

## PREDICTING THE ‘UNPREDICTABLE’ GENERAL ANTI-AVOIDANCE RULE (GAAR) IN EU TAX LAW\*

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### ABSTRACT

*General Anti-Avoidance Rule (GAAR) is a type of rule designed to combat the tax-avoidance scenarios that in a legal form lawfully but aims to circumvent the legal consequences. GAAR is necessary for a tax system to address unexpected innovative tax avoidance scenarios. In the field of tax law, GAAR has been criticized for being too abstract and thus harmful to legal certainty. In the context of EU integration, the concept of GAAR has been developed and elaborated by Court of Justice of European Union as well as secondary laws, but there are quite a few different formulations. In the existing literature, it is established that, there are the subject test and the objective test cumulatively in the GAAR, which examines the taxpayers' subjective intension and the objective economic reality. As to the relation between these two tests, scholars have established the theory that, the formulation and the context of the subjective test is actually influenced by the tax rule involved (that is, the purpose of the norm being circumvented). This paper will revisit GAARs in the EU tax law and present that, the theory of GAAR based on the purpose of the violated tax norm is indeed supported by latest case law of CJEU as well new Directives. Furthermore, the intention of the norm reconciles the subject test and the objective test. In this regard, the unpredictability of 'GAAR' actually has become more predictable.*

**KEYWORDS:** *General Anti-Avoidance Rule (GAAR), EU law, Abuse of Law. Common Consolidated Corporate Tax Base (CCCTB), Anti-Tax Avoidance Directive (ATAD), legal certainty*

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## **1. INTRODUCTION**

In the development process of EU market integration, barriers from discrepancy between national tax laws are obvious. Despite the harmonization of customs law, the integration process in the other fields of tax law is relatively slow, especially regarding direct taxation, such as corporate tax. Indirect taxation has been harmonized much better, due to the comprehensive Value Added Tax (VAT) Directives and relevant implementing regulations. The reason behind is, direct taxation is still the core of Member States' fiscal autonomy. However, exercising such fiscal autonomy will always be in line with EU internal market law.

In a tax law system, including national tax laws as well as EU tax law harmonization, it is very common to provide a general anti-avoidance rule (GAAR), which combats any tax avoidance scenario that the legislators cannot expect or contemplate when they made the law. Since GAAR has the function to combat unexpected tax avoidance scenarios, being abstract and flexible enough is the essence of such rule; otherwise a GAAR would never be able to apply to the tax avoidance in hand.

While being abstract enough to react to all the unexpected tax avoidance scenarios, a GAAR is quote often criticized as infringing legal certainty for taxpayers. This is a paradox also appearing in the discussions of "abuse of law" / "abuse of rights" in other field of law. GAAR is inherently a rule needing flexibility and abstractness, whereas taxpayers have high expectations to a certain tax system and governance. This is why courts, scholars and practitioners continue the debates and discussions, in order to interpret such "unpredictable" rule in a logical way. The discussions have reached a consensus that, the current GAARs, no matter derived from EU secondary laws or case of Court of Justice of European Union (CJEU), can be broken into two tests: the objective test and the subjective test. The objective test refers to the objective circumstances or economic reality of the involved arrangement; the subjective test involves the taxpayers' subjective intention to deviate from the purpose of the tax law. The debates are focusing on the subjective test: whether the subjective test is still necessary or desirable and what the relation between the taxpayer's intention and the "purpose of the law". It seems that, scholars have reached the agreement of 'not to agree' regarding the definition of GAAR in the EU law.

Based on the semi-consensus above, this paper will ask a follow-up question: what do GAAR in the EU tax law should be designed, especially regarding the subjective test. In Section 2, this paper will short revisit the main discussion focal points, to demonstrate the difficulty of explaining the GAAR. I will shortly present my theory of explaining these seemingly inconsistent formula-

tions. In Section 3, statutory GAARs will be analyzed. In Section 4, case law of CJEU from VAT, direct taxation and export refund will be compared and further demonstrate the different formulations. In Section 5, I will present a three-test structure that incorporates the purpose of the norm involved, and showing that all these various formulations still follow a predictable pattern, mainly influenced by the purpose of the norm being abused. Section 6 concludes and provides a new thinking of a GAAR.

## **2. GENERAL ANTI-AVOIDANCE RULE (GAAR) IN EU TAX LAW: AN OVERVIEW OF CONTROVERSIES AND A NEW THEORETICAL ATTEMPT**

There are enormous academic discussions on GAAR, both at the EU law level and Member States law level.<sup>1</sup> A GAAR has been recognized as a final weapon against all the creative and aggressive scenarios. However, there are also suspicions around it because a GAAR can infringe legal certainty. There are mainly two streams of discussions regarding EU GAAR: The first stream of literature observes that, despite of various different formulations, there are two main types of GAARs in EU law, and the difference lies on whether a specific piece of EU law itself being abused (the so-called abuse of right) or whether a national law being abused due to implementing EU law (the so-called abuse of law). The second stream discusses the nature of such GAAR and explores whether there is a general principle of law for GAAR.

The starting points of these academic discussions have followed the well-accepted legal principle: Rights should not be abused. The formal observance of legal form with an abusive intention can be declared as invalid or regarded as another legal consequence. Therefore, in the analytical framework, there are always two sets of tests: the subjective test and the objective test. The subjective test examines the taxpayer's subjective intention; the objective test examines the economic effect of the involved arrangement. It is sometimes difficult to distinguish these two tests apart, because these two tests are actually just describing one specific behavior from two perspectives.

De La Feria<sup>2</sup> wrote about two types of formulations in EU GAAR: The distinction of abuse of rights and abuse of law in CJEU. 'Abuse of rights' refers to

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<sup>1</sup> Freedman, J.: *General Anti-Avoidance Rules (GAARs) – A Key Element of Tax Systems in the Post-BEPS Tax World? The UK GAAR*, WU Institute for Austrian and International Tax Law - Tax Law and Policy Series, 2014. Available at: <https://ssrn.com/abstract=2769554>.

<sup>2</sup> De La Feria, R.: *Prohibition of abuse of (Community) law: The creation of a new general principle of EC law through tax*, *Common Market Law Review*, 45(2), 2008, pp. 395–441.

abusing a specific EU law instrument, such as abusing VAT Directive; abuse of law concept, derived from the CJEU's evaluation of Member States' anti-avoidance rules as their justification to restrict the EU fundamental freedoms. CJEU seems stricter when evaluating Member states' law that is claimed to restrict the fundamental freedoms, i.e. the abuse of law cases. National anti-avoidance concern can only be justified when national anti-avoidance rules are designed to combat scenarios whose 'sole' purpose is tax-avoidance. As to abuse of rights cases, CJEU is more lenient to accept there is tax avoidance and focus less on the taxpayers' subjective intention or purpose.

Due to the variety of case law regarding tax avoidance, it has been argued if there is a general principle of anti-tax avoidance in the EU law.<sup>3</sup> Some scholars have affirmative opinion<sup>4</sup> whereas others are still quite skeptical.<sup>5</sup> As Panayi analyses<sup>6</sup>, it seems that there is not yet a completely coherent approach of anti-avoidance developed by CJEU, but two universal consensuses: first, taxpayers are in principle to structure their affairs in such a way as to limit their tax liability, so 'trying to reduce tax burden' itself does not automatically constitute tax avoidance. Second, Member States are entitled to adopt some measures against abusive scenarios, provided that these measures do not infringe EU law, such as fundamental freedoms. However, it is still difficult to draw the boundary of EU Member States' legitimate discretion to combat abusive scenarios and the boundary of taxpayers' legitimate freedom to minimize tax burden.

Among the academic discussions and the subjective test is the core of the debates. Lang has argued that, the subjective test is redundant in the analytical framework, because it is too controversial. It is too difficult to find out the intention of a human being.<sup>7</sup> Even for the statutory GAARs provided by EU secondary law, such as Anti-Tax Avoidance Directive (ATAD), de Wilde is

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<sup>3</sup> Panayi, C.: *European Union Corporate Tax Law*, Cambridge University Press, 2013, at 8.1 (Online version)

<sup>4</sup> For example Piantavigna, P.: *Tax Abuse in European Union Law: A Theory*, EC Tax Review, 20(3), 2011., p. 134–47; Jiménez, A. M.: *Towards a homogeneous theory of abuse in EU (direct) tax law*, Bulletin for International Taxation 66 (4/5), 2012, p. 270–92, available at SSRN: <https://ssrn.com/abstract=2392512>.

<sup>5</sup> For example, Seiler, M.: *GAARs and Judicial Anti-Avoidance in Germany, the UK and the EU*, Linde, Vienna, 2016.

<sup>6</sup> See *supra* footnote 5, Panayi, C., at 8.1 (Online version).

<sup>7</sup> Lang, M.: *Cadbury Schweppes' Line of Case Law from the Member States' Perspective*, in De La Feria, R., Vogenauer, S. (ed.), *Prohibition of Abuse of Law: A New General Principle of EU Law*, Oxford, 2011.

also very critical and described ATAD's GAAR as Pandora's box<sup>8</sup>, because it is almost impossible to predict what CJEU would adjudicate based on ATAD. Even from the perspective of Member States, some scholars are also very skeptical. Seiler has compared development GAARs from EU, Germany and UK<sup>9</sup>, and provocatively concludes that a GAAR is 'danger and detrimental to the legal culture'.<sup>10</sup> He argues that, the subjective test is meaningless and unnecessary, providing undesirable opportunities for taxpayers to refute the existence of abuse and grants tax authorities' risky discretion to pardon taxpayers. Therefore Seiler is opposing extending the application scope of the GAAR.

Despite of all the criticisms to the subjective test, it is undeniable that in a tax avoidance case, the taxpayer's intention is an important indicator; when there are no sufficient objective circumstances, the arrangement could be labeled as tax avoidance or abuse of law. Such subjective test is 'objectivized'<sup>11</sup>, and can function as an important indicator for the start of the tax authorities' investigations. Some scholars such as Seiler, argue that, the subjective test in GAAR merely involves an interpretation method of law, I agree; but I seriously doubt the progressive claim<sup>12</sup> that the subjective test, or even GAAR is redundant and 'harmful' for the legal culture. The opponents of GAAR argue that the subjective test can easily be used by the taxpayers to justify their arrangement as an excuse and also can be used by tax authorities to pardon the taxpayers.

To seek a theory that can contain these different formulations, my theory for the GAAR is, the subjective test will depend on the harmonization degree of the law involved. The more harmonized the involved law is, the less important role the subjective test would play. In other words, in a more harmonized area, such as VAT or custom duties and external refund, the subjective test would be less emphasized and easier to qualified, and even neglected by the CJEU. The details are discussed as follows.

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<sup>8</sup> de Wilde, M.: *The ATAD's GAAR: A Pandora's Box?* (May 1, 2017). Available at SSRN: <https://ssrn.com/abstract=3040709>.

<sup>9</sup> Seiler, M.: *GAARs and Judicial Anti-Avoidance in Germany, the UK and the EU*, Vienna, 2016.

<sup>10</sup> *Id.*, p. 311

<sup>11</sup> Weber, D.: *European Union - Abuse of Law in European Tax Law: An Overview and Some Recent Trends in the Direct and Indirect Tax Case Law of the ECJ – Part 1*, European Taxation, 53(6), 2013.

<sup>12</sup> Seiler, M.: *GAARs and Judicial Anti-Avoidance in Germany, the UK and the EU*, Linde, 2016.

### **3. STATUTORY GAARS IN THE DIRECTIVES: DIFFERENT FORMULATIONS**

Providing a general anti-avoidance rule in a tax law Directive is a quite popular legislation option. In the Fiscal Merger Directive<sup>13</sup>, Parent Subsidiary Directive<sup>14</sup>, and Interest and Royalty Directive<sup>15</sup>, there is a GAAR respectively. In 2011, the Common Consolidated Corporate Tax Base (CCCTB) Directive proposal<sup>16</sup> also has a GAAR and this GAAR is amended in 2014 Council's Proposal Draft<sup>17</sup>. Later in 2016, the CCTB Directive Proposal also provides a GAAR. Furthermore, in 2016, the "Anti-Tax Avoidance Directive" (ATAD) is passed, and there is also a statutory GAAR in this Directive. The scope of the anti-tax Avoidance Directive is to prevent tax avoidance of corporate income tax, and it is also in the field of direct taxation.

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<sup>13</sup> 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 (OJ L 310, 25.11.2009, p. 34–46, special edition in Croatian: Chapter 09 Volume 001 P. 317 – 329). This Directive has a long history of amendments. 'The EU Council of Ministers adopted Council Directive 2009/133/EC of 19 October 2009 codifying in a single text all Council Directives governing this matter. This includes the initial Directive 90/434/EEC (OJ L 225, 20.08.1990 p. 0001–0005), the amendments introduced by Council Directive 2005/19/EC (OJ L 58, 4.3.2005, p. 19–27) and Council Directive 2006/98/EC (OJ L 363, 20.12.2006, p. 129–136) of 20 November 2006 adding the required references following the accession of Bulgaria and Romania to the European Union.' See: [https://ec.europa.eu/taxation\\_customs/business/company-tax/merger-directive\\_en](https://ec.europa.eu/taxation_customs/business/company-tax/merger-directive_en)

<sup>14</sup> 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 (OJ L 345, 29.12.2011, p. 8–16, special edition in Croatian: Chapter 17 Volume 002 P. 218 - 226).

<sup>15</sup> 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 (OJ L 157, 30.4.2004, p. 106–113, special edition in Croatian: Chapter 09 Volume 001 P. 93 – 94).

<sup>16</sup> The 2011 version of CCCTB Directive Proposal is published at <http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=celex:52011PC0121>. Now it is already withdrawn by the European Commission because of releasing 2016 CCTB and CCCTB Directive Proposal. For the purpose of academic discussions, it is still worth analyzing it.

<sup>17</sup> The 2014 version of the CCCTB Directive Proposal (ST 10177 2014 INIT Proposal for a Council Directive on a Common Consolidated Corporate Tax Base (CCCTB) - Compromise proposal) is a compromise product in the process of deliberation and discussion in the Council of the European Union. It is usually largely influenced by the political concerns of each Member States. The full text is published at the Council website: <http://data.consilium.europa.eu/doc/document/ST-10177-2014-INIT/en/pdf>.

### 3.1. THE FISCAL MERGER DIRECTIVE

Fiscal Merger Directive aims to eliminate tax obstacles for cross-border mergers. Mergers under the Fiscal Merger Directive have a broad definition, including exchange of shares.

Fiscal Merger Directive Article 15(1)(a) provides:

” 1. 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:

(a) has as its principal objective or as one of its principal objectives tax evasion or tax avoidance; the fact that the operation is not carried out for valid commercial reasons such as the restructuring or rationalization of the activities of the companies participating in the operation may constitute a presumption that the operation has tax evasion or tax avoidance as its principal objective or as one of its principal objectives.”

Article 15 (a) clearly indicates that the Fiscal Merger Directive benefit may be refused, if the taxpayer’s “principal objective or one of the principal objectives” to conduct an operation, is tax evasion or tax avoidance. Operations are not carried out for “valid commercial reasons”, are presumed as the situation that the taxpayer has his principal objective of tax avoidance or tax evasion, to conduct the merger. In other words, valid commercial reasons are the rebuttal evidence that the taxpayers invoke to demonstrate their non-tax avoidance objectives.

### 3.2. INTEREST AND ROYALTY DIRECTIVE: NOT DISTINGUISHING TAX EVASION, TAX AVOIDANCE AND ABUSE

Interest and Royalties Directive (2003/49/EC) Article 5 provides a general anti-avoidance rule. It provides:

“1. This Directive shall not preclude the application of domestic or agreement-based provisions required for the prevention of fraud or abuse.

2. Member States may, in the case of transactions for which the principal motive or one of the principal motives is tax evasion, tax avoidance or abuse, withdraws the benefits of this Directive or refuse to apply this Directive.”

Interest and Royalty Directive does not lay down further specific conditions of tax avoidance. The GAAR of the Interest and Royalty Directive is quite simi-

lar to the old GAAR of Parent Subsidiary Directive<sup>18</sup>. The feature in common between the CCCTB's GAAR and the Interest and Royalty Directive's GAAR, is that they both takes "the principal motive" as the qualification of a tax avoidance or tax evasion. It is especially interesting to see that, unlike other Directives' GAAR, the Interest and Royalty Directive's GAAR expressly mentions the word "motive" in its text. It seems to affirm the subjective element of the taxpayer, also plays an important role in a GAAR.

### *3.3. PARENT SUBSIDIARY DIRECTIVE: TOWARD A THREE-TEST STRUCTURE*

The Parent Subsidiary Directive (Directive 2011/96/EU) Article 1 is amended in 2015<sup>19</sup> and thus adopts a new general anti-avoidance rule. Article 1 (2) to (4) are amended as:

"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.

4. This Directive shall not preclude the application of domestic or agreement-based provisions required for the prevention of tax evasion, tax fraud or abuse."

Article 1(2) of the new Parent Subsidiary Directive is a mandatory requirement to Member States. Article 1(4) of the new Parent Subsidiary Directive, maintains the non-mandatory rule that Member States still may lay down their own tax policies to adopt domestic or agreement-based rules for the preventing tax evasion, tax fraud or abuse. In the preamble (5) of the amending Directive 2015/121<sup>20</sup>, the Council mentions that Article 1(2) is a "common minimum

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<sup>18</sup> The discussion of the GAAR of the Interest and Royalty Directive, see Weber, D.: *The proposed EC Interest and Royalty Directive*, EC Tax Review, 9(1), 2000, pp. 15–30.

<sup>19</sup> The Parent Subsidiary Directive is amended by the amending Directive 2015/121 (OJ L 21, 28.1.2015, p. 1–3).

<sup>20</sup> The Parent Subsidiary Directive: "(5) Therefore, the inclusion of a common minimum anti-abuse rule in Directive 2011/96/EU would be very helpful to prevent misuse of that Directive and to ensure greater consistency in its application in different Member States."

anti-abuse rule". It is then argued whether the new Article 1 of the Parent Subsidiary Directive is a minimum harmonization that grants Member States discretion to lay down any stricter anti-avoidance rule. The answer is negative. According to the room document of Parent Subsidiary Directive amendment<sup>21</sup>, such common minimum anti-abuse rule aims to reduce inconsistency between Member States and provides a model for Member States whose tax systems do not have such GAAR.<sup>22</sup> Furthermore, the anti-avoidance rule of Parent Subsidiary Directive only deals with scenarios obtaining a tax advantage that defeats the object or purpose of this Directive. The Parent Subsidiary Directive aims to eliminate economic double-taxation, and also ensures that the Parent Subsidiary Directive is not abused by double non-taxation arrangements<sup>23</sup>. Therefore, the new GAAR of the parent subsidiary Directive is not a *carte blanche* for the Member States; otherwise such GAAR itself will infringe the purposes of the internal market law and pursuing consistency.

It's worth noticing that, the new GAAR of the Parent Subsidiary Directive contains three tests structure<sup>24</sup>: (1) the subjective test, (2) the economic reality test, (3) the norm test.<sup>25</sup> The three tests are inter-related and must be taken into account together in examining a specific case. Conceptually, they can still be analyzed separately.

The subjective element test refers to "the main purpose or one of the main purposes of obtaining a tax advantage", and it examines the taxpayer's objec-

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<sup>21</sup> See the Council's working document on amending the parent subsidiary Directive, File number: FISC 99 ECOFIN 679, 27 June 2014; File number: FISC 104 ECOFIN 706, 27 June 2014.

<sup>22</sup> Weber, D.: *The New Common Minimum Anti-Abuse Rule in the EU Parent-Subsidiary Directive: Background, Impact, Applicability, Purpose and Effect*, Intertax, 44 (2), 2016, pp. 98–129; Debelva, F., Luts, J.: *The General Anti-Abuse Rule of the Parent-Subsidiary Directive*, European Taxation, 55(6), 2015.

<sup>23</sup> The amendment purpose, see also the Council's working document on amending the parent subsidiary Directive, File number: FISC 99 ECOFIN 679, 27 June 2014; File number: FISC 104 ECOFIN 706, 27 June 2014.

<sup>24</sup> Weber, D.: *The New Common Minimum Anti-Abuse Rule in the EU Parent-Subsidiary Directive: Background, Impact, Applicability, Purpose and Effect*, Intertax, 44 (2), 2016, pp. 98–129.

<sup>25</sup> *Ibid.* In Weber's term, he also names "the norm test" as "the objective test". But the word "objective" Weber uses here is not the meaning of "objective circumstances" as an adjective, but refer to the underlying rationale of a norm, as a noun. Such usage is also used in some reasoning of the rulings of the Court of Justice of the European Union, such as paragraph 55 of the Cadbury Schweppes (C-196/14), refers to "the specific objective" a national restriction. See Weber, *ibid.*

Some scholar uses the same terminology, and names it as "theological element". See Piantavigna, P., Tax Abuse in European Union Law: A Theory, EC Tax Review, 20(3), 2011, pp. 134–147.

tive intention. The taxpayer's "main" purpose or one of the main purposes to conduct the disputed arrangement must be obtaining the advantage, to qualify the subjective test. The existence of a tax advantage is the pre-condition when examining the taxpayer's main purpose. The tax advantage exists, when the specific tax norm does lead to a preferential consequence for the taxpayer. Therefore, to examine the existence of an advantage, will overlap with the norm test. The economic reality test, as some scholars<sup>26</sup> also name it as "objective test", refers to the situation that the arrangement's economic reality, despite of its choice of legal form. The arrangement is regarded "genuine" in consistent with its economic reality. It examines the objective circumstances. The norm test, examines whether an arrangement results in the conflict with the purpose of the norm. It refers to "...defeats the object or purpose of this Directive" in the text.

### *3.4. GAAR IN THE CCCTB DIRECTIVE PROPOSAL DEVELOPMENT: ALSO TOWARD A THREE-TEST STRUCTURE AND FURTHER REFINING*

#### **3.4.1. ARTICLE 80 OF THE 2011 COMMISSION CCCTB DIRECTIVE PROPOSAL: A MISTAKE?**

When the Commission drafted the CCCTB Directive Proposal, it clearly indicated that, a general anti-avoidance rule (GAAR) is necessary to combat unexpected tax avoidance scenarios. In the preamble (20) of the 2011 CCCTB Directive Proposal, the Commission seems to affirm the importance status of the general principle of anti-avoidance for the CCCTB Directive.

Article 80 of the 2011 CCCTB Directive Proposal provides:

"Article 80 General anti-abuse rule

1. Artificial transactions carried out for the sole purpose of avoiding taxation shall be ignored for the purposes of calculating the tax base.
2. The first paragraph shall not apply to genuine commercial activities where the taxpayer is able to choose between two or more possible transactions which have the same commercial result but which produce different taxable amounts."<sup>27</sup>

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<sup>26</sup> For example, Lenaerts, K.: *The Concept of "Abuse of Law" in The Case Law of the European Court of Justice on Direct Taxation*, Maastricht Journal of European and Comparative Law, 2015.

<sup>27</sup> The underlying reason of the GAAR, can be found in the Commission's working document No. 65. The Commission claims that, a GAAR is necessary under the CCCTB Directive be-

Article 80(1) of the 2011 CCCTB Directive Proposal adopts a “the sole purpose test” for the subjective test, that examines the purpose of the disputed transactions. When the sole purpose of the transactions is to avoid tax, Article 80 (1) should apply. As to the objective test, Article 80(1) requires “artificial transactions”. In other words, Article 80 (1) of the 2011 CCCTB Directive Proposal has a very strict subjective test, which might be quite difficult to qualify.

### 3.4.2. ARTICLE 80 OF THE 2014 COUNCIL CCCTB COMPROMISE PROPOSAL DRAFT:

In December 2014, the Council of European Union further continued their discussion on the CCCTB Directive. In the compromise proposal in 2014<sup>28</sup>, they amend the Article 80 from 2011 Directive Proposal. It sets out,

“Article 80 General anti-abuse rule

1. Not genuine arrangements or series of arrangements carried out for the main purpose or one of the main purposes of obtaining a tax advantage which defeats the object or purpose of this Directive, shall be ignored for the purposes of calculating the tax base. An arrangement may comprise more than one step or part.
2. For the purposes of paragraph 1, 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.
3. Where arrangements or a series of arrangements are ignored according to paragraph 1, the tax base shall be calculated by reference to economic substance in accordance with Chapter IV of this Directive.”

Comparing to the 2011 version, the scope of Article 80 of 2014 CCCTB Directive Proposal has been obviously broadened.<sup>29</sup> This is influenced by the

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cause it can provide an important tool for the tax authorities to combat tax avoidance scenarios that the Commission does not expect when the Directive Proposal is drafted. A GAAR can also combat the tax avoidance scenarios that the typical special anti –avoidance rules cannot deal with. The CCCTB working documents are all published at the Commission’s website: [http://ec.europa.eu/taxation\\_customs/taxation/company\\_tax/common\\_tax\\_base/index\\_en.htm](http://ec.europa.eu/taxation_customs/taxation/company_tax/common_tax_base/index_en.htm).

<sup>28</sup> The 2014 version of the CCCTB Directive Proposal is published at the Council website: <http://www.consilium.europa.eu/register/en/content/int/?typ=ADV>.

“Proposal for a Council Directive on a Common Consolidated Corporate Tax Base (CCCTB), Document number: ST 15756 2014, Interinstitutional File2011/0058 (CNS).

<sup>29</sup> See Chen, S. C.: *Commentary, CCCTB – Proposal on a Common Consolidated Corporate Tax Base for discussion at the Working Party on Tax Questions – Direct Taxation, Highlights & Insights on European Taxation*, March 2015.

OECD's 2013 BEPS project. First of all, instead of "artificial transactions carried out for the sole purpose of avoiding taxation", Article 80(1) of the 2014 Proposal provides that "not genuine arrangements ore series arrangements" carried out for "the main purpose ore one of the main purposes" of obtaining a tax advantage which defeats the object or purpose of this Directive are subject to the GAAR. The meaning of "arrangement" is broader than "transaction", and the new Article 80 does not require the "sole" purpose of obtaining tax advantage, but a "main purpose" is sufficient. The threshold of a tax avoidance scenario is obvious lowered in the new Article 80 because of the subjective test is changed from "the sole purpose test" to "the main purpose test".

### 3.4.3. ARTICLE 58 OF 2016 CCTB DIRECTIVE: FURTHER HARMONIZATION BRINGS THE FOCUS AGAIN TO THE OBJECTIVE TEST (THE ESSENTIAL AIM TEST)

In 2016 October, the Commission has re-launched the CCCTB Directive Proposal and issued two Directive Proposals, because the whole CCCTB system will be implemented in two steps. The first step would harmonize the corporate tax base and the second step is to harmonize the group taxation. The first step is implemented by Common Corporate Tax Base (CCTB) Directive.

"Article 58 General anti-abuse rule

1. For the purposes of calculating the tax base under the rules of this Directive, a Member State shall disregard an arrangement or a series of arrangements which, having been put in place for the essential 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. 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 in place for valid commercial reasons that reflect economic reality.
3. Arrangements or a series thereof that are disregarded in accordance with paragraph 1 shall be treated, for the purpose of calculating the tax base, by reference to their economic substance."

Comparing Article 58 of CCTB Directive Proposal and Article 80 of the 2014 CCCTB Directive Proposal, we immediately see the difference: Article 58 adopts the "essential purpose" test for the subjective test, whereas Article 80 of 2014 CCCTB Directive Proposal adopts "the main purpose test". This disparity seems to be another proof of lacking legal certainty of various GAARs from appearance. However, I am of the different opinion. My theory of ex-

planation is that, the purpose of the legislation will consistently influence the subjective test in a GAAR. To a higher degree an area is harmonized by EU law, the less the subjective test would be required. The essential aim test and the sole aim test are more difficult to be qualified than the main purpose test, so the main purpose test would be used in a GAAR of the field that is not fully harmonized.

Under this theory of the norm purpose test, we need to compare the scope of harmonization of CCTB Directive Proposal to the 2011/2014 CCCTB Directive Proposals. It seems that, in order to combat Base Erosion and Profit Shifting (BEPS) problems and encourage research and development (R&D)<sup>30</sup>, the CCTB Directive Proposal has broadened its harmonization scope, to include the more comprehensive loss-offsetting mechanism and a super deduction of R&D costs.

Therefore, since CCTB Directive Proposal has a larger scope than the previous versions of CCCTB Directive Proposals in 2011 and 2014, the subjective test of GAAR of CCTB Directive Proposal therefore would be moved to 'the essential aim test', which is less weighted than the main purpose test and the sole purpose test.

### 3.5. ANTI-TAX AVOIDANCE DIRECTIVE

In 2016 July, "Anti-Tax Avoidance Directive" (ATAD)<sup>31</sup>, which consists of several "classical" anti-avoidance provisions, including CFC rules, limitation of interests' deductibility rules, exit taxation, CFC Rules, hybrid mismatches, is officially adopted. In addition to all the specific rules, Article 6 of the Anti-Tax Avoidance Directive provides a statutory GAAR in Article 6 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.

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<sup>30</sup> Proposal for a Council Directive on a Common Corporate Tax Base, COM(2016) 685 final 2016/0337 (CNS).

<sup>31</sup> 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 (OJ L 193, 19.7.2016, p. 1–14). It is adopted without further discussions. See: [http://www.consilium.europa.eu/press-releases-pdf/2016/7/47244644093\\_en.pdf](http://www.consilium.europa.eu/press-releases-pdf/2016/7/47244644093_en.pdf).

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. ”

The anti-tax avoidance Directive, is originally discussed in the framework of the CCCTB Directive by the European Council, and inspired by the OECD’s BEPS actions<sup>32</sup>. Therefore, Article 7 of the Anti-Tax Avoidance Directive Proposal resembles Article 80 of the 2014 Council CCCTB Compromise Proposal.

### 3.6. SUMMARY OF THE STATUTORY GAARS IN THE DIRECTIVES

The GAARs indicated in the Parent Subsidiary Directive, The Fiscal Merger Directive and the Royalty and Interest Directive, have similar legal consequences: Member States can refuse to grant the Directive benefits. In addition to refusing to grant the Directive benefits, the Parent Subsidiary Directive allows Member States to adopt domestic or agreement-based rules combating tax avoidance/tax evasion/tax fraud/for abusing the Parent Subsidiary Directive. The CCCTB Directive Proposal provides the discretion to re-characterize not genuine arrangements. All these statutory GAARs provide no single definition for tax avoidance, but all GAARs in these Directives provide a clause for the taxpayers to rebut the presumption of tax avoidance.

The 2016 CCTB Directive Proposal is more advanced, comparing to the Fiscal Merger Directives and the Interests and Royalty Directive, in several aspects. First of all, CCCTB does not mention tax evasion or tax fraud anymore, but only apply to “*not genuine arrangements*”. It can be interpreted to exclude the criminalized or obvious illegal situations, and only cover the abuse of law situations. Secondly, it allocates the burden of proof more clearly. The taxpayers still can counter-argue that the arrangements are genuine, but they bear the main burden of proof. Third, it clearly indicates that economic substance is the key point to prove. The GAAR of the CCCTB Directive has taken into account the case law from the European Court of Justice (see Section 4), and therefore it is more comprehensive than GAARs in the other direct taxation Directives.<sup>33</sup>

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<sup>32</sup> See explanatory Memorandum of 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 2016/0011 (CNS), Brussels, 28.1.2016, point 3

<sup>33</sup> The anti-abuse rules in the CCCCTB Directive are discussed in a workshop, see the CCCTB 2010 Room Document “Anti-Abuse Rules in the CCCTB”, published at: <http://ec.europa.eu/>

Last but not the least, the GAAR in ATAD is the same as the GAARs in Parent Subsidiary Directive and 2016 CCTB Directive Proposal. We can see the consistency in these latest Directives between 2015 and 2016, and it is likely that in the future GAAR of EU law Directives in the field of direct taxation would follow the same pattern in ATAD, which also reflects also the development of case law.

#### **4. THE JURISPRUDENCE OF COURT OF JUSTICE OF EUROPEAN UNION REGARDING GAAR**

##### *4.1. CUSTOMS DUTIES: EMSLAND-STÄRKE AND LATER DEVELOPMENTS*

The jurisprudence from Court of Justice of European Union also develops its own formulation of “tax avoidance”, and this is the so-called judicial GAAR. It has been disputed whether there is already a general principle of anti-abuse in the field of EU direct taxation. According to some scholars’ analysis, the answer should be affirmative<sup>34</sup>; but others have the opposite view<sup>35</sup>. No matter such general principle of anti-abuse has been established or not, ECJ indeed has established some patterns for examining tax avoidance. After describing the leading case law, I will summarize these.

Case law regarding tax avoidance is developed within the context of discussing “abuse of EU law”. From the case law Emsland-Stärke<sup>36</sup>, the Court clearly lays down the two tests: the subjective element test and the objective element test.

Case law Emsland-Stärke involves a Regulation on export refunds in EU law. The Regulation 2730/79 grants the benefits of export refund on agricultural products. The taxpayer Emsland-Stärke, sets up a branch in Switzerland and exports products from Germany to Switzerland and sells the products to a sister company in Switzerland, but the sister-company immediately re-exports/imports the products to Italy. Because the import duty of Italy is lower than the

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taxation\_customs/resources/documents/taxation/company\_tax/common\_tax\_base/2010-10-20-wp-antiabus\_en.pdf.

<sup>34</sup> For example, Piantavigna, P.: *Tax Abuse in European Union Law: A Theory*, EC Tax Review, 20(3), 2011, pp. 134–147; Jiménez, A. M.: *Towards a homogeneous theory of abuse in EU (direct) tax law*, Bulletin for International Taxation 66 (4/5), 2012, pp. 270-292.

<sup>35</sup> For example, Panayi mentions that the Court’s terminology and argument are not consistent and thus the general principle of abuse of tax law, does not exist yet. Panayi, C.: *European Union Corporate Tax Law*, Cambridge University Press, 2013, p.333.

<sup>36</sup> C-110/99. Emsland-Stärke GmbH v. Hauptzollamt Hamburg-Jonas. ECLI identifier: ECLI:EU:C:2000:695

export refund, conducting such U-turn scenario, gives rises to benefits to the taxpayer. The German tax authorities decided that Emsland- Stärke's transaction is abusing the Community law.

The CJEU in Emsland-Stärke requires both the "objective test" and the "subjective test". The objective test is means, "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." In other words, the objective test analyses the objective circumstances. The subjective test refers to "the intention (of the taxpayer) to obtain an advantage from the Community rules by creating artificially the conditions laid down for obtaining it." In other words, the subjective test examines the taxpayer's subjective intention to conduct the disputed arrangement.

The court adopts a cumulative objective and subjective tests in the reasoning. The reasoning of the objective test in fact actually consists of two separate tests: "the objective circumstances test" and "the purpose of the rule test", is "the norm test". In Emsland-Starkes, the court rules in paragraph 52,

"A finding of an abuse requires, first, a combination of objective circumstances in which, despite formal observance of the conditions laid down by the Community rules, *the purpose of those rules has not been achieved.*" The last sentence actually refers to the hidden third test: "the purpose of the involved rules" has not been achieved because of the disputed arrangement.

The court's approach in Emsland-Stärke judgment has been cited other custom duties cases, including Christodoulou and Other. The much recent case Christodoulou and Others<sup>37</sup>, a case regarding imported goods valuation according to EU's Common Customs Code's, not only cites Emsland-Stärke as a general background, but also reiterates the reasoning in Emsland-Stärke judgment. Therefore, it is quite clear that ECJ does not abandon the reasoning from Emsland-Stärke, and reaffirms that the subjective test and the objective test are both necessary.

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<sup>37</sup> C-116/12 - Christodoulou and Others, ECLI identifier: ECLI:EU:C:2013:825. Commentary for this case, see Lasiński-Sulecki, K.: *Will the Court of Justice apply its anti-abuse doctrine in customs valuation cases?*, World Customs Journal, 2015.

#### **4.2. VAT DIRECTIVE: HALIFAX AND LATER DEVELOPMENTS**

The Subjective Test Is Less Weighted Than Emsland-Stärke in The VAT Case.

After Emsland-Stärke, the case Halifax<sup>38</sup> is the most important case law that analyses the conditions of tax avoidance. The case Halifax involves an arrangement of requesting VAT deduction under the Sixth VAT Directive. Halifax is a banking company in UK, and it conducts transactions with other two companies Leeds Development and County, and Halifax, Leeds Development and County are belong to the same group, because Leeds Development and County are wholly owned subsidiaries of Halifax. Halifax is exempted from VAT almost totally because of its banking industry service.

Halifax entered into agreements with Leeds Development and County to build sites for Halifax's business centers in North Ireland. Leeds Development and County also entered into agreements with builders at arm's length. Halifax, Leeds Development and County request the deduction of VAT based on the sixth VAT Directive. The UK tax authorities refuse such request and decided that these arrangements are conducted only for the purpose of avoiding VAT tax. Therefore the preliminary question is referred, whether such arrangements are still within the meaning of economic activities within the VAT Directive; the second question is whether the benefits of the 6th VAT Directive should be disallowed when the transaction is based on an abusive practice. The Court's first answer is affirmative, and the second answer discusses the condition of an "abuse of law".

The key paragraphs of the Halifax case that elaborate the conditions of tax avoidance are paragraph 74 to paragraph 75. The court rules that, in the sphere of VAT, the abusive practice can only be established when (1) despite that the transactions fulfill the formal conditions according to the law, the grant of the tax advantage will be contrary to the purpose of the legislation; and (2) from a number of objective factors that the essential aim of the transaction is to obtain a tax advantage.

Unlike Emsland-Stärke, the Halifax judgment does not expressly mention the subjective element of the taxpayer. Rather, the Court's silence seems to follows the Advocate General Opinion,<sup>39</sup> which claims that the subjective intention of the taxpayer is not decisive to assess the existence of abuse. Scholars

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<sup>38</sup> C-255/02 - Halifax and Others v Commissioners of Customs & Excise. ECLI identifier: ECLI:EU:C:2006:121

<sup>39</sup> Opinion of Advocate General Poiares Maduro in Case 255/02 Halifax and Others, ECLI identifier: ECLI:EU:C:2005:200, paragraph 70-71.

have quite different on the function of the subjective/intension test. Pistone<sup>40</sup> suggests that from Halifax ruling the existence of objective factors is already sufficient to demonstrate the abuse. To the contrary, as Weber analyses<sup>41</sup>, what Advocate General Opinion really emphasizes, is that the intention of the “person” is not decisive, whereas the intention of “the activities”, still needs to be examined in any case. In other words, the subjective test still exists, but the taxpayers have to provide some objectified evidence to establish the legitimacy of the transaction.

In my view, the Court in the Halifax ruling indeed weighs the subjective element less in the examination of the tax avoidance, but the Court does not abandon the subjective element completely. To examine “the essential aim of the transaction” is not purely objective, and inevitably taking into account the intention of the taxpayer. A transaction or legal act will need an actor to implement it, and thus the aim of a transaction involves the intention of the actor.

#### *4.3. ABUSE OF LAW IN THE DIRECT TAXATION CASES: DISPUTES ABOUT INFRINGING FUNDAMENTAL FREEDOMS*

##### *4.3.1. THE LEADING CASES: CADBURY SCHWEPPEES, THIN CAP, GLAXO WELCOME*

Halifax is the leading case on the conditions of tax avoidance in the context of the EU 6<sup>th</sup> VAT Directive, and the latter case Cadbury Schweppes, extends the anti-abuse doctrine in the field of direct taxation. Unlike the cases in VAT Directive and Export refund Regulation indicated above, direct taxation is not fully harmonized, and therefore the tax avoidance concept, is discussed in the context whether a specific national anti-avoidance rule is compatible with EU law, i.e. fundamental freedoms. The most significant cases regarding tax avoidance in the field direct taxation are Cadbury Schweppes<sup>42</sup>, Thin Cap<sup>43</sup> and Glaxo Wellcome<sup>44</sup>. In these direct taxation judgments, the Court of Jus-

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<sup>40</sup> Pistone, P.: *Abuse of Law in the Context of Indirect Taxation: From (Before) Emsland-. Stärke to Halifax (and Beyond)*, in: De La Feria, R., Vogenauer, S. (eds.), *Prohibition of Abuse of Law: A New General Principle of EU Law?*, 2011.

<sup>41</sup> Weber, D.: *Abuse of Law in European Tax Law: An Overview and Some Recent Trends in the Direct and Indirect Tax Case Law of the ECJ-part I*, *European Taxation*, 53(6), 2013.

<sup>42</sup> C-196/04. Cadbury Schweppes plc and Cadbury Schweppes Overseas Ltd . v. Commissioners of Inland Revenue. ECLI identifier: ECLI:EU:C:2006:544.

<sup>43</sup> C-524/04. Test Claimants in the Thin Cap Group Litigation v. Commissioners of Inland Revenue. ECLI identifier: ECLI:EU:C:2007:161.

<sup>44</sup> Case C-182/08. Glaxo Wellcome GmbH & Co. KG v Finanzamt München II. ECLI identi-

tice has the same formulation of general tax avoidance concept, while this formulation is different from the VAT and custom duties cases above. Here I take the judgment *Cadbury Schweppes* as an illustration.

The *Cadbury Schweppes* case involves a UK anti-abuse CFC rule that levies tax on the non-distributed profits of a controlled “foreign” subsidiary, including subsidiaries established in another EU Member State, such as Ireland in the case. The question then arises whether the UK CFC rule, an anti-abuse rule, infringes the freedom of establishment under the EU law. Therefore the Court examines the concept abuse of law as the justification to restrict EU fundamental freedoms. According to the Court<sup>45</sup>:

” In order to find that there is such an arrangement 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 Community law, the objective pursued by freedom of establishment, has not been achieved” (paragraph 64) and “In those circumstances, in order for the legislation on CFCs to comply with Community law, the taxation provided for by that legislation must be excluded where, despite the existence of tax motives, the incorporation of a CFC reflects economic reality.” (paragraph 65)

In other words, the Court’s reasoning in *Cadbury Schweppes* case also consists of three cumulative tests: (1) the wholly artificial arrangements that do not reflect the economic reality; (2) the taxpayer’s subjective intention to conduct the arrangement is solely to obtain a tax advantage; (3) despite of the observance of the formal legal conditions, freedom of establishment in EU law is not achieved. This model is already quite similar to the statutory GAAR of the Parent Subsidiary Directive and the CCCTB Directive, discussed above. It is clear that, in this case, the Court cites the case law *Halifax* as well as *Emsland-Satrke*, and thus it is clear that the subjective element of the taxpayer is still taken into account.

#### 4.3.2. ANTI-TAX AVOIDANCE AS A JUSTIFICATION TO RESTRICTION OF EU FUNDAMENTAL FREEDOMS

In these cases on tax avoidance regarding direct taxation, the Court deals with the non-harmonized area in the EU law. Direct taxation, such as corporate income tax, is still the Member States’ competence according to the EU law.

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fier: ECLI:EU:C:2009:559.

<sup>45</sup> See footnote 44, paragraph 64-65.

The EU has laid down very few Directives, including Fiscal Merger Directive, Parent Subsidiary Directive and Interest and Royalty Directive, to eliminate tax obstacles such as economic double taxation, for conducting cross-border activities in the internal market, but the national tax system is still decided by Member States. Unlike the VAT Directives, which already harmonize the VAT tax base thoroughly within the EU, national direct tax laws are still not harmonized and have disparities with each other, from tax rates to the tax base calculation.

The cases in the field of direct taxation involve the question of the compatibility of a national legislation with the EU fundamental freedoms. Preventing tax avoidance, has been well-accepted as a justification for the national legislation in the jurisprudence<sup>46</sup>, but is the national legislation is still subject to the proportionality principle. The national tax legislations might restrict the freedom of establishment or free movement of capital, but these legislations can be justified if they are anti-avoidance rules applying to “wholly artificial arrangements” whose sole purpose is obtaining the tax advantage.

The CJEU jurisprudence shows that the national anti-avoidance rules are interpreted quite strictly, because anti-avoidance is decided as a justification to restrict EU fundamental freedoms. The formulations of the jurisprudence regarding the national anti-avoidance rules are different from the jurisprudence from abusing community law. As Piantavigna<sup>47</sup> and De la Feria<sup>48</sup> observe, the tax avoidance jurisprudence in un-harmonized direct taxation cases, is different from Halifax and Emsland-Stärke. In Piantavigna’s term, the direct taxation cases Cadbury Schweppes, represent the “abuse of law”, whereas the cases Halifax and Emsland-Stärke deal with “abuse of rights (that are granted from the EU secondary law, such as 6<sup>th</sup> VAT Directive)”. De la Feria has the similar observation, and uses the terminology as the type of “abuse of law” for un-harmonized direct taxation cases, versus the type of “abuse of Community Law” for the harmonized tax cases Halifax and Emsland-Stärke.

Unlike the statutory GAARs in the Directives or the subjective test used in Export refund Regulation (See the case Emsland-Stärke) and the 6<sup>th</sup> VAT Directive (See the case Halifax), the subjective test in these un-harmonized direct taxation cases is much stricter. The further detailed discussions are in the next section.

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<sup>46</sup> The early jurisprudence, see Weber, D.: *Tax Avoidance and the EC Treaty Freedoms: A Study of the Limitations under European Law for the Prevention of Tax Avoidance*, Kluwer Law International, 2005.

<sup>47</sup> *Supra*. Piantavigna, at pp. 134–147.

<sup>48</sup> De La Feria, R.: *Prohibition of abuse of (Community) law: The creation of a new general principle of EC law through tax*, *Common Market Law Review*, 45 (2), 2008, pp. 395–441.

#### 4.3.3. THE STRICT SUBJECTIVE TEST: WHOLLY ARTIFICIAL ARRANGEMENTS WITH THE "SOLE" PURPOSE OF SEEKING TAX ADVANTAGE

Unlike the Halifax that focuses the objective test, in the direct tax cases, such as Cadbury Schweppes, the Court still take the cumulative test approach. Both the objective test and the subjective test are necessary to decide the existence of the abuse.

The subjective and objective tests sometimes may overlap<sup>49</sup>, and it is difficult to distinguish these two tests. When the court examines the economic reality of the arrangement, the taxpayer's subjective intention will play a role to decide the purpose of the arrangement. Although there are doubts about the necessity of the subjective test and criticized its uncertainty<sup>50</sup>, the subjective test is still necessary and useful when the court examines the tax avoidance. Legality is the main reason that the court should no leave out the subjective test. To qualify as an unjustifiable, not legitimate behavior, the taxpayer must have tax avoidance intention to conduct such arrangement. If an arrangement is contrary to the purpose of the law merely due to the (too) broad and (too) general formulation of the law, it still should not be classified as tax avoidance, because the taxpayer does not have the intention to do that. The requirement of a subjective intention test is in fact the mechanism protecting the taxpayers, and actually ensures the legal certainty more comprehensively, rather than breaking certainty.

Furthermore, in the direct taxation cases, the subjective test is obviously easier to be passed, than the statutory GAARs of harmonized tax Directives and the 6<sup>th</sup> VAT Directive as well as Export Refund Regulation. The subjective test in the direct taxation cases, require a sole purpose of obtaining a tax advantage to qualify as the wholly/purely artificial arrangements. Merely having a main purpose of obtaining tax advantage is not sufficient to pass the subjective test in the un-harmonized direct taxation cases.

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<sup>49</sup> Weber, D.: *Abuse of Law in European Tax Law: An Overview and Some Recent Trends in the Direct and Indirect Tax Case Law of the ECJ-part 1*, European Taxation 53(6), 2013, at p. 251.

<sup>50</sup> Lang, M.: *Cadbury Schweppes' Line of Case Law from the Member States' Perspective*, in De La Feria, R., Vogenauer, S. (ed.), *Prohibition of Abuse of Law: A New General Principle of EU Law*, Oxford, 2011., pp. 401-402.

#### 4.3.4. THE INTERACTION BETWEEN INDIRECT TAXATION AND FUNDAMENTAL FREEDOM JURISPRUDENCE: WEBMINDLICENSES KFT (CASE C-419/14)

From the discussions above, it appears that, CJEU adopts different criteria to analyze tax avoidance from a VAT case and the compatibility of a national law with EU fundamental freedoms. The former involves Halifax whereas the latter involves Here comes another question: when a tax avoidance case involves indirect taxation as well as fundamental freedoms, what CJEU would use as its analytical framework: Halifax or Cadbury Schweppes, or both? Here comes a preliminary ruling involving both issues, adjudicated by CJEU. It seems that, the Court

In December 2015, CJEU has adjudicated a preliminary ruling case WebMindLicenses Kft (Case C-419/14) that concerns an abuse of VAT Directive as well as exercising fundamental freedoms. This ruling is very important because the Court interprets the Halifax jurisprudence along with the tax avoidance jurisprudence developed in the direct taxation cases.

WebMindLicenses (WML) is a Hungarian company wholly owned by its manager. As of 2009, WML licensed all its know-how enabling a website to offer online real-time erotic interactive audiovisual services throughout the world to a Portugal company Lialib. The VAT consequence of such arrangements is that the online erotic services are regarded as supplied in Portugal and the VAT tax rate of Portugal applies. Portugal VAT tax rate is lower than Hungarian VAT tax rate, and thus the Hungarian tax authorities investigated and required WML to pay VAT because the exploration of such know-how had taken place in Hungary. The Hungarian tax authorities took the view that WML's licensing agreement aims to circumvent Hungarian tax law and has no real commercial reasons, because the Portugal company Lialib is irrationally managed and deliberately run at a loss. WML argues that, the banking system in Hungary does not offer facilities for such erotic online services and this is the reason WML must have a licensing agreement with Lialib in Portugal. WML submits commercial, technical and legal reasons to involve Lialib to against the tax avoidance claim.

The Hungarian Court refers a set of preliminary questions to the Court of Justice of European Union, and asks how the "abuse" in VAT Directive should be interpreted if an arrangement is conducted via exercising freedom of establishment in the EU law. As indicated above, the tax avoidance tests are formulated differently in VAT cases, such as Halifax and direct taxation cases in the context fundamental freedoms, such as Cadbury Schweppes. WebMindLicenses Kft jurisprudence is important, because the Court of Justice incorporates the direct taxation case law Cadbury Schweppes into its reasoning.

The Court's analysis on tax avoidance in WebMindLicenses KfT case still resembles Halifax's model discussed above. The Court first indicates<sup>51</sup> that, preventing tax avoidance, tax fraud, and tax evasion is an important aim of the VAT Directive, and reiterates the case law Halifax. The Court's analysis in this part is the "norm test". Further, the Court emphasizes that, VAT Directive harmonizes the tax base, but leaves the tax rate un-harmonized. Bearing less tax burden due to the lower tax rate, does not constitute the tax advantage per se<sup>52</sup>. The taxpayer does not have the obligation to choose the transaction which leads to the highest amount of VAT. This is consistent with the more favorable treatment doctrine established in previous indirect taxation case law. Second, the Court emphasizes again the importance of the objective factor tests. The Court rules<sup>53</sup> that "the place of supply of services" is an objective issue and nothing to do with the taxpayer's intention. Very interestingly, the Court refers to "the wholly artificial arrangement" test derived from case law Cadbury Schweppes, to examine the disputed licensing agreement's legitimacy. The Court refers to Cadbury Schweppes "by analogy", and further indicates that, the existence of the Portugal company Lialib's premises, staff, equipment, human and technical resources, own responsibility and risk to the economic activities, are the key objective factors to establish that the licensing agreement is not a merely whole artificial arrangement. It is quite important that, the Court includes the "wholly artificial arrangement test" into the objective factor test. The Court does not further discuss the taxpayer's subjective intention, although it indeed refers the same terminology as the case law Cadbury Schweppes. In other words, the subjective test is also less weighted, as the same as Halifax indicated above.

The Court also clarifies that, in the referred proceedings, does not involve freedom of establishment of the EU law, because Lialib is nor a subsidiary nor a branch of WML. WML's licensing agreement with Lialib, does not involve freedom of establishment under EU law. Therefore the case will not involve the discussion whether freedom of establishment is restricted or not, although the referring court asks the questions regarding the fundamental freedoms under EU law.

WebMindLicenses KfT case is significant that, in a VAT case the Court uses the analogy to the direct taxation case Cadbury Schweppes. Unlike the scenario in Halifax or Part-service involving a domestic situation, WebMindLicenses KfT case discusses a cross-border licensing agreement. This is why the Court

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<sup>51</sup> Case C-419/14 WebMindLicenses kft v Nemzeti Adó- és Vámhivatal Kiemelt Adó- és Vám Főigazgatóság, ECLI identifier:EU:C:2015:832, paragraphs 35-36

<sup>52</sup> *Id.*, paragraph 40

<sup>53</sup> *Id.*, paragraph 38

adopts the jurisprudence from Cadbury Schweppes, which involves a “letter box subsidiary” from another Member State.

In case of cross-border situation, the “wholly artificial arrangement” criterion will be more important in the objective test in the Court’s reasoning. In my opinion, if a VAT case involves only a domestic situation rather than a cross-border situation, the Court will still follow the Halifax jurisprudence. I expect that the jurisprudence of abuse of law regarding VAT and fundamental freedoms may converge, in a case involves both and Halifax. At the Web-MindLicenses KfT case, the reasoning is still consistent with Halifax, which emphasizes less the taxpayer’s subjective intention.

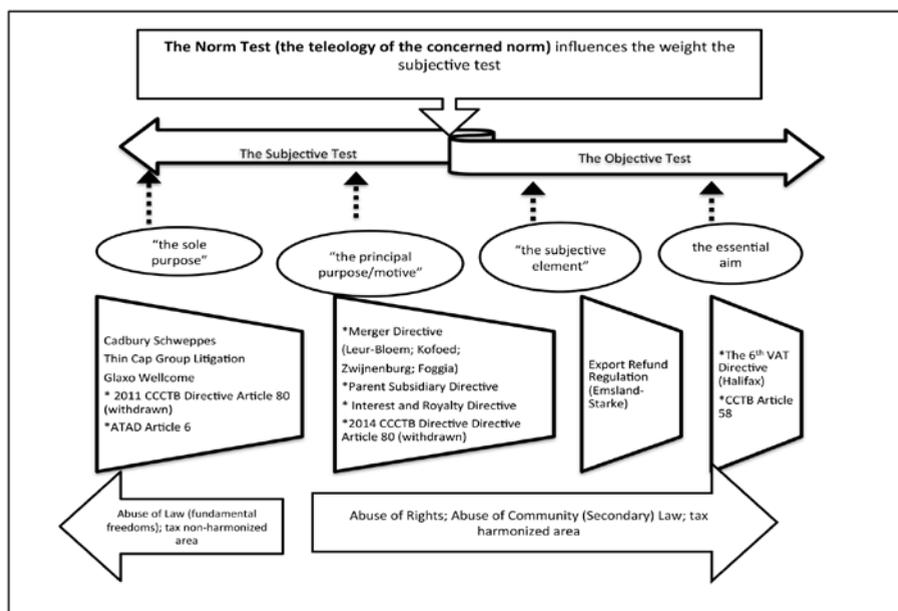
## **5. THE SPECTRUM OF THE GENERAL TAX AVOIDANCE RULE’S TESTS IN EU LAW**

From the case law discussed above, there are quite a few disparities in the tests that the Court adopts. However, these cases can still be illustrated in a spectrum of the degree of objective-ness and subjective-ness of the tests. I will use the three-test structure to explain the new GAAR of the Parent Subsidiary Directive, as my model to demonstrate the cases in the spectrum. The key to influence the location in the spectrum is “the norm test”, i.e. the purpose of the norm that the transaction aims to abuse. In fact, in the reasoning of these case laws, these three tests are appearing repeatedly, implicitly or expressly.

It is quite clear that the subjective test in different type of cases, refers to different degree of requirement. In the fully harmonized area, such as VAT tax base and the export refund, the subjective test is less weighted. The more the degree of harmonization of the area, the more the objective test is emphasized. In Halifax, the subjective test is even not clearly indicated. In Emsland-Stärke, the court uses “the subjective element”. As to harmonized direct taxation area which is harmonized by Parent Subsidiary Directive, Interest and Royalty Directive, the statutory GAARs in these three Directives require “the principal purpose (or principle motive) of obtaining the tax advantage” as he subjective test to qualify tax avoidance.

These above-mentioned cases regarding tax avoidance can be illustrated in a spectrum according to the strictness of the subjective tests as follows. In my view, the case Halifax, has the less weighted subjective test, and only refers to “the essential aim” to obtain the tax advantage. The Emsland-Stärke judgment adopts a little higher degree for the subjective test, and it refers to the subjective “element”. It is interesting to see that, export refund and imported goods valuation, are the two counterparts of “the customs union”. The ECJ’s jurisprudence adopts the same reasoning for tax avoidance concept.

As to the statutory GAARs of the three harmonized tax Directives, they refer to “(one of) the principal purpose(s) (or motive, in Interest and Royalty Directive) of obtaining tax advantages”, and thus the subjective test is even further higher than the subjective element test and the essential aim test. Last, the subjective test derived from cases on the compatibility of national anti-avoidance legislations with EU fundamental freedoms, is the strictest one. It requires “the sole purpose” of obtaining the tax advantage.



Source: The Author.

The decisive key that influences the strictness of the subjective test seems the involved norm<sup>54</sup>. From the case law and the statutory GAARs the more the concerned norm involved is harmonized by the EU law, the less strict of the subjective test will be. Therefore, the subjective test of the tax avoidance in the highly harmonized VAT Directive is the least strict; the subjective test in the non-harmonized direct taxation area, is the strictest.

This spectrum can also explain the reason why the GAAR of the CCCTB Directive of the 2011 version and the 2014 version are different. Article 80 of

<sup>54</sup> The same opinion, Kiebbeled, B.: *Anti-Abuse in the Field of Taxation: Is There One Overall Concept?* Editorial, EC Tax Review 144–145, 2009; Cerioni, L.: *The “Abuse of Rights” in EU Company Law and EU Tax Law: A Re-reading of the ECJ Case Law and the Quest for a Unitary Notion*, European Business Law Review, 21(6), 2010, pp. 783–813.

the CCCTB Directive of the 2011 version, adopts very similar wording from the case *Cadbury Schweppes*. Article 80(1) of the 2011 CCCTB Directive, refers to “Artificial transactions carried out for the sole purpose of avoiding taxation”. Article 80(2) of the 2011 CCCTB Directive, also refers to the more favorable tax treatment doctrine established in *Halifax*. According to the spectrum, the area that the CCCTB Directive regulates, is indeed corporate income tax that has not been harmonized by the EU law, therefore the European Commission seems to use the jurisprudence *Cadbury Schweppes* to draft Article 80 of the 2011 CCCTB Directive. However, the CCCTB Directive itself harmonizes only corporate income tax at a group basis, and chooses Directive as the legal form. In my view, Article 80 of the 2014 CCCTB Directive is consistent with the whole system, and thus changing the subjective test of the CCCTB GAAR from “the sole purpose of taking the advantage” to “the principal purpose”, is correct.

As to Article 29 of CCTB Directive, since the scope of harmonization of the CCTB Directive Proposal has been increased, comparing to 2011 and 2014 version, it is quite predictable that the subjective test is shifted to the right of the spectrum: less emphasized and focus on the objective circumstances more. The development of the CCCTB Directive is quite clear evidence that, even these GAAR formulations look very messy, there is still an inherent and consistent pattern.

To sum up, depending on the field of taxation, the statutory and judicial GAARs under EU law, have adopted different degree of the subjective element in the subjective test. All these GAARs reflect the three-element pattern and can be illustrated in the spectrum above. This spectrum is also consistent with the theoretical distinction of ‘abuse of right’ and ‘abuse of law’, and further adds the support that, such distinction does not make these two types of formulations apart, but in continuity. Such spectrum also consistent with the recent cases after 2010, in VAT, *WebMindLicenses Kft* (Case C-419/14) and *Customs Duties Christodoulou and Others* (Case C-116/12), so this continuity also shows that, this (claimed) unpredictable GAAR has gradually become more predictable, both in CJEU’s case law and development of statutory GAARS in the EU secondary law.

## **6. CONCLUSION: THE RE-THINKING OF “THE PURPOSE OF THE INVOLVED LAW”**

After revisiting the main statutory anti-avoidance rule (GAAR) in the EU secondary law and case law in the field of tax, it can be derived that, the various formulations of the subjective tests of these GAARs, still follow a predictable pattern. Among the development of the statutory GAARs, we can see the

European Commission has improved its legislative technique, and laid down statutory GAARs which are consistent with CJEU's jurisprudence.

In the existing discussions on whether a subjective test is needed and whether there is a general principle of GAAR, there is a leeway and compromise for the disputes, in my theoretical attempt in this spectrum. For one, this spectrum shows the variation of different subjective tests derived from different instruments of EU law; for the other, this spectrum is also consistent with the academic argument that GAAR is a method of interpretation of law. What decides the location and weight of the subjective test in this spectrum is 'the purpose of law', i.e. the hidden norm test. In other words, the three-test structure is better in explaining the GAAR's variety and also reflects that the purpose of law also plays an important role. Last but not the least, this spectrum shows that, the subjective test and the objective test are just inter-linked. To abandon any of them is not desirable for an analytical framework.

GAAR has been criticized for being abstract and lacking of legal certainty, whereas under this three-test structure spectrum, it is not completely unpredictable. No matter a GAAR is just as an interpretation method or already classified as a general principle we can still predict to an extent how CJEU could interpret or apply it, when we take into account the purpose of the law as the third test. I would argue that, the subjective test might not be detrimental but useful for both the tax authorities and taxpayers. When the purpose of the norm is closely evaluated, the tax authorities could not arbitrarily use the subjective test to pardon abusive scenarios, even when a specific abusive arrangement has become a practice and systematic arrangement in the industry, widely used by all other taxpayers of the same industry. For taxpayers, by taking into account the purpose of the norm, the subjective test can also indicate the direction that they need to show that the objective circumstances. The purpose of the involved law can also be a convincing interpretation aid and offers more certainty to taxpayers. To sum up, incorporating a three-test structure for interpreting the GAAR, can mitigate the uncertainty for taxpayers and also preserve the necessary abstract nature. It is not that hopeless to predict the 'unpredictable'.

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