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Recent developments in anti-abuse measures

« Fraus omnia corrumpit »

« Le droit cesse où l'abus commence » (Planiol)

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Introduction

In recent years public opinion became more and more sensitive to tax fraud.

Public authorities multiplied measures to combat tax fraud and tax avoidance.

See what is done under the BEPS program by OECD members.

EU authorities also took their part in complementing anti-abuse measures in the taxation field.

<u>But it raises a question</u>: as fraud, or abuse of law has been defined by court cases, why do we need to implement this notion in regulations?

This is the question we shall try to answer.

I. Definition of "abuse of law" by court cases

"*Any legal order which aspires to achieve a minimum level of completion must contain self protection measures, so to speak, to ensure that the rights it confers is not exercised in a manner which is abusive, excessive or distorted. This requirement is not at all alien to Community law*"

(concl. A.G. Tesauro in Case C 367/96, Kefalas).

But this general principle is not sufficient to determine in which circumstance there might be an abuse of tax law, bearing in mind that:

- *"There is no legal obligation to run a business in such a way as to maximize tax revenue for the State"* (see Case C 108/99, BLP Group);
- *"The principle of prohibition of abuse of law is in tension with the principle of legality and legal certainty"* (concl. A.G.M. Bobek in Case C 251/16, Edward Cussens).

Definition of "abuse of law" by court cases

This is the reason why the ECJ tried to give a definition as objective as possible of the "abuse of law".

The landmark case is Emsland Starke (Case C 110/99) where it was ruled that there might be an abuse **if two conditions are met**:

- "*First a combination of objective circumstances in which, despite formal observance of the conditions laid down by the Community rules, the purpose of those rules has not been achieved";*
- *"Second, a subjective element consisting in the intention to obtain an advantage from the Community rules by creating artificially the conditions laid down for obtaining it".*

Those principles were applied indistinctly to direct and indirect taxation.

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A. Indirect taxation (see C 255/02, 21 February 2006, Halifax plc)

- "*Community law cannot be relied on for abusive or fraudulent ends*" (pt. 68);
- "*However [-] Community legislation must be certain and its application foreseeable by those subject to it*" (pt. 72);
- *"In the sphere of VAT an abusive practice can be found to exist only if, first, the transaction concerned, notwithstanding formal application of the conditions, laid down by the relevant provisions of the Sixth directive and the national legislation transposing it, result in the* ***accrual of a tax advantage*** *the grant of which would be* ***contrary to the purpose of those provision*** (pt. 74);
- *"Second, it must also be apparent from a number of objective factors that the* ***essential aim*** *of the transaction concerned is* ***to obtain a tax advantage*** *[-]. The prohibition of abuse is not relevant where the economic activity carried out may have some explanation other than the attainment of tax advantage* (pt. 75).

Those principles were recently confirmed (see Case C 251/16, 22 November 2017, Edward Cussens)

" *In order for it to be found that an abusive practice exists, the tax authority of a Member State bear the burden of proving that two conditions are fulfilled"*

(concl. A.G. M. Bobek, pt. 58).

Objective condition: is the tax advantage contrary to the purpose of the "relevant provision"?

According to A.G. Bobek:

- *"Case law does not refer to failure to fulfill the purpose of "the Directive" in general terms but rather the "relevant provision thereof " (pt. 65);*
- *"Therefore, a finding that the objective provision is fulfilled in principle requires (i) the identification of the "relevant provision", (ii) the purpose thereof, and (iii) a demonstration that that purpose has not been met" (pt. 65).*

And in his demonstration, A.G. Bobek tried to find out which provision of the directive was not fulfilled in the present case.

Subjective condition: "*Was the essential aim to obtain a tax advantage?*"

What do we mean by *"essential aim"?*

According to A.G. "*the subjective test must be applied restrictively" [-]. If the transactions at issue may have some economic justification other than a tax advantage, then the test is not fulfilled"* (pt. 101).

Two remarks:

- The "subjective test" must be based on "objective" facts and circumstances that will be taken into consideration by the Court in charge of determining if the test was fulfilled;
- In a situation where the scheme was wholly artificial, the Commission suggested that the two conditions would be merged, the "objective" one absorbing the "subjective" one; this was rejected by the A.G., even if it is clear that the subjective condition is likely to be fulfilled in a wholly artificial scheme;

B. Direct taxation (see Case C 196/04, 12 Sept. 2006, Cadburry Schweppes)

Same criteria would be applicable, especially when the exercise of one major freedom would be restricted in order to combat tax fraud or tax evasion:

"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" (pt. 55).

In his conclusions, A.G. Leger referred to the (then) recently issued case Halifax and stressed that: *"a wholly artificial arrangement intended to avoid national tax law can therefore only be established on the basis of objective factors"* (pt. 117).

Those principles were recently confirmed (see concl. of A.G. Kokott in case C 115/16, N. Luxembourg 1)

In her conclusions, A.G. Kokott refers to the same criteria to characterize an abuse of law.

She also gives two interesting precisions:

- National tax authorities cannot *"rely directly against the individual on the basis of the general principle of E.U. law that abuse of right is prohibited*"; this is possible in VAT field since this tax is fully harmonized and *"particularly susceptible to fraud"* (pt. 104 to 107 conclusions);
- "*A wholly artificial arrangement that does not reflect economic reality or the essential aim of which is to avoid tax that would otherwise be payable based on the purpose of the law may constitute an abuse under tax law. The tax authorities must demonstrate that an appropriate arrangement would have given rise to a tax liability and the taxable person must demonstrate that there are important, non fiscal reasons for the arrangement chosen"* (pt. 118 conclusions).

What could be concluded from case-law?

- That there is a general principle in E.U. law that abuse of law is prohibited;
- That, for the application of tax law, an abuse will be characterized if two conditions are met:
  - ✓ an objective one: a tax advantage is obtained, contrary to the objective (purpose) of the relevant tax provisions;
  - ✓ a subjective one: the essential (sole) aim of the taxpayer is to obtain a tax advantage, which is the case in wholly artificial schemes;
- That it is the tax authorities burden to prove that those two conditions are met, given all the facts and circumstances of the case.

Then why do we need to have anti-abuse measures in the derived EU legislation since the principle may be applied regardless of domestic and/or E.U. measure (see Cussens case)?

II. Definition of abuse of law in derived E.U. legislation

For many years there was almost no anti-abuse provisions in E.U. legislation.

Things have changed in recent years.

Which reasons ? Which consequences ?

A. The texts

First anti-abuse measure could be found in Article 4.3 of the Council Regulation of 18 December 1995 on the Protection of the E.C. financial interests:

- ✓ *"Acts which are established to have as their purpose the obtaining of an advantage contrary to the objectives of the Community law applicable in the case by artificially creating the conditions required for obtaining that advantage shall result, as the case shall be, either in failure to obtain the advantage or in its withdrawal."*

- Directive 2009/133/CE, 19 October 2009, on **merger** of companies also contained in Article 15 an anti-abuse provision:

  - ✓ *"A member State may refuse to apply or withdraw the benefit of all or any part of the provisions of Articles 4 to 14 where it appears that one of the operations referred to in Article 1 has as its principal objective or as one of its principal objectives tax evasion or tax avoidance; the fact that the operation is not carried out for valid commercial reasons such as the restructuring or rationalization of the activities of the companies evasion or tax avoidance as its principal objective or as one of its principal objectives."*

- More recently (27 January 2015) an anti-abuse provision was introduced in the Directive 2011/96/EU, "**parent-subsidiary**" directive:

  - ✓ *"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 purpose 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."*

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And finally (for the moment) directive ATAD (2016/1164) introduces a general anti-abuse rule that will be applicable as from 1st January 2019.

It is interesting to compare the drafting of the Commission project and the final version that was adopted by the Council:

Commission project:

"non genuine arrangements or a series thereof carried out for the essential purpose of obtaining a tax advantage that defeats the object of 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"

Final version:

"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 to all relevant facts and circumstances. An arrangement may comprise more than one step or part."

See also the CCCTB GAAR regarding "artificial transactions".

B. The questions

1. The wording of those texts is slightly different: does it mean that they should be interpreted in a different way?

Merger	Parent-subsidiary	ATAD
An "operation"	An arrangement or a series of arrangements	An arrangement or a series of arrangements
Not carried out for valid commercial reasons	That are not genuine having regard to all relevant facts and circumstances	That are not genuine having regard to all relevant facts and circumstances
Constitute a presumption that the operation has tax evasion or tax avoidance as its main objective or as one of its main objectives	The main purpose or one of the main purpose of obtaining a tax advantage that defeats the object or purpose of the directive	The main purpose or one of the main purpose of obtaining a tax advantage that defeats the object or purpose of the applicable tax law

2. Does this wording comply with ECJ case law?

- Operation/arrangement or series of arrangements; ECJ = OK
- Not genuine having regard to all facts and circumstances; ECJ = OK
- Main purpose or one of the main purpose; ECJ = essential purpose.
- Defeat the object of the directive / tax law; ECJ = defeat a specific provision of the directive/tax law
- Burden of the proof: nothing is said; ECJ = burden of the proof to the tax administration.

3. Does it mean that national legislation that would strictly comply with the directives cannot be challenged?

- Member-States have introduced in their legislation provisions copied from the directives. Are they above any critics?
- The answer will probably depend on the application that will be made of those provisions.

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CONCLUSION

- Specific anti-abuse provisions were introduced in E.U. directives to ensure the same level of severity between the Member States.
- But in the end of the day it is the national legislation that will be applied to the taxpayers.
- Is this a way for Member States to secure their national legislation ?
- But procedural rules and guaranties given to the taxpayer differ greatly from one Member State to the other.
- It is really useful to try to harmonize a definition of tax abuse when the application of this notion may be substantially different?