



The conceptual boundaries of tax avoidance and aggressive tax planning

Pasquale Pistone

Kiev (Ukraine), 6 February 2018

Outline

- 1. Tax avoidance and abusive practices**
- 2. The reaction to tax avoidance**
- 3. Classification of anti-avoidance clauses and overview from the EU**
- 4. EU tax law and the reaction to tax avoidance**
- 5. Possible different boundaries of tax avoidance in national tax law as consequence of different anti-avoidance rules**
- 6. Tax avoidance and aggressive tax planning**
- 7. Conclusions**

1. Tax avoidance and abusive practices

Tax avoidance is the circumvention of a taxing rule resulting from a friction between form and substance that unduly prevents the application of such rule

Tax avoidance can also occur in the form of undue entitlement to a preferential treatment, tax advantage or exemption

Three elements characterize tax avoidance:

1. Friction between form and substance to obtain tax advantage (causal link with internal inconsistency)
2. Purely artificial transactions lacking valid economic reasons
3. Intention to avoid tax duly reflected in objective elements

Generally tax avoidance reflects the existence of abusive practices. However, its actual positive legal dimension partly depends on how a legal order reacts to it

2. The reaction to tax avoidance

- ▶ **Interpretation vs anti-avoidance clauses**
- ▶ **Interpretation**
 - ▶ Teleological interpretation
 - ▶ Equivalent substance-over-form techniques applicable in common law countries
- ▶ **Anti-avoidance clauses**
 - ▶ Types
 - ▶ GAARs – wide powers of recharacterisation for tax authorities, requiring case-by-case analysis
 - ▶ TAARs – like a GAAR, but applicable to some transactions
 - ▶ SAARs – almost automatically applicable, narrow identification of transactions to which it applies

3. Classification of anti-avoidance clauses and overview of EU Member States

- ▶ **Substance over form and factual recharacterisation:** Cyprus, Czech Republic, Estonia, Finland, Hungary, Netherlands, Poland, Romania, Slovakia, Sweden
- ▶ **Abuse of law GAAR:** Austria, Belgium, Bulgaria, Denmark, France, Germany, Greece, Ireland, Italy, Luxembourg, Malta, Portugal, Spain, UK
- ▶ **Fraus legis GAAR:** Croatia, Netherlands (*judicial + richtige heffing*)
- ▶ **No GAAR, but application of civil law:** Latvia, Lithuania, Slovenia
- ▶ **Judicial approach prevailing:** France, Netherlands

IS

- ▶ Abuse of tax law or *fraus legis*

Since the taxpayer escapes the application of a taxing rule by exploiting the friction between form and substance

IS NOT

- ▶ Sham

Since the taxpayer does not generate an appearance (which would lead to tax evasion), but an actual substance.



**The effect of tax avoidance is
an unjustified enrichment for
the taxpayer**

4. EU tax law and tax avoidance

- ▶ Supranational law of the European Union prevails over national law with partial surrender of powers to the Union (directives)
- ▶ Powers kept at national level must be exercised in conformity with EU rules on fundamental freedoms (non-discrimination of goods, persons, services and capital) and prohibition of State aids within EU
- ▶ Judicial reaction to tax avoidance (= abusive practices) developed at interpretation level by the European Court of Justice as justification to violations of fundamental freedoms by EU Member States.
- ▶ The EU principle of proportionality requires this reaction to target the actual abusive practices (case-by-case analysis required)
- ▶ Landmark cases: Halifax (VAT), Cadbury Schweppes (direct tax)
- ▶ Anti-tax avoidance directive (ATAD) introduced on 12.7.2016, to be implemented by 1.1.2019

EU law sets precise limits and criteria for the reaction to tax avoidance by means of its primary and secondary law

4. The reaction to tax avoidance in the EU

Until ATAD

- ▶ **EU Member States could decide whether and how adopting GAARs, TAARs and SAARs**
- ▶ **However, when applying such anti-avoidance rules, they must comply with the requirements of EU primary law**

In the era of ATAD

- ▶ **EU Member States must counter tax avoidance in line with the measures included in ATAD**
- ▶ **They may apply stricter rules to counter tax avoidance**
- ▶ **The application of anti-avoidance rules both indicated in ATAD and national law must comply with the requirements of EU primary law**

- ▶ ***Emsland-Stärke, 51***: protection of EU law may not be invoked in the framework of abusive or fraudulent practices (principle of EU law)
- ▶ ***Halifax, 69***: definition of abuse in EU tax law
“transactions carried out not in the context of normal commercial operations, but solely (***Part Service, 42***: “*essential aim*”) for the purpose of wrongfully obtaining advantages provided for by Community law”
- ▶ ***Halifax, 74 y 75***: core elements to a definition of abuse
“notwithstanding formal application of the conditions laid down by the relevant provisions...accrual of a tax advantage...contrary to the purpose of those provisions“, ...“apparent from...objective factors”
- ▶ ***Cadbury Schweppes, 51***: wholly artificial transactions aimed at circumventing the legislation; **67**: objective factors (for CFC: staff, premises and equipment)
- ▶ ***SGL, 71***: right to prove evidence of commercial justification for non ALP

Article 54 EU Charter of Fundamental Rights - Nothing in this Charter shall be interpreted as implying any right to engage in any activity or to perform any act aimed at the destruction of any of the rights and freedoms recognised in this Charter or at their limitation to a greater extent than is provided for herein.

- ▶ Various measures refer to obligation to counter avoidance, evasion and fraud in **EU VAT Recast Directive** and, in most directives (direct tax, including Parent/Subsidiary Directive as of 1.1.2016), to the right of countering such phenomena
- ▶ ATAD

EU Recommendation 8806 of 6.12.2012 (aggressive tax planning): taking advantage of the technicalities of a tax system or of mismatches between two or more tax systems for the purpose of reducing tax liability through double deductions or double non-taxation



The EU Anti-tax avoidance package

Pure soft law

COM 23 – the Anti-BEPS tax package and its underlying policy

COM 24 – the EU external tax strategy (endorsed on 25.5.16)

Recommendation 271 – PPT GAAR in tax treaties and PE definition

Legislation

Automatic EoI on CbC reporting and tax rulings

ATAD I 2016/1164 (12.7.2016), then amended by ATAD II

1. Interest limitation (Article 4)
2. Exit taxes (Article 5)
3. EU GAAR (Article 6)
4. CFC (Articles 7-8)
5. Anti-Hybrid rule (Article 9)

Implementation by 1.1.2019

6. Tax avoidance and aggressive tax planning

Tax avoidance

▶ **Three elements:**

1. Friction between form and substance to obtain tax advantage (causal link with internal inconsistency)
2. Purely artificial transactions lacking valid economic reasons
3. Intention to avoid tax duly reflected in objective elements

Generally reflecting existence of abusive practices

Aggressive tax planning

▶ **Three elements:**

1. Exploitation of cross-border tax disparities to obtain bilateral tax advantages (causal link with external inconsistency)
2. Misalignment between taxing powers and value creation
3. Unintended tax advantages from double non-taxation

No abusive practice in one tax system

Conclusions

- ▶ Implementation of BEPS through EU law in principle desirable in order to enhance level-playing field within the EU Internal Market (questionable protectionist impact on relations with third countries)
- ▶ Coordination of concepts and reactions to aggressive tax planning and tax avoidance removes biases connected with actual differences
 - ▶ Reaction to aggressive tax planning reflects the need to preserve balanced allocation of taxing powers between States (justification) without evidence to prove actual existence of abusive practices
 - ▶ Reaction to tax avoidance under European Union law:
 - ▶ Requires evidence of actual existence of abusive practice
 - ▶ Justifies measures suitable to achieve their goals and in line with the principle of proportionality
 - ▶ Protects all persons acting in good faith
- ▶ Implementation of EU Anti-BEPS Directive likely to have a strong impact on existing national GAARs, TAARs and SAARs



Thank you!

p.pistone@ibfd.org