

**Report on the proceedings of the Seminar A**

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**Seminar A: IFA / EU – Abuse and EU tax law**

This seminar, a traditional feature of IFA congresses organized by IFA with the participation of the EU Commission started with an overview on the latest developments at the EU presented by Mr. Michel Aujean, Director of Tax Policy at DG Taxation and Customs Union.

The presentation focused on policy and legislative issues in the field of indirect taxation (VAT, excise duties, environmental taxes) and direct taxation (in particular, company taxation).

Value Added Tax

The EU Council has been discussing the so-called VAT package, including the change of the place of supply of services, a simplification through the one-stop-shop provision, the improvement of the eight Directive on the refund procedures.

Moreover, apart from the consultation on reduced VAT rates which was recently launched, new priorities in the works of the EU Commission were identified in the fight against the VAT fraud, in the financial services area, in the mechanism to avoid double taxation, also through MAP and arbitration procedures, the introduction of electronic invoicing obligations and new VAT rates. The VAT treatment of public bodies has been postponed to 2009.

With respect to VAT fraud, the Commission issued a Communication in 2006 and launched a series of consultations focusing on the introduction of monthly EC sales listings, on a quicker exchange of information and on an improvement of the possibilities of verifying the VAT identification numbers. More far reaching studies are actually dealing with intra-community supplies which, being zero-rated today, are contributing to VAT carousel frauds. One of the solutions under analysis, which is however supported by a limited number of Member States, is the introduction of a pure reverse charge mechanism. An anti-fraud experts group has been set up in order to deal with the issues mentioned above.

Excise duties

The proposal to increase the minimum rates to take into account inflation in the field of alcoholic taxation was rejected.

A public consultation in the complex field of excise duties on tobacco, where price manipulation is one of the most sensitive issues, should result in a proposal to be made in 2008.

Environmental taxation

Various proposals are currently discussed in the field of the climate change and harmonized energy taxation.

The targets for the year 2020 are a 20% unilateral emission reduction, a 20% energy savings and a 20% share of renewable energies. Moreover, the Commission considers to adjust and to increase the minimum rate on commercial diesel taxation which is considered as a source of distortion of competition for the last years.

The basic idea about the 2005 proposal on passenger car related taxes is to move from registration to circulation taxes to be linked to CO<sub>2</sub> emissions.

#### Direct taxation

Apart from the amendments on the EU directives, such as the Parent-Subsidiary Directive, the Merger Directive and the Interest-Royalties Directive, significant results were reached by the EU Joint Transfer Pricing Forum such as the code of conduct on arbitration, on documentation requirements and on advance pricing agreements. The Forum was enlarged to 27 tax administrations and 15 business members with a new two-year mandate.

The major project of the Commission is the CCCTB. After the work of the six subgroups, the discussion is now focusing on administration and apportionment, and on the impact assessment of the CCCTB proposal. A study on impact assessment and a legislative proposal are foreseen for 2008.

In the field of harmful tax competition, the Group on the Code of Conduct continues to monitor roll-back and standstill measures. Different proposals on improving the internal procedures of the Code group, reviewing the relations of the Code with the State Aid measures, the use of anti-abuse measures to effectively implement exchange of information on transfer pricing issues and the extension of the Code to third countries, are currently under discussion.

With respect to the Savings Directive 2003/48/EC, an expert group from the financial services area was set up by the Commission in order to review the functioning of the Directive with the purpose of closing the existing loopholes and to correct inaccuracies. Discussions will start soon with Singapore, Hong Kong and Macau to promote the adoption of equivalent measures.

The Commission has issued three communications, followed by a very positive reaction from the Council in March 2007, with respect to (i) co-ordinating the Member States' direct tax systems in the Internal Market, (ii) exit taxation, and (iii) tax treatment of losses in cross-border situations. The preliminary discussions at the Council showed the existing consensus on the necessity to work on coordination issues and to set up subgroups with the Member States to work on exit tax, on the tax treatment of charities and of gambling. It was announced that in the near future the attention will be on anti-abuse provisions (see below), on dividend withholding taxation and on dispute resolution.

Finally, it is expected a Commission proposal for a review of the Capital Duties Directive aimed at a final phasing out of the capital duty by 2010, a survey on the implementation of the Merger Directive 90/434/EEC, a report on the functioning of the Interest and Royalties Directive 2003/49/EC where a proposal is still pending, and a report on tax issues in the venture capital market.

#### The notion of abuse in ECJ case law

The second part of the seminar dealt with the notion of abuse in ECJ case law. The panel did not discuss ECJ case law on the compatibility of domestic anti-avoidance legislations of EU Member

State with community law. It was preliminarily pointed out the potential extension of the ECJ case law in international taxation in general outside the European borders such as in the discussion about the scope of discriminatory provisions in cross-border areas.

What is meant by abuse ?

Reference was made to the following wording used by AG Maduro in the Halifax case: “*the requirement of legal certainty must be observed..., so that those concerned may know precisely the extent of their rights and obligations*”. It was argued that the critical need for certainty implies the importance of a precise and narrow definition of abuse. Thus, part of the panel expressed some criticism on general anti-avoidance principles.

However, another panellist, again by making reference to the wording used by AG Maduro in the Halifax case according to which “*legal certainty must be balanced against other values of the legal system*”, argued that any legal system should avoid that the strict and formalistic application of the law would lead to unreasonable result. Thus, legal certainty must be balanced against reasonableness and fairness.

According to one panellist, the use of terms implying value judgment, such as for example “*wrongfully*” obtaining advantages, was considered as inappropriate wording to be used in ECJ decisions although this was considered unavoidable by other panellists.

Tax avoidance always contains two elements, namely the tax avoidance motive and the circumvention of the purpose/goal of the rule at issue. This second aspect was considered more difficult to ascertain since it requires the identification of the actual goal of a legal provision.

Various tax avoidance measures are adopted in different jurisdictions, namely sham, substance over form, abuse of law (*fraus legis*), and other specific legislation (e.g. CFC rules). It was also pointed out the significance of the OECD MC which, at paragraph 22.1 of the Introduction, states “*such [anti-avoidance] rules, are part of the basic domestic rules set by domestic tax laws for determining which facts give rise to a tax liability; these rules are not addressed in tax treaties and are therefore not affected by them.*”. Thus, it was argued that any domestic anti-abuse rule is always consistent with tax treaties since these are rules which are determining the facts giving rise to a tax liability.

The concept of *fraus legis*, existing in EC law as acknowledged by the ECJ in Halifax, implies that one cannot improperly or fraudulently take advantage of EC laws and regulations. According to ECJ, two elements should be met to have abuse of law: a subjective element being the intention of the taxpayer and an objective element being a set of facts and circumstances resulting in tax benefits which are contrary to the goal of EC law. It was also pointed out that in Cadbury Schweppes the ECJ has admitted the validity of domestic anti-avoidance rules (CFC) in case of artificial situations. ECJ case law is based on the notion of purely artificial schemes with the purposes to get around tax obligations. The decision of the ECJ to take into account subjective criteria such as “artificial” scheme or “to get around tax obligations” in drafting the notion of abuse of law was criticized.

Under ECJ case law, abuse is identified where despite the observance of applicable rules the objective purpose or intention of the legislation is frustrated and there is an intention to obtain an advantage incompatible with the objective of the EC legal rules.

In Halifax, the ECJ also clarified that there is no abuse if the economic activity carried out may have some other explanation other than the mere attainment of the tax advantages.

It was pointed out that in order to ascertain whether the prevention of abuse might be a valid justification for restrictions it is necessary to carry out the proportionality test.

A distinction should be made between the notion of abuse of Member State laws, which can be addressed by domestic anti-abuse measures that must be tested for consistency with EC law (e.g. Cadbury Schweppes), and the notion of abuse of EC law, which in principle can be addressed by domestic anti-abuse measures if no specific EC measure is available; in the Kefalas case (C-367/96), for example, an abuse of a company law directive was identified on the basis of domestic Greek legislation. One of the panellists argued that there should be no room for domestic anti-abuse legislation if an EC anti-abuse measure is available, such as the holding period provided by Art. 3(2) of the Parent-Subsidiary Directive to prevent dividend stripping.

Another panellist argued that there is probably no difference in practice if the ECJ denies the assertion of freedoms where they are being abused or if the ECJ accepts abuse as a justification for domestic anti-abuse legislation.

As clarified in Cadbury Schweppes (Case C-196/04), the ECJ test means "*wholly artificial arrangements intended to escape the national tax normally payable*". Both motive and wholly artificial arrangement must be present. However, it was argued that where there is a wholly artificial arrangement Art. 43 EC Treaty does not apply, thus eventual justifications are not an issue. In other words, a fictitious arrangement might not give access to EC Treaty freedoms.

The panel seemed to agree that artificial means that it is "*not reflecting economic reality*" and that is "*solely*" for tax purposes, although it was pointed out the wide variety of national responses to ECJ case law by Member States in the field of abuse. The changes occurred in UK CFC legislation following the Cadbury Schweppes decision under which intra-group transactions can never add value was strongly criticized. An over reaction to be avoided was also considered the response by Germany to the ECJ case law on thin capitalization under which domestic thin cap rules became applicable to wholly domestic cases.

According to a panellist from UK, the notion of abuse developed by the ECJ seems to be confined to fictitious situations (i.e. wholly artificial arrangements), such as letter box companies or front subsidiaries in the CFC rule. Thus, such a concept appears to be very close to the concept of sham and therefore probably not needed.

It was argued that in Cadbury Schweppes the ECJ specified that an establishment is genuine where, based on objective factors ascertainable by third parties (e.g. premises, staff and equipment), it reflects economic reality. Although in theory the intention of the taxpayer matters, in practice, as also pointed out by AG Maduro in Halifax, the intentions of the taxpayers are inferable from the artificial character of the situation in the light of a set of objective circumstances and it is therefore confusing with the objective test.

The panel discussion then moved on dealing with the possible justification of domestic anti-abuse legislation. A first suggestion arising from the ECJ case law is that domestic anti-abuse rules should be suitable and proportionate to their objectives and should therefore contain safe harbour criteria. National legislation establishing presumption of abuse must be rebuttable. It was also argued that probably the burden of proof should not be entirely on taxpayers.

The ECJ as clarified that any anti-abuse test requires a case-by-case analysis with a rejection of broad generalizations. From *Cadbury Schweppes*, it can be inferred that the shifting of profits in a low tax jurisdictions within the EU is fine as far as the arrangement is not wholly artificial. From *Marks & Spencer*, it results however that a Member State can have a rule restricting the ability to shift losses from one jurisdiction to another.

At the end, the Panel questioned whether anti-abuse provisions should be a matter of the national courts or of the ECJ. It was argued that while national courts are in charge of all cases of domestic anti-abuse provisions, the ECJ should test whether domestic rules are consistent with Community law and should set Community law standards for abuse.

One of the panellists wished the issuance by the Commission of principles and guidelines for the harmonization of national anti-abuse rules and for a European-wide definition of abuse.