2)(D) (regarding denial of benefits on property acquired from a decedent); 1092(c)(4)(H) (regarding straddles); 1274A(e)(2) (regarding an election to elect the cash method of accounting for certain low value transactions); 1503(d)(4) (regarding contribution of property to dual consolidated loss corporations),

2. For example, in the context of annuities not held by natural persons the code permits fair market value to be used in the calculation of income rather than the usual net surrender value if the Secretary suspects abuse. Sec. 72(u)(A). *See also*, for example, secs. 404(k)(5)(A) (regarding denial of deductions for contributions of an employer to an employees' trust or annuity plan and compensation under a deferred-payment plan); 672(f)(4) (in the taxation of trusts and estates context); 897(h)(5)(B)(ii)(II) (applicability of the FIRPTA wash sale rules); 2107(d) (shift of burden of proof that one of the principal purposes of an expatriation had not been tax avoidance if the Secretary reasonably concludes that the expatriation would result in certain tax reductions); 6113(b)(2)(B) (regarding disclosure of non-deductibility of certain contributions).

goes on to define them, and to permit the Secretary to prescribe regulations determining the types of situations falling into this category.

The IRC does include a few provisions that are somewhat wider in scope. Most notably, section 269 in its entirety grants power to the Secretary to combat acquisitions made to avoid or evade income taxes.[3] Note that the IRC does not distinguish between tax avoidance and tax evasion, as is common in many jurisdictions, even in this case. Similarly, section 269A was enacted to counter abuse by personal service corporations formed or availed of to avoid or evade income taxes,[4] and section 269B for stapled entities, although in this case the detailed rules are left for regulations.[5] Section 845 regulates the taxation of reinsurance contracts involving tax avoidance or evasion, again without defining such terms.

Conversely, section 306 specifies an exception if the Secretary is convinced that a disposition of 306 stock was not "in pursuance of a plan having as one of its principal purposes the avoidance of Federal income tax".[6] Similarly, certain adjustments to earnings and profits are negated when an avoidance purpose is lacking,[7] non-recognition treatment of certain distributions in corporate divisions is permitted if not in pursuance of a plan having as one of its principal purposes the avoidance of Federal income tax.[8] Other, similar reversals of consequences exist in the IRC when a tax avoidance purpose is lacking.[9]

In yet other cases, abuse changes the consequences of certain transactions, for example, in the context of constructive ownership of stock for the purposes of determining the character of stock redemptions.[10] Section 357(b) also reverses the favourable treatment of an assumption of liability in a non-recognition transaction when the principal purpose of the assumption

3. *See*, secs. 269(a) (in general), 269(b)(1)(D) (regarding certain liquidations), 269(c) (explains the extent of the powers of the Secretary).
4. *See* sec. 269A(a).
5. *See* sec. 269B(b).
6. Sec. 306(b)(4).
7. Sec. 312(m).
8. Sec. 355(a)(1)(D)(ii).
9. *See*, for example, 453(e)(7) & 453(g)(2) (installment method rules); 614(e)(1) (regarding certain aggregation rules in the natural resources context); 871(m)(3)(B) (regarding the treatment of notional principle contracts as dividend equivalent); 1031(f)(2)(C) (regarding and exception for denial of benefits in the context of like kind exchanges); 1256(e)(3)(C)(v) (regarding marked to market contracts).
10. Sec. 302(c)(2)(B). *See also* secs. 467(b) (accrual of rental payments); 542(c)(8) (abuse affects the definition of personal holding companies)

is the avoidance of tax. Other examples exist, especially in the part of the IRC that administers the tax system and its procedures.[11]

Finally, the IRC includes several specific "anti-avoidance" rules,[12] using this term, and other "anti-abuse" rules, again without specifically defining these terms. These rules also appear often at the procedural part of the IRC. For example, a transfer of an asset among taxpayers filing joint returns may be disqualified if done with a principal purpose of tax avoidance.[13]

29.1.2. The meaning of tax planning, abusive tax planning and aggressive tax planning in national legal systems

The United States does not refer to tax planning, abusive tax planning or aggressive tax planning as legal notions. The right of every taxpayer to arrange his affairs in a manner that would minimize taxpaying is well established, and may even be viewed as the baseline for US tax practice. The concept of abuse or inappropriate taxpaying behaviour more generally is addressed mainly through the norms themselves. The examples mentioned in section 29.1.1. also include a few references to abuse, yet none of them define abuse as an independent concept. US law prefers to describe what is abusive in specific circumstances, and avoids generalizations on the matter.

The closest concept to abusive or aggressive tax planning would be the reference to "tax shelters", a general name for transactions that are somehow inappropriate even if they comply or may be viewed as complying with the letter of the law.

The term tax shelter was popularized in the 1970s to describe an individual tax-favoured investment, usually investment popular among high-income taxpayers following expert tax advice. Such investment typically involved assets subject to favourable cost recovery rules, and often involved

11. Other examples include: secs. 1272(a)(2)(E)(ii) (reversal of an exception to the requirement to include original issue discount in current income when tax avoidance is one of the principal purposes of the transactions; 6662(d)(2)(C)(ii) (enterprise with a significant tax avoidance or evasion purpose included in the definition of tax shelter for the accuracy-related penalties purposes); 6662A (imposition of accuracy-related penalty on understatements with respect to "reportable transactions"); 6707A (penalty for failure to include reportable transaction information with return); 7872(c)(1)(D) (treatment of below-market loans one of the principal purposes of which is tax avoidance).

12. *See*, for example, sec. 338

13. Sec. 6015(c)(4)(B)(i).

partnership arrangements. Most of this "industry" was eliminated by the Tax Reform Act of 1986.

In the 1990s, however, the term surfaced again in the context of corporate investment, leading to the corporate tax shelters era. Again, tax-favoured investments are marketed to taxpayers, but this time the tax planning schemes are more sophisticated and the stakes higher. The tax planning clearly has become much more aggressive. The key components of these instruments are both tax-favoured assets and financial instruments. They main strategy in this industry is secrecy – to ensure that the scheme is not discovered in audit, taxpayers prefer, and are willing to pay, exclusive instruments or similar circumstances. At present, many of these tax shelters have been discovered[14] and even successfully struck down in the courts.[15] In some more widespread cases, such as the so-called Son of Boss tax shelters, the IRS also used other techniques, such as settlement opportunities (mini-amnesty).[16] Yet little has been done in terms of tax reform to address the challenges of tax shelters beyond SAARs and new procedural rules that attempt to combat tax shelters, including disclosure rules for aggressive positions,[17] themselves defined very specifically, which does not seem to have resolved much of the issue beyond the typical "cat and mouse" game between the government and taxpayers. Nonetheless, it should be noted that

14. *See* the IRS website listing these transactions, available at: https://www.irs.gov/Businesses/Corporations/Listed-Transactions, and that listing notices about transactions of interest, available at: https://www.irs.gov/Businesses/Corporations/Transactions-of-Interest---Not-LMSB-Tier-I-Issues.

15. *See*, for example, Superior Trading LLC vs. Commissioner, Nos. 12–3367, 12–3370, 12–3368, 12–3371, 12–3369 (7th Cir., 26 Aug. 2013).

16. Available at https://www.irs.gov/uac/Strong-Response-to-"Son-of-Boss"-Settlement-Initiative.

17. The American Jobs Creation Act of 2004 (P.L. 108-357). Technically, the IRC requires the disclosure of reportable transactions**.** Each taxpayer that has participated in a "reportable transaction" must disclose information for each reportable transaction in which she participated, using Form 8886. Form 8886 must be attached to the tax return for each tax year of participation. Even if a transaction is identified as a "listed transaction" or "transaction of interest" after the filing of a tax return, the transaction must be disclosed within a certain period of time. Treas. Reg. 1.6011-4.

Material advisors with respect to any reportable transaction must also disclose information about the transaction on Form 8918.

Loss transactions must always be disclosed (Form 8886). If an advisor provides material aid, assistance, or advice on a transaction that results in a taxpayer claiming a loss of at least one of the following amounts and meets other filing requirements, then the advisor is a material advisor and must file Form 8918.

1. For individuals, at least $2 million in a single tax year or $4 million in any combination of tax years.

2. For corporations (excluding S corporations), at least $10 million in any single tax year or $20 million in any combination of tax years.

in the most egregious cases the government has forcefully pursued the tax advisors behind some of the shelters, including criminal charges resulting in significant jail time served by some of them.

The effect of BEPS on tax shelter matters is likely to be very small if not non-existent. First, BEPS is unlikely to affect much substantive tax law. Second, the United States already utilizes the other anti-shelter mechanisms suggested by the BEPS Project. The one exception may be the principal purpose test (PPT) in tax treaties that is likely not even to be discussed in the United States due to the consistent aversion to GAARs and similar measures.

29.2. The reaction to avoidance and aggressive tax planning in the BEPS context

29.2.1. Domestic general anti-avoidance rules (GAARs)

The United States is not an EU Member State, of course. Therefore, EC Recommendations do not have any status or effect on US law. In any event, US tax law traditionally has avoided ordinary GAARs or generally applicable norms that give the IRS power to reclassify or otherwise characterize transactions differently from the taxpayer's characterization. In particular, US law avoids subjective, intent-based wide-scoped anti-abuse rules.

US law does not employ an all-encompassing intent-based norm of any kind. One should probably seek the roots of the resistance to GAARs in the US legal culture seeking to limit the power of the government vis-à-vis the

3. For partnerships with only corporations (excluding S corporations) as partners (looking through any partners that are also partnerships), at least $10 million in any single tax year or $20 million in any combination of tax years, whether or not any losses flow through to one or more partners.
4. For all other partnerships and S corporations, at least $2 million in any single tax year or $4 million in any combination of tax years, whether or not any losses flow through to one or more partners or shareholders.
5. For trusts, at least $2 million in any single tax year or $4 million in any combination of tax years, whether or not any losses flow through to one or more beneficiaries.
6. A loss from a foreign currency transaction under IRC sec. 988 is a loss transaction if the gross amount of the loss is at least $50,000 in a single tax year for individuals or trusts, whether or not the loss flows through from an S corporation or partnership.
Some losses do not have to be reported as such: losses from casualties, thefts, and condemnations, losses from Ponzi Schemes, losses from the sale or exchange of an asset with a qualifying basis, losses arising from any mark-to-market treatment of an item, certain Swap losses (Notice 2006-16). *See also* Rev. Proc. 2004-66 & Rev. Rul. 2009-9.

citizenry. This is particularly true with respect to the federal government's taxing powers. For the same reasons, US law outside tax law also does not include a relevant, overarching anti-abuse norm of the GAAR variety. The practical necessity for anti-abuse tools has been filled by judicially developed doctrines.

Despite the general predisposition against GAARs, two sets of norms may nonetheless be considered in this context.

The first of these is section 482,[18] which functions as the United States' statutory transfer pricing regime. Section 482 operates as a GAAR-like rule in that it provides the IRS with significant discretion to intervene in the characterization of income from related-party transactions. This power is translated into a complex arm's length-based regime through detailed regulations.[19] While transfer pricing rules target some of the same abuses as various specific anti-abuse rules (SAARs), these two sets of rules apply separately and concurrently, and within the US tax system are not specifically coordinated. Although transfer pricing rules provide the IRS with significant power to intervene in the pricing of intercompany transactions, the US government has struggled to enforce transfer pricing rules. Both the government itself and the courts have clearly interpreted section 482 as a limited transfer pricing provision. Therefore, it would be difficult to discuss section 482 in the same category as traditional GAARs.

The second statutory provision that may be relevant for this discussion is the relatively new section 7701(o) that codified the economic substance doctrine that had formerly been used by US courts.[20] This doctrine was developed by the courts, yet has always been controversial and hence not uniformly applied. The codification is the result of a long debate over the scope of this doctrine that had been applied inconsistently by various courts. A key impact of section 7701(o) is that it clarified that a transaction has economic substance only if (i) the transaction changes the taxpayer's economic position in a meaningful way apart from federal income tax effects *and* (ii) the taxpayer has a substantial business purpose for engaging in the transaction, apart from federal income tax effects. This does not mean that every transaction must have a non-tax business purpose to escape section 7701(o),

18. All references are to the United States Internal Revenue Code and Treasury Regulations, unless otherwise provided.
19. Treas. Reg. 1.482-1 to -9.
20. Section 7701(o) was codified as part of the enactment of the Health Care and Education Reconciliation Act of 2010. *See also* Martin J. McMahon Jr., *Living with the Codified Economic Substance Doctrine*, 128 Tax Notes 731 (16 Aug. 2010).

since the decision whether the economic substance doctrine is "relevant" to a transaction is preliminary to the above test and should be made regardless of its content.[21] It is unclear how the courts and the IRS would interpret this provision. Finally, the legislative history for section 7701(o) specifically excludes certain transactions and business decisions that are considered "normal" from its application, including, but not limited to: (i) the capitalization choice between debt and equity; (ii) the choice to use a foreign or a domestic corporation for a foreign investment; (iii) restructuring for a ("tax-free") reorganization; (iv) leasing transactions (that are subject to separate, facts and circumstances, scrutiny); (v) and the choice to enter into a related-party transaction.[22] The breadth of this exclusion is unclear at this point.[23]

The eventual impact of this rule as codified is still uncertain, primarily because it applies to transactions entered into after 30 March 2010, which makes it difficult to assess beyond noting additional risk to taxpayers and additional power given to the IRS as a result of its enactment. Commentators have emphasized primarily the impact of the codification on the penalties regime applicable to underpayments attributable to transactions lacking economic substance that now includes strict liability elements.[24] Moreover, section 7701(o) does not truly codify the economic substance doctrine, since it does not establish a statutory norm as to when the doctrine should be applied; it merely provides the infrastructure and the legal instruments for its application. Note also that it does not affect other judicial doctrines. Therefore, again, it would be difficult to closely compare section 7701(o) with traditional GAARs.

The lack of congressionally enacted GAARs has resulted in the courts being forced to face transactions that were not explicitly covered by SAARs, yet were perceived as abusive or contrary to Congress' intent. The courts have responded by developing judicial doctrines based on general anti-abuse principles and standards. These doctrines have then become available for the IRS to use in challenging transactions not covered by SAARs and apply equally to domestic and cross-border transactions. Note that within the

21. This is explicitly asserted by section 7701(o)(5)(C).
22. Staff of the Joint Committee on Taxation, Technical Explanation of the Revenue Provisions of the "Reconciliation Act of 2010", as amended, in combination with the "Patient Protection and Affordable Care Act", 152-153 (JCX-18-10, 31 March 2010).
23. *See*, for example, Monte A. Jackel, *Dawn of a New Era: Congress Codifies Economic Substance*, 127 Tax Notes 297 (19 April 2010).
24. *See*, for example, McMahon, *supra* n. 20.

United States' discourse, these judicial doctrines are never referred to as GAARs.

The seminal case in the development of these doctrines is *Gregory v. Helvering*,[25] in which the taxpayer attempted to convert ordinary income dividends into capital gains via a chain of transactions, the sole purpose of which was the reduction of tax. The Supreme Court disregarded these transactions based on their lack of "business purpose". The requirement of a business purpose other than the reduction of tax is sometimes mentioned as a separate requirement or doctrine, although it is usually discussed together with other doctrines, such as the economic substance doctrine mentioned above. The most GAAR-like and oft-mentioned judicial doctrine developed after *Gregory* is really a principle known as "substance over form". This principle has developed to include a variety of derivative judicial doctrines and techniques with a similar purpose.[26]

The substance-over-form principle has been used in various circumstances. Most notably, in the international context it was employed in several cases to disregard intermediate entities as mere "conduits" or "shams" used to obtain tax treaty benefits. Such tax planning schemes (sometimes known as "treaty shopping") take advantage of the relative mobility and flexibility of certain (often "passive") income earned by corporate groups. The seminal case in this area is *Aiken Industries v. Commissioner*,[27] a case in which a US parent corporation restructured a loan, originally made to it by a Bahamas subsidiary, into a back-to-back loan directed through another subsidiary resident in Honduras. The benefit of the restructuring was the application of the United States Honduras double tax treaty, which eliminated the withholding tax on the interest payments made by the US parent to the Honduran entity. The Tax Court in this case sided with the IRS, disregarding the Honduran intermediary as a mere conduit, and relying on the fact that the arrangement between the US entity and the Honduran entity simply replicated the former direct arrangement. Nevertheless, the government's victory in Aiken has proven bittersweet, as the case had provided a roadmap for arrangements in which the intermediary entity is assigned a minimal risk or function, which the government has not been able to challenge successfully.[28]

25. 293 U.S. 465 (1935) (hereinafter *Gregory*).
26. For a more comprehensive review, *see* Philip West & Amanda Varma, United States Report, in Stef van Weeghel et al., *Tax treaties and tax avoidance: application of anti-avoidance provisions*, 2010 IFA cahiers de droit fiscal international.
27. *Aiken Ind. v. Comm'r*, 56 T.C. 925 (1971).
28. *See* Yariv Brauner, *Beneficial Ownership – the U.S. report*, in Michael Lang et al., ed., *Beneficial Ownership* (Linde, 2013).

The sham doctrine is another articulation of the substance-over-form doctrine. It could be divided into "sham entity" and "sham transaction" applications. The sham entity application may be traced to the US Supreme Court decision in *Higgins v. Smith*,[29] where the taxpayer simply sold, at a loss, securities to a wholly owned corporation (prior to the enactment of a code provision preventing it). The Court disregarded the corporation, drawing an analogy to *Gregory*, and noting that the transaction did "not vary control or change the flow of economic benefits". Yet, the Court has been very careful over the years in the application of this doctrine, strictly adhering as a general rule to the corporate personhood fiction, and applying the sham doctrine only when no valid business purpose for forming the entity existed.[30] The Court clarified that the corporate form may be disregarded only where it is singularly a sham.[31]

A similarly narrow attitude may be found in the treaty context. The *Aiken Industries*[32] case mentioned above is the seminal case establishing the doctrine in this context that later evolved into the US version of the beneficial ownership requirement in tax treaties. It applied the traditional US common law principle that required "dominion and control" over income for economic ownership. Yet, it eventually had limited success as an anti-treaty shopping rule due to its focus on the matching cash flow element in the facts of the specific case. Following *Aiken Industries*, the United States began to include the "beneficial ownership" language in its tax treaties. The 1977 US Model included such language, in part as an initial attempt to develop anti-treaty shopping rules.

Nonetheless, Aiken Industries has also presented taxpayers with a roadmap for circumventing its rule. The other facet of the old dominion and

29. *Higgins v. Smith*, 308 US 473 (1940).
30. *See*, for example, *Moline Properties, Inc. v. Comm'r*, 319 US 436 (1936), where a lender had requested that an individual form a corporation to hold the mortgage and title to certain property. The corporation carried out some activity, including refinancing and leasing portions of the property.
31. The Supreme Court has affirmed the *Moline Properties* principle in subsequent cases, holding that a corporation may act as an agent of its owner in certain narrow circumstances. *Commissioner v. Bollinger*, 485 US 340 (1988). In *Bollinger*, the Supreme Court cited a previous decision, *National Carbide Corp. v. Commissioner*, 336 US 422 (1949), for factors to be used in determining whether a corporation could be deemed an agent for its shareholders and concluded that the corporation was an agent where "the fact that the corporation is acting as its shareholders' agent with respect to a particular asset is set forth in a written agreement at the time the asset is acquired, the corporation functions as agent and not principal with respect to the asset for all purposes, and the corporation is held out as the agent and not the principal in all dealings with third parties relating to the asset".
32. *Aiken Industries, Inc. v. Commissioner of Internal Revenue*, 56 T.C. 925 (1971)

control rule was the disapproval of a complete matching of cash flow in back-to-back transactions. Slight diversion from such matching was viewed as sufficient, and potentially as a small enough price to pay for the preservation of the opportunity to treaty shop. In response, the United States attempted to challenge some of these arrangements and expand the scope of the *Aiken Industries* decision, yet with little success. Hence, it chose to take a legislative approach, by implementing some specific domestic anti-abuse rules and a more aggressive general countermeasure – the limitation on benefits clause that was gradually introduced into all new US tax treaties. At the same time, certain jurisdictions with strong economic ties to the United States and favourable tax treaties had accommodated such planning by allowing taxpayers to leave (and consequently be taxed on) only small margins in their jurisdictions in exchange for the diversion of such back-to-back arrangements to them, as demonstrated, inter alia, by the Northern Indiana case,[33] where an exclusive tax reduction motive could not disqualify a transaction. Regardless of one's opinion of the sense of litigating this case, this had been a devastating loss to the US government. It affirmed the general position among tax planners about the narrow scope of *Aiken Industries* and the sufficiency of rather minimal "substance" to sustain the form of multi-step tax minimizing arrangements. Interestingly, this decision included no mention, not even implicit, of the beneficial ownership concept. The government chose not to pursue this avenue of argumentation even in the appeal, after losing in the Tax Court.

Similar tax planning, based on treaty shopping methodologies, had been used also for other types of income (other than interest), as demonstrated, for instance, by the *SDI Netherlands* case concerning royalties.[34]

The only other win for the government in the United States was in *Del Commercial*,[35] yet one should be aware, first, that in this case the taxpayer loss was primarily due to its own actions inconsistent with its tax planning scheme and contracts. Second, the case demonstrates, similar to *SDI Netherlands*, the declining importance of the concept of beneficial ownership: in *SDI Netherlands* the government failed to use it, leaving the court wondering about this failure, while in *Del Commercial* the court itself refrained from a beneficial ownership analysis. The court focused

33. *Northern Indiana Public Service Company v. Commissioner of Internal Revenue*, 105 T.C. 341 (1995).
34. *SDI Netherlands B.V. v. Commissioner*, 107 T.C. 161 (1996).
35. *Del Commercial Properties Inc. v. Commissioner of Internal Revenue* T.C. Memo 411 (1999)

on another common doctrine, following the substance-over-form charge, known as the step transaction doctrine.

According to this doctrine, formally separate steps of a transaction may be treated as a single transaction for tax purposes. The step transaction doctrine may be viewed as another variation of the substance over form principle. In determining whether steps should be integrated under the step transaction doctrine, courts and the IRS typically have applied three alternative tests. In the strictest test, the "binding commitment" test, a series of transactions will be "stepped together" only if, at the time the first step occurs, there is a binding commitment to undertake the subsequent steps. In the "mutual interdependence" test, a series of transactions will be stepped together if the steps were "so interdependent that the legal relations created by one transaction would have been fruitless without a completion of the series". Under the "end result" test, a series of transactions will be stepped together if the parties' intent at the commencement of the transactions was to achieve the particular result and the steps were all entered into to achieve that result. The step transaction doctrine has been used by courts to prevent a taxpayer from structuring a transaction in a certain way to gain treaty benefits, inter alia.

29.2.2. EC Recommendation C-(2012) 8806 of 6 December 2012 and subject-to-tax rule

As already mentioned, the United States is not a member of the EC. In addition, the United States has a long-standing commitment to the use of foreign tax credits for the elimination of double taxation rather than exemption mechanisms. Therefore, the issue of subject-to-tax clauses has not been part of the agenda of US tax treaty policymaking. Consequently, the United States has not introduced and is not expected to introduce a subject-to-tax rule as proposed by the EC or otherwise.

29.3. Transfer pricing rules, GAARs, specific anti-avoidance rules (SAARs) and linking rules

29.3.1. Transfer pricing

The US transfer pricing regime arose from an anti-abuse rule enacted to prevent tax avoidance in circumstances that are irrelevant to transfer pricing (fragmentation of income among related entities to minimize taxation under

a progressive corporate tax rates regime that has since ceased to exist). The language of the provision – section 482 mentioned above – was sufficiently wide to encompass other abuses related to actions of related corporations. Section 482 changed course therefore and has started to be so utilized as the original target became irrelevant with the flattening of corporate tax rates. Nonetheless, it is clear that the rule had anti-abuse origins, and despite its very general language the IRS was limited to using it only in abusive situations and only to ensure clear reflection of income in related-party circumstances.

The implementation of the rule was organized around a new standard, now known as arm's length, chosen by the Treasury and the IRS to be the most appropriate for income allocation among related parties. This well-known choice was for reliance on markets to extrapolate price proxies for non-market transactions. The US transfer pricing regulations responded to the charge in section 482 and poured arm's length content into the provision.

Unfortunately, the evolution of the transfer pricing regime in the United States resulted in the near abandonment of the original purpose of the rules in favour of the implementation and instrumentality of the mechanism chosen for its application. First the government and then the courts have limited the regime to a literal application of the arm's length standard in complete disregard of the object and purpose of the regime. It was all about the comparability of market and non-market transactions in the most straightforward and literal manner. This approach eventually resulted in disturbing conflicts with the ignored object and purpose of the rules. Yet, when the government attempted to revise the rules and adjust the arm's length instruments to stop certain perceived abuses, it consistently failed, both in attempts to finalize regulations and in the courts, while attempting to defend purposive interpretation that allegedly deviated from the literal arm's length as practised. Most pointedly, in a recent, controversial case the court explicitly stated that the purpose of transfer pricing is to treat related-party transactions in the same manner as non-related party transactions, completely ignoring the anti-abuse roots of the regime. Of course, the application of the detailed arm's length rules in the regulations combats much of tax avoidance attempted by related parties, yet it does so indirectly and only through the prism of the literal arm's length and the prescribed regulations. There is no direct targeting of abuse or tax avoidance. The failure of the regime proves this point, and the transactions put under scrutiny by BEPS are the most salient examples of this outcome.

Assessing the efficacy of transfer pricing rules in combating tax avoidance, one should note the impact of the instrumentality of the arm's length rules on the practice. Rules with a strong anti-abuse flavour shift power to the tax authorities and eventually to the courts to shape the contours of avoidance. Procedural rules with less anti-abuse flavour, such as the US transfer pricing rules, end up with the practice adjusting and eventually reaching a stable status quo that is very difficult to change, regardless of its desirability or of changing circumstances. This is exactly what happened with the practice of transfer pricing in the United States. Changes in market circumstances, such as the rise of intangibles, resulted in surges in litigation, yet the conservative approach of the government and the courts resulted in only a few outlier cases in support of the government position and almost universal fortification of the literal arm's length as established by tax practice.

Two lines of cases are notable in this context. The first, surging in the 1980s, involved the valuation of intangibles, which established a norm of reliance on business valuation techniques and markets. This is ironic, since the actual cases were not decided based on the valuations themselves but almost universally on rough justice proxies that appealed to the courts that found the evaluation of business valuations very challenging. Such outcomes were concerning for both the government and taxpayers, ending with both strongly refraining from litigation on such matters, preferring practical compromises and such.

The second, more recent cases involved the specific cost sharing rule included in Treas. Reg. 1.482-7. Despite its safe harbour character, the courts chose to emphasize the dominance of literal arm's length even in this case of an explicit exception from arm's length, resulting in a series of bitter losses for the government.

These outcomes point again to the poor efficacy of transfer pricing as practised in the United States as an anti-tax avoidance mechanism.

29.3.2. Limitation on benefits (LOB)

All but two (soon to be only one) of the US tax treaties currently in force contain LOB articles. LOB articles intend to ensure that an entity allegedly resident in one state has a sufficient nexus with that state to justify the application of the treaty. In general, an LOB article provides that only "qualified residents" are entitled to benefits under the treaty if such benefits are restricted to residents of the contracting states under the treaty. Under

the 2006 US Model, individuals, the contracting states, or political subdivisions thereof, and certain tax-exempt organizations are qualified residents. A company resident in a contracting state is a qualified resident if it meets the requirements of one of a few tests included in different versions and combinations in different actual tax treaties.

The first test is known as the public company test. It is generally met if a company, the principal class of its shares, and any disproportionate class of shares, is regularly traded on one or more recognized stock exchanges. Subsidiaries of publicly traded companies are qualified residents if five or fewer publicly traded companies that would be entitled to benefits are the direct or indirect owners of at least 50% of the aggregate vote and value of the company's shares (and at least 50% of any disproportionate class of shares).

The second ("ownership") and third ("base erosion") tests are often combined. Companies qualify under an "ownership and base erosion test" if (a) 50% of the aggregate voting power and value of the company is owned, directly or indirectly, by certain qualified residents; and (b) less than 50% of the entity's gross income is paid or accrued to certain persons not entitled to benefits under the treaty.

A company not otherwise eligible for treaty benefits generally under the tests described above may nevertheless qualify for treaty benefits with respect to certain items of income if the company meets the fourth test, known as the "active trade or business" test.[36] In general, an entity may meet the active trade or business test if: (a) the entity is engaged in "the active conduct of a trade or business" in its residence state; (b) the income derived from the source state is "derived in connection with, or is incidental to" that trade or business; and (c) the item is derived from a trade or business conducted in the source state or from a related person, yet the trade or business activity in the residence state is "substantial" compared to the trade or business activity in the source state.

Several of the US tax treaties, but not the 2006 US Model, have triangular provisions that add additional requirements to the LOB article. Under a triangular provision, when an enterprise of a contracting state derives income from the other contracting state, and that income is attributable to a permanent establishment in a third jurisdiction, treaty benefits will be limited

36. Some treaties include "derivative benefits" provisions that may be used by non-qualified residents to benefit from treaty benefits, albeit not the tested treaty benefits, but, for instance, their own country's treaty benefits, if any.

unless the combined tax that is paid with respect to such income in the residence state and the third jurisdiction is more than a specified percentage of the tax that would have been payable in the residence state if the income were earned in that state by the enterprise and were not attributable to the permanent establishment in the third jurisdiction.

The "main purpose" language of the Commentary on the OECD Model was specifically rejected by the US Senate in its consideration of proposed treaties with Italy and Slovenia. The Senate placed reservations on those treaties when it approved them in 2000, which were based on concerns about a main purpose anti-abuse rule. The Slovenians promptly agreed to the treaty with the reservation, but the Italian treaty entered into force only in late 2009 after almost 10 years of consideration by the Italians. It is likely that the BEPS PPT, using the "one of the principal purposes" language, will be similarly rejected.

29.3.3. CFC rules

An important part of the United States' anti-abuse rules has been devoted to curtailing what Congress considered to be inappropriate deferral of United States taxation of income earned by foreign subsidiaries of domestic corporations. Since 1937, the response from the IRS to inappropriate deferral had been to identify and limit it with specific legislation. This resulted in several anti-deferral regimes, each attempting to stop such tax planning schemes. This ad hoc approach increased the complexity of the law. Congress responded in 2004, essentially reducing anti-deferral to one regime primarily targeting corporations (Subpart F), and one primarily, yet not exclusively, targeting individual investors (passive foreign investment company (PFIC) rules). This section describes them in order.

29.3.3.1. Subpart F

The controlled foreign corporation (CFC) laws were first proposed by the Kennedy Administration in 1961, partly as a means to prevent the outflow of US corporate investment overseas.[37] The Kennedy Administration's original recommendation to completely eliminate the ability of companies to defer

37. *See* Hearings on the President's 1961 Tax Recommendations before House Committee on Ways and Means, Doc. No. 140, 87th Cong., 1st Sess. 8-10 (1961).

their US tax on offshore earnings met with congressional resistance;[38] the concern was primarily about the global competitiveness of US corporations. The Subpart F rules, which significantly reduced the ability of taxpayers to defer tax on mobile income that was perceived as lending itself to potential abuse of the deferral system, represented a narrowing of the original proposal, intended to allow businesses to maintain their competitiveness in the world economy.[39]

The CFC rules that were subsequently codified in 1962 as the "Subpart F" regime, currently require a US shareholder (a defined term) of a CFC (also a defined term) to include in gross income its pro rata share of (i) the Subpart F income (another defined term) of the CFC; (ii) previously excluded Subpart F income withdrawn from investment in less-developed countries; and (iii) the increase in earnings of the CFC invested in certain U.S. property.[40] Included within the 1962 legislation were (i) rules providing that US shareholders would be taxed on the gain on the sale or disposition of CFC stock at ordinary income rates instead of capital gain rates to the extent of a CFC's earnings and profits that had not been previously taxed under Subpart F; and (ii) rules preventing sales or exchanges of certain intellectual property by a US corporation to a foreign affiliate from escaping ordinary income tax rates.[41] The government's CFC policy has zigzagged over the years between legislation that limits the impact of the Subpart F rules, and that attempts to expand these rules.[42] The future trend regarding Subpart F is currently unclear. If fundamental tax reform occurs in the United States,

38. *See*, for example, The Dissenting Views of Senators Frank Carlson, Wallace F. Bennett, John Marshall Butler, Carl T. Curtis and Thruston B. Morton in Section 11 – Foreign Source Income, H.R. 10650, as amended by the Sen. Fin. Comm., 1962-3 C.B. 1059; Additional Views of Senator Eugene J. McCarthy on H.R. 10650, 1962-3 C.B. 1054; and the Supplemental and Minority Views of Senators Paul Douglas and Albert Gore, 1962-3 C.B. 1092.
39. *See* P.L. 87-834, 76 Stat. 960 (1962). H.R. Rep. No. 1447, 87th Cong., 2d Sess. (1962); S. Rep. No. 1881, 87th Cong., 2d Sess. (1962); H.R. Conf. Rep. No. 2508, 87th Cong., 2d Sess. (1962).
40. *See* P.L. 87-834, 76 Stat. 960 (1962).
41. Id.
42. *See* section 954(c)(6) CFC look-through rule, enacted in 2004, which generally provided an exclusion for certain dividends, interest, rents and royalties received or accrued by one CFC from a related CFC from Subpart F income, with more recent proposed legislation that would significantly extend the scope of current inclusions from intangible property transferred outbound. Proposed Section 954(a)(4) would create a new category of Subpart F income called "foreign base company excess intangible income". *See* "The President's Plan for Economic Growth and Debt Reduction" at page 50 (available at: http://www.whitehouse.gov/sites/default/files/omb/budget/fy2012/assets/jointcommitteereport.pdf (accessed 18 Sept. 2012)).

significant modification of the Subpart F regime likely will be part of the agenda.

The United States applies a combination of transactional and jurisdictional approaches to CFC anti-avoidance. On the one hand, the Subpart F regime taxes the (mainly) passive income of a CFC; however, the location of a CFC is also vitally important to the application of Subpart F. As defined in the Code and expanded upon further below, the definition of "Subpart F income" includes a number of different categories of income. The most significant category of Subpart F income is foreign base company income (FBCI), which includes foreign personal holding company income, foreign base company sales income, foreign base company services income and foreign base company oil-related income.[43] Each of these categories of income is primarily transaction based, but also includes a jurisdictional component. For example, foreign personal holding company income (FPHCI) generally includes dividends, interest, rents, royalties, along with other types of passive income, including certain gains from the sale of property.[44] However, a "same country" exception to the inclusion of certain items of FPHCI as Subpart F income means that an item of passive income paid from one entity to another entity in the same jurisdiction can be excluded from Subpart F income, provided the item of income and the payor meet certain requirements. Similarly, while foreign base company sales income generally consists of income from transactions involving the purchase and sale of personal property involving related parties, there is a jurisdictional component to this set of rules as well; sales income generally is only categorized as Subpart F income in cases where the transactions do not have a specified connection with the CFC's country of organization.[45] It does not include income from services provided to an unrelated person or income from services provided to any person in the CFC's country of incorporation.[46] Finally, a "high tax exception" applies to all types of foreign base company income, under which a CFC's income that otherwise may be treated as Subpart F income may be excluded if it is considered "high tax" income.[47] Also note that the US "check-the-box" rules, which effectively allow for elective or pass-through status for many foreign entities, have had a significant impact on

43. *See* Internal Revenue Code (the "Code") Sections ("Section" or "Sections") 952(a) and 954(a).
44. *See* sec. 954(c).
45. *See* sec. 954(d).
46. Id.
47. *See* sec. 954(b)(4) and Treas. Reg. §1.954-1(d). This exception, although it recognizes the potential for abuse value related to different tax rates, does not reflect a general US policy that ties the potential for abuse to the actual level of foreign tax.

the Subpart F regime.[48] Because US taxpayers may now elect to treat many foreign entities as disregarded entities, payments running between foreign affiliates, which prior to the advent of the check-the-box rules would have given rise to Subpart F income, are now exempt from these rules.

29.3.3.2. PFIC

Enacted in 1986, PFIC is an anti-deferral regime complementary to Subpart F, targeting (portfolio) investment by individuals that is perceived as structured for the primary purpose of US tax minimization. The PFIC rules, like the Subpart F rules, are drafted as objective, mathematical rules, rather than intent-based rules. They apply regardless of control and with no *de minimis* or threshold application; their effect is, first, to identify shares held by US residents in certain circumstances, and, second, to tax the shareholders in a manner that eliminates the benefit of deferral. PFIC shares are identified as such if they are held by US taxpayers in a foreign corporation that meets one of two tests in any given year: (i) 75 per cent or more of the company's gross income is passive income; or (ii) 50 per cent or more of the company's assets are passive, i.e. de facto or potentially producing passive income (based on average value or adjusted basis of the assets).[49] Passive income is generally income qualified as FPHCI, in coordination with Subpart F. A minimal exception is provided for start-up corporations or corporations changing businesses for the single relevant year only.[50] Once applied, the PFIC "taint" cannot be purged with respect to the particular shareholder until she is taxed under one of three particular regimes. The default regime does not impose an interest charge upon a realization event, thereby reversing the benefit of deferral. One may escape the interest charge by voluntarily conceding the benefits of deferral and electing to be taxed as if the corporation were transparent with respect to such shareholder's shares (qualified electing fund or QEF election).[51] A mark-to-market regime is also available to shareholders in publicly traded PFICs.[52] For non-publicly traded PFICs, the regime is designed in such a way as to incentivize shareholders to make the QEF election and avoid the punitive interest charge. Taxation is triggered by distributions or stock dispositions, which are defined broadly for this purpose.

48. *See* T.D. 8697, 61 Fed. Reg. 66584 (12/18/96). The regulations were effective as of 1 Jan. 1997.
49. *See* sec. 1297(e).
50. *See* sec. 1297(b)(2)-(3).
51. *See* sec. 1295(b).
52. *See* sec. 1296.

29.3.3.3. PFIC and CFC

Because the PFIC and Subpart F rules overlap, the IRC provides a coordination rule that gives preference to the latter; i.e. a company that is considered both a CFC and a PFIC (with respect to a specific taxpayer) generally are governed by the Subpart F rules.[53]

29.3.4. BEPS Action 2 linking rules

The United States does not presently employ linking rules of the type recommended by the OECD in BEPS Action 2. Moreover, the United States seems to be committed to its so-called check-the-box rules that permit the "hybridization" of entities by a simple election. Despite the prominent role of this election in hybrid structures involving US MNEs, the rule itself was not discussed by the BEPS reports.

The Obama administration has made a few proposals that are intended to be consistent with BEPS Action 2. One proposal basically adopts the OECD proposal for interest and royalty payments made to related parties. Another proposal would reverse the taxpayer-friendly look-thru rules to Subpart F in the case of hybrids. There is little likelihood that these proposals will eventually be enacted.

29.3.5. Earning stripping (section 163(j))

The United States has thin capitalization rules limiting the deductibility of interest paid by a US person to a related party if the related party is not taxed on the interest.[54] Pursuant to section 163(j), an interest deduction is denied, whole or in part if the taxpayer corporation has a debt-to-equity ratio of at least 1.5:1 and its net interest expense exceeds 50% of its adjusted gross income.

29.3.6. Other SAARs

The importance of SAARs in the US system makes their comprehensive review beyond the scope of this report. Yet, a few of the most prominent

53. *See* sec. 1297(d).
54. Similarly, the rule applies when the debt is guaranteed by the related person.

and relevant examples are helpful. First, notably, some SAARs specifically target passive income earned by corporate groups.

29.3.6.1. Anti-conduit regulations[55]

The anti-conduit regulations permit the IRS to ignore, and consequently deny, treaty benefits in certain back-to-back loans and similar financing transactions. These rules have been criticized on the grounds that they override US treaty obligations, yet the United States has adopted the position that these rules are a permissible domestic anti-abuse rule and merely articulate the beneficial ownership concept, operating as a supplement to the LOB articles in US tax treaties.

29.3.6.2. Section 894(c)

This statute and the attending regulations generally provide that a foreign person is not entitled to reduced treaty rates on income derived through a fiscally transparent entity under certain conditions, namely: (i) the foreign country does not treat such income as income of such a person; (ii) the relevant treaty does not specifically address income derived through fiscally transparent entities; and (iii) the foreign country does not tax the distribution of income from the relevant entity to the foreign person.

29.3.6.3. US investment by foreign subsidiaries

Various other rules attempt to reduce the desirability of investment in the United States by foreign subsidiaries of US corporations. Some rules target such investment in cases in which it is perceived as circumventing Subpart F. Section 956 is an example of these rules and is briefly described in the Subpart F discussion. Other rules concern investment in US real estate, ensuring US taxation of profits in cases of both direct and indirect ownership.[56]

Other SAARs indirectly affect passive income earned by corporate groups.

55. Treas. Reg. 1.881-3, issued pursuant to sec. 7701(l).
56. *See* sec. 897.

29.3.6.4. Section 267

Section 267 limits the deductibility of losses and interest related to transactions between US persons and controlled foreign affiliates in certain circumstances.

29.3.6.5. Section 7874 and regulations

In response to the migration of corporate groups originally controlled by US parent companies into foreign-controlled groups (typically in low-tax jurisdictions), Congress enacted an "anti-inversion" regime that, in certain cases, treats the inverted (i.e. now foreign) company as a US corporation for US tax purposes or, alternatively, limits the ability of the inverted company and/or its shareholders from taking advantage of certain tax attributes in connection with the transaction.

29.3.6.6. Transfers of intangibles – Section 367(d)

Complementing the transfer pricing rules, this "super-royalty rule" taxes a US person selling an intangible to a foreign person as if the transfer was a licence and the income a royalty stream, ensuring a clear reflection of income that is difficult to assess ex ante. The specific application of this rule and the regular relevant transfer pricing rules applicable to intangibles are currently relatively easily avoidable in appropriate circumstances via the use of the cost sharing regime.[57]

29.4. Application of GAARs, TP rules and SAARs

The application of anti-abuse rules in the United States is generally non-hierarchical. The lack of a regular GAAR results in a system that uses many SAARs in parallel. There is no effective legal status hierarchy among these; therefore they apply independently of each other and typically in an uncoordinated manner.

The transfer pricing rules may be viewed as anti-abuse rules or part of the anti-abuse system in US tax law, yet technically they operate in a traditional manner, i.e. as tax accounting rules determining how much income

57. *See*, for example, *Veritas Software Corp. v. Com'r* 133 T.C. 297 (2009), nonacq AOD. 2010-005.

the relevant taxpayer (the domestic taxpayer among the related parties involved in a transaction) has in any particular year. As such, this determination is made prior to the application of any other anti-abuse laws, and its consequences would establish the facts and circumstances, the benchmark that the other SAARs would test. Of course, it is possible that an application of any SAAR would result in a tax position that is not at arm's length and would require at least reconsideration under the transfer pricing rules, yet this is not the case typically.

A few rules include internal ordering provisions, either substantive or in their procedural companion. For example, when both the Subpart F and PFIC rules apply, the former generally prevails. These ordering rules should not be viewed, however, as hierarchical in nature in most cases.

There are multiple procedural rules related to the application of the transfer pricing and specific anti-abuse rules. Yet, beyond the preliminary application of the transfer pricing rules (for the reasons explained above) and the strong preference for the application of domestic rather than treaty law first, they do not generally affect the outcome in the United States. Note that many of the procedural rules accompanying SAARs are rather specific, providing conditions, terms and paperwork requirements. The IRS is typically very strict in following these conditions.

List of Abbreviations

ACE	Allowance for corporate equity
AIF	Alternative investment fund
ALS	Arm's length standard
AO	Abgabenordnung (Tax Code, Germany)
APA	Advance pricing agreement
AT	Agencia Tributaria (Tax Administration, Spain)
ATAD	EU Anti-Tax Avoidance Directive
ATO	Australian Tax Office
ATP	Aggressive tax planning
ATR	Advance tax ruling
AVL	Arvonlisäverolaki 1501/1993 (Act on Value Added Tax, Finland)
AY	Türkiye Cumhuriyeti Anayasası (Turkish Constitution)
BAO	Bundesabgabenordnung (Federal Tax Code)
BEPS	Base erosion and profit shifting
BFH	Bundesfinanzhof (Federal Fiscal Court, Germany)
BIT	Bilateral investment treaty
BITC	Belgian Income Tax Code
BVAT	Belgian VAT Code
BVerfG	Bundesverfassungsgericht (Federal Constitutional Court, Germany)
CAAR	Centro de Arbitragem Administrativa (Arbitration Tax Court, Portugal)
CAP	Purchase or production cost-plus tax and profit method
CARF	Conselho Administrativo de Recursos Fiscais (Brazilian Administrative Council of Tax Appeals)
Cass.	Cour de Cassation (French Court of Cassation)
CbCR	Country-by-country reporting
CCCTB	Common consolidated corporate tax base
CE	Conseil d'Etat (French Administrative Supreme Court)
CFC	Controlled foreign company
CGI	Code général des impôts (French General Tax Code)
CITA	Corporate Income Tax Act (Croatia, Netherlands, Spain)
CITR	Corporate Income Tax Regulation
CJEU	Court of Justice of the European Union
Cons. const.	Conseil constitutionnel (French Consitutional Council)
CPL	Production cost-plus profit method

CRS	Common reporting standard
CUP	Comparable uncontrolled price method
DEMPE	Development, enhancement, maintenance protection and exploitation
DGT	Dirección General de Tributos (General Tax Directorate, Spain)
DTC	Double tax convention
DVDDK	State Council Plenary Session of Tax Cases (Turkey)
DWTA	Dividend Withholding Tax Act (Netherlands)
EBITDA	Earnings before interest, taxation, depreciation and amortization
ECHR	European Court of Human Rights
ECJ	European Court of Justice
EstG	Einkommensteuergesetz 1988 (Individual Income Tax Act 1988)
EVL	Laki elinkeinotulon verottamisesta 360/1968 (Act on Business Taxation, Finland)
FATCA	Foreign Account Tax Compliance Act
FATCA IGA	FATCA intergovernmental agreement
FBCI	Foreign base company income
Final Reports	OECD BEPS Final Reports
FPHCI	Foreign personal holding company income
FTA	French tax authorities
GAAR	General anti-avoidance rule
GTA	General Tax Act (Croatia)
GTL	General Tax Law (Lei Geral Tributária, Portugal)
GVK	Gelir Vergisi Kanunu (Income Tax Law, Turkey)
ImmoInvFG	Immobilien-Investmentfondsgesetz (Real Estate Investment Funds Act)
InvFG	Investmentfondsgesetz 2011 (Investment Funds Act 2011)
IP	Intellectual property
IRS	Internal Revenue Service
İYUK	İdari Yargılama Usulü Kanunu (Law on Administrative Trial Procedure, Turkey)
KHK	Kanun Hükmünde Kararname (Statutory Decree, Turkey)
KStG	Körperschaftsteuergesetz 1988 (Corporate Income Tax Act 1988)
KHO	Korkein hallinto-oikeus (Supreme Administrative Court of Finland)
KOVE	Large Taxpayers' Office (Finland)

KVK	Kurumlar Vergisi Kanunu (Corporate Tax Law, Turkey)
KVL	Keskusveolautakunta (Central Tax Board, Finland)
LähdeveroL	Laki rajoitetusti verovelvollisen tulon verottamisesta 627/1978 (Act on Taxation of Income of a Person Subject to Limited Tax Liability, Finland)
LIR	Loi modifiée du 4 Décembre 1967 concernant l'impôt sur le revenu (Income Tax Act, Luxembourg)
LOB	Limitation on benefits
LPF	Livre des procédures fiscales (French Tax Procedure Code)
MAAL	Multinational anti-avoidance law
MAP	Mutual agreement procedure
MCAA	OECD's Multilateral Competent Authority Agreement
MET	Minimum effective taxation clause
MFZ	Madeira Free Zone
MNE	Multinational enterprise
MNL	Multinational group
MP	Provisional measure
NRITA	Non-Resident Income Tax Act (Spain)
OECD	Organisation for Economic Co-operation and Development
OECD MC	OECD Model Convention
OECD TPG	OECD Transfer Pricing Guidelines 2010
PCEX	Quotation price on exports method
PCI	Quotation price on imports method
PE	Permanent establishment
PerVL	Act on Inheritance and Gift Tax (Finland)
PFIC	Passive foreign investment company
PIC	Independent price method
PIT	Personal Income Tax
PRL	Resale price less profit method
PSD	Parent-Subsidiary Directive
PVEx	Export sales price method
QEF	Qualified electing fund
RAO	Reichsabgabenordnung 1919
RFB	Receita Federal do Brasil (Federal Revenue Secretariat)
RPM	Resale price method
SAAR	Specific anti-avoidance rule
SARS	South African Revenue Service
SME	Small or medium-sized enterprise

SPV	Special purpose vehicle
StAnpG	Steueranpassungesetz (Tax Adaptation Bill, Luxembourg)
STT	Subject to tax
TAAR	Tagged anti-avoidance rule
TBS	Tax Benefits Statute (Portugal)
TNMM	Transactional net margin method
TP	Transfer pricing
TPG	OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations
TTIP	Transatlantic Trade and Investment Partnership
UCITS	Undertakings for Collective Investment in Transferable Securities
VML	Laki verotusmenettelystä 1558/1995 (Act on Assessment Procedure, Finland)
VOVA	Tax Recipients' Legal Services Unit
VPDG	Verrechungspreisdokumentationsgesetz (Transfer Pricing Documentation Act)
VSVL	Varainsiirtoverolaki 931/1996 (Act on Transfer Tax, Finland)
VUK	Vergi Usul Kanunu (Tax Procedural Law, Turkey)
VwGH	Verwaltungsgerichtshof (Austrian Supreme Administrative Court)
VYL	Väliyhteisölaki 1217/94 (Act on the Taxation of Shareholder sin Controlled Foreign Company Entities, Finland)

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