

Teisės aktualijos

TAX MITIGATION VS. TAX EVASION IN THE CASE LAW OF THE EUROPEAN COURT OF JUSTICE

Koen Lenaerts

Vice-President of the Court of Justice of the European Union
Professor of European Union Law, Leuven University
(All opinions expressed herein are personal to the author)

In the field of direct taxation, it is of paramount constitutional importance to draw a conceptual distinction between “tax mitigation” (or “tax avoidance”) and “tax evasion”, since that distinction is essential for the European Court of Justice (the “ECJ”) in determining the extent to which EU law places limits on the exercise of national taxing powers. On the one hand, the expression “tax mitigation” relates to situations where an individual (or a company) seeks, in compliance with the law, to minimise the taxes he or she (or it) pays. In a cross-border context, tax mitigation is made possible by regulatory competition among the national tax systems. Given that the power to levy direct taxes remains with the Member States, the latter are, for example, free to “organise, in compliance with [EU] law, [their] system for taxing distributed profits and, in that context, to define the tax base and the tax rate which apply to the shareholder receiving them”¹.

As Member States apply different income and corporation tax rates, a natural (or legal) person may decide to exercise an economic activity in a Member State other than his or her (or its) State of residence so as to profit from tax advantages. “[An EU national]”, the ECJ wrote in *Barbier*, “cannot be deprived of the right to rely on the provisions of the Treaty on the ground that he is profiting from tax advantages which are legally provided by the rules in force in a Member State other than his State of residence”². Consequently, the application of the fundamental freedoms cannot be ruled out by the fact that the exercise of such freedoms is motivated by a desire to mitigate tax liabilities. On the other hand, an EU national may not rely on the fundamental freedoms in a way that undermines the effectiveness of the tax system of the

¹ See, e.g., Case C374/04 *Test Claimants in Class IV of the ACT Group Litigation* [2006] ECR I11673, paragraph 50; Case 446/04 *Test Claimants in the FII*

Group Litigation [2006] ECR I11753, paragraph 47; Case C194/06 *Orange European Smallcap Fund* [2008] ECR I3747, paragraph 30, and Case C128/08 *Damseaux* [2009] ECR I6823, paragraph 25.

² Case C364/01 *Barbier* [2003] ECR I-15013, paragraph 71.

Member State that has jurisdiction to tax him or her. In the ECJ's words, "nationals of a Member State cannot attempt, under cover of the rights created by the Treaty, improperly to circumvent their national legislation. They must not improperly or fraudulently take advantage of provisions of [EU] law"³. Accordingly, EU law does not protect natural or legal persons who seek to pay less tax by creating situations that *artificially* fall within the scope of application of the fundamental freedoms. Restrictions on the free movement of companies and capital which seek to prevent tax evasion and do not go beyond what is necessary to attain that objective are compatible with EU law. In summary, whilst a Member State may not prevent genuine tax mitigation, EU law does not provide a shield for tax evaders.

Logically, the question is then how to draw a distinction between those two concepts. To that end, the ECJ has developed the notion of "abuse of law"⁴, according to which "a national measure restricting [a fundamental freedom] may be justified where it specifically relates to wholly artificial arrangements aimed at circumventing the application of the legislation of the Member State concerned"⁵. This means that a Member State may adopt measures

which, whilst constituting a restriction on free movement, seek to prevent abusive practices and are thus able to be justified.

The purpose of my contribution is thus to explore the concept of "abuse of law" as applied by the ECJ in the field of direct taxation. To that effect, it is divided into three parts. Part I provides a very brief account of the evolution of the concept of "abuse of law" in light of the case law of the ECJ, from its first appearance in *Van Binsbergen* to its application in *Halifax*. Part II is devoted to examining *Cadbury Schweppes*⁶, the landmark case in which the ECJ explained, for the first time, the role played by the concept of abuse of law in the field of direct taxation. Part III looks at two important direct taxation cases decided in the aftermath of *Cadbury Schweppes*, namely *Thin Cap*⁷ and *Glaxo Wellcome*⁸. Finally, a brief conclusion describes the steps that a national court must follow when determining whether a particular behaviour constitutes such an abuse.

I. Historical evolution

At first, the ECJ did not provide a definition of abusive practices, but limited itself to acknowledging that Member States were, in principle, entitled to counter so-called "U-turn" or "circumvention" transactions, i.e. "situations where either persons or goods move from one Member State to another, although the final destination of the transaction is the original Member State; the central focus is the exercise of a right conferred by [EU] law, the right to

³ Case 115/78 *Knoors* [1979] ECR 399, paragraph 25; Case C-61/89 *Bouchoucha* [1990] ECR I-3551, paragraph 14; and Case C-212/97 *Centros* [1999] ECR I-1459, paragraph 24.

⁴ See, generally, DE LA FERIA, R.: VOGENAUER, S., (eds). *Prohibition of Abuse of Law: A New General Principle of EU Law?* Oxford: Hart Publishing, 2011.

⁵ See, to that effect Case C264/96 *ICI* [1998] ECR I-4695, paragraph 26; Case C-324/00 *Lankhorst-Horst* [2002] ECR I-11779, paragraph 37; C9/02 *Lasteyrie du Saillant* [2004] ECR I2409, paragraph 50; and Case C-446/03 *Marks & Spencer* [2005] ECR I-10837, paragraph 57.

⁶ C196/04 *Cadbury Schweppes and Cadbury Schweppes Overseas* [2006] ECR I7995.

⁷ Case C524/04 *Test Claimants in the Thin Cap Group Litigation* [2007] ECR I2107.

⁸ Case C182/08 *Glaxo Wellcome* [2009] ECR I8591.

free movement, in order to circumvent the national law of a Member State”⁹. In the key passage of *Van Binsbergen*, the first case to which the doctrine of abuse can be traced, the ECJ ruled that “a Member State cannot be denied the right to take measures to prevent the exercise by a person providing services whose activity is entirely or principally directed towards its territory of the freedom guaranteed by article [56 TFEU] for the purpose of avoiding the professional rules of conduct which would be applicable to him if he were established within that state”¹⁰. However, as the ECJ made clear in *Kefalas* and *Centros*¹¹, the *Van Binsbergen* line of case law¹² did not imply that Member States enjoy “*carte blanche* in the application of [their] own national anti-abuse provisions”¹³. The ECJ declined to hold that national measures

⁹ See 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*, 2008, Vol. 45, p. 395, at 399.

¹⁰ C33/74 *Van Binsbergen v Bedrijfsvereniging voor de Metaalnijverheid* [1974] ECR I299, paragraph 27.

¹¹ Case C367/96 *Kefalas* [1998] ECR I-2843 and *Centros*, *supra* note 3.

¹² See, regarding the freedom to supply services, Case C-148/91 *Veronica Omroep Organisatie v Commissariaat voor de Media* [1993] ECR I-487, paragraph 12, and Case C-23/93 *TV 10 v Commissariaat voor de Media* [1994] ECR I-4795, paragraph 21; regarding the freedom of establishment, *Knoors*, *supra* note 3, paragraph 25, and *Bouchoucha*, *supra* note 3, paragraph 14; regarding the free movement of goods, Case 229/83 *Leclerc and Others v ‘Au Blé Vert and Others* [1985] ECR I, paragraph 27; regarding social security, Case C-206/94 *Brennet v Paletta* [1996] ECR I-2357; regarding the free movement of workers, Case 39/86 *Lair v Universität Hannover* [1988] ECR 3161, paragraph 43; regarding the common agricultural policy, Case C-8/92 *General Milk Products v Hauptzollamt Hamburg-Jonas* [1993] ECR I-779, paragraph 21, and regarding company law, *Kefalas*, *supra* note 11, paragraph 20.

¹³ WEBER, D., Abuse of Law – European Court of Justice, 14 December 2000, Case C-110/99, *Emsland-Stärke*. *Legal Issues of Economic Integration*, 2004, Vol. 31, p. 43, at 50.

prohibiting “U-turn” or “circumvention” transactions fall outside the scope of application of the fundamental freedoms. In so far as those measures constitute a restriction on free movement, the fact that they seek to combat abusive practices must therefore be examined in terms of a possible justification for such a restriction. As the ECJ pointed out in *Kefalas*, “the application of [a national rule, which provides that “the exercise of a right is prohibited where it manifestly exceeds the bounds of good faith, morality or the economic or social purpose of that right”], must not prejudice the full effect and uniform application of [EU] law in the Member States ... In particular, it is not open to national courts, when assessing the exercise of a right arising from a provision of [EU] law, to alter the scope of that provision or to compromise the objectives pursued by it”¹⁴. In the same way, in *Centros*, the ECJ ruled that the exercise of the right to free movement could not, in itself, give rise to abuse. For the ECJ, “the fact that a national of a Member State who wishes to set up a company chooses to form it in the Member State whose rules of company law seem to him the least restrictive and to set up branches in other Member States cannot, in itself, constitute an abuse of the right of establishment”. “The right to form a company in accordance with the law of a Member State and to set up branches in other Member States”, the ECJ also wrote, “is inherent in the exercise, in a single market, of the freedom of establishment guaranteed by the Treaty”¹⁵. Thus, *Van Binsbergen*, *Kefalas* and *Centros* all point to the need for a method of analysis capa-

¹⁴ *Kefalas*, *supra* note 11, paragraphs 21 and 22.

¹⁵ *Centros*, *supra* note 3, paragraph 27.

ble of distinguishing situations involving the legitimate exercise of a fundamental freedom from those that give rise to abusive practices.

In *Emsland-Stärke*¹⁶, the ECJ seized the opportunity to develop a test that would allow national courts to draw a distinction between those two types of situations. The facts of the case were as follows. Emsland-Stärke GmbH, a German company, exported several consignments of a potato-based product to Switzerland, for which it received an export refund. Subsequently, inquiries conducted by the German customs authorities revealed that immediately after their release for home use in Switzerland, the exported consignments in question were transported – unaltered and by the same means of transport – to Italy or back to Germany. Hence, those authorities demanded that Emsland-Stärke GmbH repay the export refund. Taking the view that it had met the conditions for the grant of export refunds set out in Regulation No 2730/79¹⁷, Emsland-Stärke GmbH challenged that decision. Thus, the crux of the case was whether, in the event of a purely formal dispatch from the EU territory with the sole purpose of benefiting from an export refund, Regulation No 2730/79 precluded an obligation to repay that refund. The ECJ replied in the negative: “The scope of [EU] regulations must in no case be extended to cover abuses on the part of a trader”¹⁸. Next, the ECJ went on to explain what is to be understood by

“abuse”. The key passages of the judgment merit quotation in full.

“A finding of an abuse requires, first, a combination of objective circumstances in which, despite formal observance of the conditions laid down by the [EU] rules, the purpose of those rules has not been achieved.

It requires, second, a subjective element consisting in the intention to obtain an advantage from the [EU] rules by creating artificially the conditions laid down for obtaining it. The existence of that subjective element can be established, *inter alia*, by evidence of collusion between the [EU] exporter receiving the refunds and the importer of the goods in the non-member country”¹⁹.

It was for the national court to establish whether the actions of Emsland-Stärke GmbH contained both objective and subjective elements that would lead to a finding of abuse. *Emsland-Stärke* is thus a seminal judgment which laid down, for the first time, “the criteria for determining the existence of abuse for the purposes of EU law”²⁰. However, that judgment left open one important question, namely whether that definition of abuse was limited to the field of agricultural levies or could be extrapolated to other areas of the EU legal order, notably to the field of taxation.

In *Halifax*²¹, a case concerning the interpretation of the Sixth VAT Directive²², the ECJ replied in the affirmative to the

¹⁶ Case C110/99 *Emsland-Stärke* [2000] ECR I11569.

¹⁷ Commission Regulation (EEC) No 2730/79 of 29 November 1979 laying down common detailed rules for the application of the system of export refunds on agricultural products, [1979] OJ L 317/1 (repealed).

¹⁸ *Emsland-Stärke*, *supra* note 16, paragraph 51.

¹⁹ *Ibid.*, paragraphs 52 and 53.

²⁰ DE LA FERIA, R., *supra* note 9, at 410. See also WEBER, D., *supra* note 13, at 51.

²¹ Case C-255/02 *Halifax and Others* [2006] ECR I1609.

²² Sixth Council Directive 77/388/EEC of 17 May 1977 on the harmonisation of the laws of the Member States relating to turnover taxes – Common system of value added tax: uniform basis of assessment, [1977] OJ L 145/1.

latter part of that question. In that case, Halifax, a banking company, wished to build new call centres in Northern Ireland. Since most of its services were exempt from VAT, it was only able to recover a small portion of the input tax for which it was liable, namely 5% of the VAT paid for construction works. However, following the tax planning scheme elaborated by its advisers, Halifax decided to set up a series of transactions involving different companies of the Halifax group which, in principle, enabled it to recover all of the input VAT paid in respect of those construction works. It applied for repayment of the input VAT paid for those works, but the UK tax authorities rejected its application on the ground that a transaction entered into solely for the purpose of VAT avoidance was neither itself a “supply”, nor a step taken in the course or furtherance of an “economic activity” within the meaning of the Sixth Directive. Accordingly, the referring court asked the ECJ whether transactions of the kind at issue in the case at hand indeed constituted “supplies of goods or services” and “economic activity” within the meaning of the Sixth VAT Directive where the sole purpose of those transactions was to obtain a tax advantage. In that regard, the ECJ pointed out that the purpose pursued by those transactions was irrelevant, in so far as they satisfied the objective criteria on which the concepts of “supplies of goods or services” and “economic activity” are based.

In addition, the UK tax authorities argued that, in light of the general principle of EU law preventing “abuse of rights”, those transactions should be disregarded and the terms of the Sixth Directive applied to the true nature of the transactions at issue. The referring court thus asked

the ECJ whether the right to deduct input VAT was ruled out where the transactions on which that right was based constituted an abusive practice. The ECJ began by recalling the key passage in *Emsland-Stärke*, according to which “[t]he application of [EU] legislation cannot be extended to cover abusive practices by economic operators, that is to say transactions carried out not in the context of normal commercial operations, but solely for the purpose of wrongfully obtaining advantages provided for by [EU] law”²³. Hence, the ECJ made clear that “[the] principle of prohibiting abusive practices [as defined by the case law] also applies to the sphere of VAT”²⁴. This did not mean, however, that the Sixth VAT Directive opposed tax planning. “[T]axpayers”, the ECJ stressed, “may choose to structure their business so as to limit their tax liability”²⁵. Just as it did in *Emsland-Stärke*, the ECJ was thus obliged to provide the national court with a method of analysis capable of distinguishing between legitimate and abusive VAT transactions. To that effect, it noted that an abusive practice takes place where:

“... First, the transactions concerned, notwithstanding formal application of the conditions laid down by the relevant provisions of the Sixth Directive and the national legislation transposing it, result in the accrual of a tax advantage the grant of which would be contrary to the purpose of those provisions.

Second, it must also be apparent from a number of objective factors that the essential aim of the transactions concerned is to obtain a tax advantage”²⁶.

²³ *Halifax*, *supra* note 21, paragraph 69.

²⁴ *Ibid.*, paragraph 70.

²⁵ *Ibid.*, paragraph 73.

²⁶ *Ibid.*, paragraphs 74 and 75.

It was for the national court to make those determinations. With regard to the first element, the national court had to take into account the principles underpinning the VAT system, in particular the complete neutrality of taxation of all economic activities and the existence of a direct and immediate link between a particular input transaction and a particular output transaction. Accordingly, “[t]o allow taxable persons to deduct all input VAT even though, in the context of their normal commercial operations, no transactions conforming with the deduction rules of the Sixth Directive or of the national legislation transposing it would have enabled them to deduct such VAT, or would have allowed them to deduct only a part, would be contrary to the principle of fiscal neutrality and, therefore, contrary to the purpose of those rules”²⁷. As to the second element, the national court had to “determine the real substance and significance of the transactions concerned. In so doing, it may take account of the purely artificial nature of those transactions and the links of a legal, economic and/or personal nature between the operators involved in the scheme for reduction of the tax burden”²⁸. If those two conditions were met, those transactions constituted an abusive practice and, as such, “[had to] be redefined so as to re-establish the situation that would have prevailed in the absence of the transactions constituting that abusive practice”²⁹. It is worth noting that, unlike *Emsland-Stärke*, *Halifax* contains no explicit reference to the “subjective element” of abuse³⁰. That silence may be explained by the criticisms

put forward by some scholars and Advocates General before the ECJ delivered its judgment in *Halifax*³¹. In particular, in his Opinion in *Halifax*, AG Poiares Maduro argued that the subjective intention of those claiming the EU right in question is not “decisive for the assessment of abuse. It is instead the activity itself, objectively considered”³². Indeed, for the Advocate General, “the intentions of the parties to [...] obtain [improperly] an advantage from [EU] law are merely inferable from the artificial character of the situation to be assessed in the light of a set of objective circumstances”³³. Arguably, a possible reading of *Halifax* suggests that the existence of objective factors may suffice to demonstrate that a transaction involves an abusive practice³⁴.

II. Cadbury Schweppes

Logically, following *Halifax*, the question that arose was whether the concept of abuse of law could be applied to cases involving *direct* taxation. Unlike VAT, direct taxation is not harmonised at EU level. Arguably, one could support the contention that an autonomous EU concept of abuse of law, developed by the ECJ, may only be applied in those areas in which the EU legislator has exercised its competences. The argument then runs that in the absence of such harmonisation, the definition of that

³¹ For an overview of those criticisms, see WEBER, D., *supra* note 13, at 53 et seq.

³² Opinion of AG Poiares Maduro in *Halifax*, *supra* note 21, paragraph 70.

³³ *Ibid.*, paragraph 71.

³⁴ PISTONE, P. Abuse of Law in the Context of Indirect Taxation: From (before) *Emsland-Stärke* 1 to *Halifax* (and Beyond) in DE LA FERIA, R.: VOGELAUER, S., (eds), *supra* note 4, 382, at 387 (who argues that *Halifax* confirms that “the existence of objective factors [is] sufficient for detecting the existence of abusive practices”).

²⁷ *Ibid.*, paragraph 80.

²⁸ *Ibid.*, paragraph 81.

²⁹ *Ibid.*, paragraph 94.

³⁰ DE LA FERIA, R., *supra* note 9, at 423.

concept should be left to national law³⁵. In *Cadbury Schweppes*, the ECJ was confronted with that very question.

It is true that *Cadbury Schweppes* was not the first direct taxation case in which the ECJ had to examine the compatibility with EU law of national measures prohibiting “circumvention” transactions. Previously, the ECJ had already ruled that Member States could pass legislation “specifically target[ing] wholly artificial arrangements”³⁶. However, the ECJ had seen no need to lay down criteria identifying those arrangements, given that the national measures at issue had such a broad scope of application that it was clear that they were not “specifically designed” to counter them³⁷. *Cadbury Schweppes* offered a good opportunity for the ECJ to explain what the expression “wholly artificial arrangements” actually meant.

In that case, the ECJ had to determine whether a national court could have recourse to the concept of abuse of law as developed in the case law with a view to examining the compatibility with the freedom of establishment of UK corporation tax law. The legal background of the case was as follows. In the UK, a UK resident parent company was not, as a general rule, taxed on the profits made by a subsidiary as they arose, where that subsidiary was established abroad. However, the UK legislation on controlled foreign companies (“CFCs”, i.e. foreign companies in which the resident parent company owns

a holding of more than 50%) established an exception to that general rule according to which the profits made by a CFC are attributed to the UK parent company and included in the parent company’s tax base, although they had not been received by that company, where the CFC was subject, in the State in which it was established, to a “lower level of taxation”³⁸. However, the taxation provided for by the legislation on CFCs did not apply where the CFC adopted an “acceptable distribution policy”³⁹, was engaged in “exempt activities”, satisfied the “public quotation condition”⁴⁰, or fell below the *de minimis* threshold laid down therein⁴¹. In addition, that taxation was also excluded where the CFC concerned met the “motive test” which laid down two cumulative conditions. First, in relation to transactions between the CFC and the parent company which produced a reduction in UK taxation and that exceeded a minimum amount, the taxpayer had to show that the reduction in UK tax was not the main purpose, or one of the main purposes, of those transactions. Second, concerning the reasons for the establishment of the CFC, the taxpayer had to show that achieving a reduction in UK tax by means of the diversion of profits was not the main reason, or one of the main reasons, for the

³⁸ A ‘lower level of taxation’ took place where ‘the tax paid by the CFC [was] less than three quarters of the amount of tax which would have been paid in the [UK] on the taxable profits as they would have been calculated for the purposes of taxation in that Member State’. *Ibid.*, paragraph 7.

³⁹ At the material time (1996), this meant that 90% of the CFC’s profits had to be distributed within 18 months of their arising and taxed in the hands of the UK resident company.

⁴⁰ This meant that 35% of the voting rights were held by the public, the subsidiary was quoted and its securities were traded in on a recognised stock exchange.

⁴¹ The CFC’s chargeable profits did not exceed £50,000.

³⁵ DE LA FERIA, R., *supra* note 9, at 425.

³⁶ See, e.g., *ICI*, *supra* note 5, paragraph 26. See more recently, Case C330/07 *Jobra* [2008] ECR I9099.

³⁷ See more recently, Case C330/07 *Jobra* [2008] ECR I9099. See also DE LA FERIA, R., *supra* note 9, at 424 and 425. See also LANG, M. *Cadbury Schweppes’ Line of Case Law from the Member State’s Perspective in DE LA FERIA, R., and VOGENAUER, S., (eds), supra* note 4, 435, at 436.

subsidiary's existence in that accounting period.

As to the facts of the case, Cadbury Schweppes ("CS"), the UK resident parent company of the Cadbury Schweppes group, owned – indirectly through a chain of subsidiaries belonging to that group at the head of which was Cadbury Schweppes Overseas ("CSO") – two subsidiaries in Ireland, namely Cadbury Schweppes Treasury Services ("CSTS") and Cadbury Schweppes Treasury International ("CSTI"). The business of the latter was to raise finance and to provide that finance to other subsidiaries in the Cadbury Schweppes group. CSTS and CSTI were established in Ireland in order that the profits related to the internal financing activities of the Cadbury Schweppes group could benefit from the tax regime of the International Financial Services Centre in Dublin ('the IFSC'), according to which companies established therein were subject to a tax rate of 10%. Taking the view that CSTS and CSTI were subject to "a lower level of taxation", the UK tax authorities decided that, in accordance with the legislation on CFCs, the profits made by CSTI for the 1996 financial year had to be attributed to CSO⁴². Those authorities thus claimed back corporation tax from CSO in the sum of £8 million. CS and CSO challenged that decision on the ground that the taxation provided for by the legislation on CFCs was contrary to the freedom of establishment, the freedom to provide services and the free movement of capital.

At the outset, the ECJ examined which of those three fundamental freedoms applied to the case at hand. Since the legislation at issue in the main proceedings only

applied to foreign companies in which the UK resident parent company owned a holding of more than 50%, "giving [the latter company] definite influence on the [foreign companies] decisions and allowing [it] to determine [their] activities"⁴³, that legislation came within the substantive scope of the provisions of the Treaty on freedom of establishment. In addition, the ECJ held that the fact that companies set up a subsidiary in a Member State other than their State of residence for the purpose of reducing their tax liability does not in itself constitute abuse⁴⁴. Nor may that fact rule out the application of the freedom of establishment. Next, the ECJ held that the UK legislation on CFCs constituted a restriction on the freedom of establishment. It observed that, whilst the profits made by subsidiaries established in the UK were never attributed to their resident parent company, the same did not hold true in relation to subsidiaries established outside that Member State⁴⁵. Such a difference in treatment entailed a disadvantage for resident companies having subsidiaries outside the UK, thus "dissuading them from establishing, acquiring or maintaining a subsidiary in a Member State in which the latter is subject to [a lower] level of taxation"⁴⁶.

As to the justification, the UK Government argued that the legislation on CFCs was intended to counter a specific type of tax avoidance involving the artificial transfer by a resident company of profits from the Member State in which they were made to a low-tax jurisdiction by means of the establishment of a subsidiary in the

⁴² As CSTS made a loss in that year, no profits could be attributed to CSO.

⁴³ *Cadbury Schweppes*, *supra* note 6, paragraph 31.

⁴⁴ *Ibid.*, paragraphs 37 and 38.

⁴⁵ *Ibid.*, paragraph 45.

⁴⁶ *Ibid.*, paragraph 46.

latter and the setting up of transactions intended primarily to make such a transfer to that subsidiary. To begin with, the ECJ recalled that the need to protect tax revenue is neither one of the grounds listed in Article 52(1) TFEU nor a reason of overriding general interest that might justify a restriction on the freedom of establishment⁴⁷. Similarly, it recalled that one cannot generally presume that a company is evading taxes merely because that company decides to exercise its freedom of establishment by setting up a subsidiary in another Member State⁴⁸. However, a restriction on the freedom of establishment may be justified “where it specifically relates to wholly artificial arrangements aimed at circumventing the application of the legislation of the Member State concerned”⁴⁹. Stated simply, restrictions on free movement which seek to counter abusive practices may be justified. In order to determine the artificial nature of an arrangement, the ECJ stated that it was necessary to examine the objective pursued by the freedom of establishment, which is to “allow a national of a Member State to set up a secondary establishment in another Member State to carry on his activities there and thus assist economic and social interpenetration within the [EU] in the sphere of activities as self-employed persons”⁵⁰. Since the freedom of establishment pursues the integration in the host Member State, the ECJ ruled that that freedom “presupposes actual establishment of the company concerned in

⁴⁷ *Ibid.*, paragraph 49 (referring to Case C-136/00 *Danner* [2002] ECR I-8147, paragraph 56, and Case C-422/01 *Skandia and Ramstedt* [2003] ECR I-6817, paragraph 53).

⁴⁸ *Cadbury Schweppes*, *supra* note 6, paragraph 50 (referring to *ICI*, *supra* note 5, paragraph 26).

⁴⁹ *Cadbury Schweppes*, *supra* note 6, paragraph 51.

⁵⁰ *Ibid.*, paragraph 53.

the host Member State and the pursuit of genuine economic activity there”⁵¹. Accordingly, in the key passage of the judgment the ECJ held that:

“... In order for a restriction on the freedom of establishment to be justified on the ground of prevention of abusive practices, the specific objective of such a restriction must be to prevent conduct involving the creation of wholly artificial arrangements which do not reflect economic reality, with a view to escaping the tax normally due on the profits generated by activities carried out on national territory”⁵².

As to the case at hand, the ECJ examined whether the UK legislation on CFCs was capable of preventing wholly artificial arrangements and, if so, whether it went beyond what was necessary to attain that objective. “By providing for the inclusion of the profits of a CFC subject to [a] very favourable tax regime in the tax base of the resident company”, the ECJ wrote, “the legislation on CFCs makes it possible to thwart practices which have no purpose other than to escape the tax normally due on the profits generated by activities carried on in national territory”⁵³. Regarding the necessity of that legislation, the ECJ held, quoting *Emsland-Stärke* and *Halifax*, that:

“[i]n 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 [EU] law, the objective pursued by [the] freedom of establishment [i.e., the pursuit of genuine economic activity

⁵¹ *Ibid.*, paragraph 54.

⁵² *Ibid.*, paragraph 55.

⁵³ *Ibid.*, paragraph 59.

in the host Member State], has not been achieved”⁵⁴.

Accordingly, in situations where, despite the existence of tax motives, the incorporation of a CFC reflects economy reality, the profits of such a CFC cannot be included in the tax base of the resident parent company without infringing the freedom of establishment. Those circumstances relate to objective factors which are ascertainable by third parties with regard, in particular, to the extent to which the CFC physically exists in terms of premises, staff and equipment⁵⁵. If those factors show that the CFC does not carry on a genuine economic activity in the host Member State, its creation is to be considered as a wholly artificial arrangement (e.g. a “letter box” or “front” subsidiary)⁵⁶. Procedurally, the ECJ held that the resident company “must be given an opportunity to produce evidence that the CFC is actually established and that its activities are genuine”⁵⁷. In the same way, with a view to obtaining the necessary information regarding a CFC’s true situation, the UK may have recourse to Directive 77/799 and, in this case, to the DTC it had concluded with Ireland for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income and capital gains of 2 June 1976⁵⁸. As to the ‘motive test’ set out in the UK legislation on CFCs, it was for

the national court to determine whether the scope of application of that test was limited to preventing “wholly artificial arrangements”.

One may draw five direct implications from the ruling of the ECJ in *Cadbury Schweppes*. First, and foremost, the ECJ stressed the fact that the home Member State must be able to counter wholly artificial arrangements which undermine its tax jurisdiction in relation to the activities carried out on its territory. Otherwise, the balance between Member States, in terms of allocation of the power to impose taxes, would be jeopardised⁵⁹. Second, national measures seeking to prevent tax evasion must be specifically designed to counter abusive practices, i.e. their scope must be limited to prohibiting wholly artificial arrangements which do not reflect economic reality. Third, the ECJ recalled that “the mere fact that a resident company establishes a secondary establishment, such as a subsidiary, in another Member State cannot set up a general presumption of tax evasion and justify a measure which compromises the exercise of a fundamental freedom guaranteed by the Treaty”⁶⁰. It follows that Member States cannot prevent *bona fide* tax mitigation. Fourth, where the setting-up of a subsidiary in the host Member State does not reflect economic reality, the objective pursued by the freedom of establishment has not been achieved.

⁵⁴ *Ibid.*, paragraph 64.

⁵⁵ *Ibid.*, paragraph 67.

⁵⁶ *Ibid.*, paragraph 68.

⁵⁷ *Ibid.*, paragraph 70.

⁵⁸ Council Directive 77/799/EEC of 19 December 1977 concerning mutual assistance by the competent authorities of the Member States in the field of direct taxation, [1977] OJ L 336/15. See also Council Directive 2011/16/EU of 15 February 2011 on administrative cooperation in the field of taxation and repealing Directive 77/799/EEC, [2011] OJ L 64/1.

⁵⁹ *Cadbury Schweppes*, *supra* note 6, paragraph 56 (referring to *Marks & Spencer*, *supra* note 5, paragraph 46).

⁶⁰ *Cadbury Schweppes*, *supra* note 6, paragraph 50 (referring to *ICI*, *supra* note 48, paragraph 26; Case C-78/98 *Commission v Belgium* [2000] ECR I-7587, paragraph 45; Case C-436/00 *X and Y* [2002] ECR I-10829, paragraph 62; and Case C-334/02 *Commission v France* [2004] ECR I-2229, paragraph 27). See also Case *Lasteyrie du Saillant*, *supra* note 5, paragraph 51.

Hence, such establishment constitutes a wholly artificial arrangement which does not entitle taxpayers to obtain a more favourable tax treatment in the home Member State. Fifth, the concept of abuse of law comprises both subjective and objective elements. Subjectively, the person or company concerned must have the intention of obtaining a tax advantage. Objectively, in order to determine the existence of a wholly artificial arrangement, one must look at objective factors ascertainable by third parties which prove that the subsidiary at issue does not carry out a genuine economic activity in the host Member State. For example, those factors could examine whether the subsidiary physically exists in terms of premises, staff and equipment. Moreover, the ECJ pointed out that there is no abuse of the freedom of establishment where the subsidiary carries out a genuine economic activity, regardless of whether its establishment in a particular jurisdiction is motivated by the desire to mitigate tax liability.

Some scholars posit that the concept of abuse of law applied by the ECJ in *Cadbury Schweppes* is narrower than that applied by the ECJ in *Halifax*⁶¹. Indeed, whilst in the former case the ECJ defined “abusive practices” as “wholly artificial arrangements”, in the latter case it held that “the essential aim of the transactions con-

cerned is to obtain a tax advantage”. Later, in *Part Service*⁶², another VAT case, the ECJ clarified that the expression “essential aim of the transaction” is not to be interpreted as meaning “the sole aim pursued by the transaction”, but as denoting “the principal aim of the transaction or transactions in question”⁶³. This means that, in the context of VAT, a national court may find that an arrangement constitutes abuse, “notwithstanding the possible existence, in addition, of economic objectives arising from, for example, marketing, organisation or guarantee considerations”⁶⁴. For Vanistendael, the fact that *Halifax* and *Part Service* concerned purely internal situations may explain why the concept of abuse applied by the ECJ in the context of VAT litigation is broader than that applied in direct taxation cases. In his view, in those two cases, the national court “was dealing with [a problem of] interpretation that was very much akin to the interpretation of a national tax rule”⁶⁵. In his view, the ECJ was right to adopt a more flexible concept of abuse which grants national courts a margin of appreciation. Besides, he argues that “cross-border abuses had to do with VAT carousels, which could be easily classified as an abuse, because there is no redeeming Union virtue in these carousels, except for the naked desire for a tax advantage”⁶⁶. However, situations involving a fundamental freedom are different. In *Cadbury Schweppes*, there was a clear EU interest in making sure that in order to prevent the reduction of tax revenues, na-

⁶¹ DE LA FERIA, R., *supra* note 9, at 428. See also VANISTENDAEL, F. *Cadbury Schweppes* and Abuse from an EU Tax Law Perspective, in DE LA FERIA, R.; VOGENAUER, S., (eds), *supra* note 4, 408, at 422 (who argues that “[t]he difference is that under the [*Cadbury Schweppes*] ruling, any other reason than a tax advantage is sufficient to keep at bay the abuse concept, whilst under the [*Part Service*] holding there may be a mix of tax and non-tax reasons, but if the tax reasons are more important or even one of the important reasons, abuse is established”).

⁶² Case C425/06 *Part Service* [2008] ECR I897.

⁶³ *Ibid.*, paragraph 45.

⁶⁴ *Ibid.*, paragraph 62.

⁶⁵ See, in this regard, Case C-285/09 *R* [2010] ECR I-2605. See also VANISTENDAEL, F., *supra* note 61, at 423.

⁶⁶ *Ibid.*

tional authorities did not “abuse” the concept of “abuse of law”, by depriving individuals of the tax advantages accompanying a legitimate exercise of the right to free movement. To that end, the ECJ decided to limit the concept of abuse to “wholly artificial transactions”.

Moreover, Edwards and Farmer argue that the concept of an abuse endorsed by the ECJ in *Centros* is narrower than that set out in *Cadbury Schweppes*⁶⁷. In *Centros*, the ECJ did not establish any link between the existence of abuse and the artificial nature of the transaction. “By imposing a requirement for genuine establishment of the subsidiary, the [ECJ] seems to be diverging significantly from its approach in *Centros* and *Inspire Art*, where it was clear that the company whose right of establishment was allegedly thwarted had no genuine economic activity in the Member State where it was incorporated”⁶⁸. Can those two judgments be reconciled? Does *Cadbury Schweppes* modify the *Centros* line of case law? Or has the ECJ adopted a different concept of abuse for direct taxation cases? Commentators have answered those questions in three different ways. First, one could argue that *Centros* applies the same concept of abuse as that developed by the ECJ in *Cadbury Schweppes*, i.e. it allows Member States to counter “wholly artificial arrangements”. Following such a reading of *Centros* and *Cadbury Schweppes*, the scope for actual abusive behaviour in the realm of company law would be very

small. Thus, if *Centros* is interpreted in the light of *Cadbury Schweppes*, Ringe opines that “it is difficult to imagine that the [ECJ] will ever find a company law situation that is “wholly artificial”⁶⁹. Second, it is possible to argue that *Cadbury Schweppes* compels the ECJ to revisit its ruling in *Centros*. In that regard, in his Opinion in *Cartesio*, AG Poiares Maduro held that “[*Cadbury Schweppes*] represents a significant qualification of the rulings in *Centros* and *Inspire Art*, as well as a reaffirmation of established case law on the principle of abuse of [EU] law, even though the [ECJ] continues to use the notion of abuse with considerable restraint – and rightly so”⁷⁰. As Edwards and Farmer suggest, this would mean that some degree of economic integration in the Member State of incorporation would be required⁷¹. Finally, one can argue that the concept of abuse endorsed by the ECJ in *Cadbury Schweppes* does not apply to the company law sphere. As the ECJ itself recognised in *Centros*, a distinction should be drawn between national rules governing the formation of companies and rules concerning the carrying on of certain trades, professions or businesses⁷². Accordingly, Lang points out that “[d]enying a corporation access to the Internal Market by already considering the formation of a corporation a wholly ar-

⁶⁷ EDWARDS, V.; FARMER, P. The Concept of Abuse in the Freedom of Establishment of Companies: A Case of Double Standards? in ARNULL, A.; EECKHOUT, P.; TRIDIMAS, T., (eds). *Continuity and Change in EU Law Essays in Honour of Sir Francis Jacobs*. Oxford: OUP, 2008, p. 205.

⁶⁸ *Ibid.*, at 218.

⁶⁹ See RINGE, W-G., Sparking Regulatory Competition in European Company Law: The impact of *Centros* Line of Case Law and its Concept of ‘Abuse of Law, in DE LA FERIA, R., and VOGENAUER, S., (eds), *supra* note 4, 108, at 113.

⁷⁰ Opinion of AG Poiares Maduro in Case C210/06 *Cartesio* [2008] ECR 19641, paragraph 29.

⁷¹ EDWARDS, V., and FARMER, P., *supra* note 67, at 226. See also VELLA, J., Sparking Regulatory Competition in European Company Law: A Response in DE LA FERIA, R., and VOGENAUER, S., (eds), *supra* note 4, 127.

⁷² *Centros*, *supra* note 3, paragraph 26.

tificial arrangement would have been more severe than examining the specific economic performance of the corporation”⁷³.

III. Thin Cap and Glaxo Wellcome

***Thin Cap*: anti-avoidance rules on thin capitalisation**

This case concerned the compatibility with the freedom of establishment of UK anti-avoidance rules which were targeted at “thin capitalisation”. Thin capitalisation consists in financing a company by way of loan in preference to equity capital, in order to benefit from a more advantageous tax treatment⁷⁴. Previously, in *Lankhorst-Hohorst*, the ECJ had examined the compatibility with EU law of German rules on thin capitalisation. However, the scope of those rules was too broad, as they applied generally to any situation in which the parent company had its seat, for whatever reason, in another Member State⁷⁵. By contrast, in *Thin Cap*, the UK legislator had progressively adapted its legislation so as to avoid such over-inclusiveness. Accordingly, *Thin Cap* was the first case in which the ECJ was called upon to apply the concept of abuse set out in *Cadbury Schweppes*.

The UK legislation in force up until 1995 provided that interest paid by a resident company was, in principle, treated as a distribution to the extent that it represented more than a reasonable commercial return on the loan in question. However,

where the loan was granted by a non-resident company to a resident company, the interest paid for that loan was treated as a distributed profit – and that, regardless of whether that interest represented a reasonable commercial return on that loan –, unless the UK had concluded a double taxation convention (“DTC”) to the contrary. In accordance with those conventions, the interest paid for that loan was deductible where the amount of interest did not exceed what would have been paid on an arm’s length basis. Between 1995 and 2004, the UK legislator amended those rules in the following terms. Interest paid by one company to another belonging to the same group of companies was treated as a distribution to the extent to which that interest exceeded the amount that would have been paid at arm’s length between the payer and the payee of the interest, or between those parties and a third party. However, those rules did not apply when both the borrowing company and the lending company were subject to tax in the United Kingdom.

At the outset, the ECJ noted that, since UK anti-avoidance rules only applied in relation to companies which controlled or exercised a definite influence over the borrowing company, the freedom of establishment applied to those rules⁷⁶. Next, the ECJ found that there was a difference in treatment according to the place in which the lending company had its seat. Where the lending company had its seat in the UK, the borrowing company could deduct the interest it paid under the loan from its taxable profits. Conversely, where the lending company had its seat in a Member

⁷³ LANG, M. *Cadbury Schweppes’ Line of Case Law from the Member States’ Perspective* in DE LA FERIA, R.; VOGENAUER, S., (eds), *supra* note 4, 435, at 448.

⁷⁴ In this regard, see the Opinion of AG Geelhoed in *Thin Cap*, *supra* note 7, paragraphs 3 to 5.

⁷⁵ *Lankhorst-Hohorst*, *supra* note 5, paragraph 37.

⁷⁶ *Thin Cap*, *supra* note 7, paragraph 35.

State other than the UK, such deduction was, in principle, excluded, thus increasing the liability of the borrowing company to tax. By putting a resident borrowing company receiving loans from a non-resident company in a less advantageous position than that of a resident borrowing company receiving loans from resident company, UK anti-avoidance rules constituted a restriction on the freedom of establishment. Indeed, those rules made it less attractive for companies established in a Member State other than the UK to acquire, create or maintain a subsidiary in the latter Member State.

As to the justification, the UK argued that its anti-avoidance rules sought to fight abusive practices⁷⁷. In recalling its case law, the ECJ concurred with the UK in that Member States are entitled to adopt measures specifically targeted to “wholly artificial arrangements designed to circumvent the legislation of the Member State concerned”⁷⁸. However, it pointed out that “[t]he mere fact that a resident company is granted a loan by a related company which is established in another Member State cannot be the basis of a general presumption of abusive practices and justify a measure which compromises the exercise of a fundamental freedom guaranteed by the Treaty”⁷⁹.

As a next step in its reasoning, the ECJ proceeded to examine whether UK anti-avoidance rules complied with the principle of proportionality. In this regard, it

found that those rules were capable of protecting the tax jurisdiction of the UK over the activities carried out on its territory. Indeed, they “prevent[ed] practices the sole purpose of which [was] to avoid the tax that would normally be payable on profits generated by activities undertaken in the national territory”⁸⁰. As to the necessity of the rules in question, the ECJ began by recalling that in order for the restriction at issue to be justified, it had to have the specific purpose of preventing wholly artificial arrangements designed to circumvent that legislation⁸¹. In that regard, it recognised that “[t]he fact that a resident company has been granted a loan by a non-resident company on terms which do not correspond to those which would have been agreed upon at arm’s length” may constitute an objective element of abuse that can be independently verified⁸². Procedurally, the ECJ ruled that the taxpayer concerned had to be given the opportunity – without being subject to undue administrative constraints – to provide evidence showing that the transactions in question had a commercial justification. In addition, where those transactions are considered to be “wholly artificial”, “the re-characterisation of interest paid as a distribution is limited to the proportion of that interest which exceeds what would have been agreed had the relationship between the parties or between those parties and a third party been one at arm’s length”⁸³. The question whether the successive sets of UK anti-avoidance rules went beyond what was necessary to combat abusive practices was a question for the national court to determine.

⁷⁷ The UK government also argued that its anti-avoidance rules sought to preserve the coherence of its tax system. However, the ECJ found no link between the tax advantage concerned and the offsetting of that advantage by a particular tax. *Thin Cap*, *supra* note 7, paragraphs 68 and 69.

⁷⁸ *Ibid.*, paragraph 79.

⁷⁹ *Ibid.*, paragraph 73.

⁸⁰ *Ibid.*, paragraph 77.

⁸¹ *Ibid.*, paragraph 79.

⁸² *Ibid.*, paragraph 80.

⁸³ *Ibid.*, paragraph 83.

B. Glaxo Wellcome: Limiting offsetting reduction in share values

In *Glaxo Wellcome*, the legal framework was as follows. In order to avoid double economic taxation of the profits distributed by companies resident in Germany to resident taxpayers, German law gave those taxpayers the right to offset in full the corporation tax paid by the distributing companies against their own income tax or corporation tax liability. In addition to that tax credit, a resident taxpayer was entitled to deduct from his taxable profits the reduction in value of the shares he held in a resident company which resulted from the distribution of dividends, given that, in the view of the German legislature, the distribution of dividends did not generate income. Accordingly, if the taxpayer did not have any other income in the year in question, that tax credit was converted into a right to a refund. Moreover, the sale of shares above their nominal value constituted income for the purposes of German law and was liable to income or corporation tax. However, German law provided that a resident taxpayer was not entitled to deduct from his taxable profits the losses resulting from the partial reduction in value of the shares he held in a resident company where he had acquired his shares from a shareholder residing in another Member State (the “contested legislation”).

With regard to non-resident taxpayers, their income from the distribution of profits of resident companies and the profits arising from the sale of shares in such companies were not liable to income or corporation tax in Germany. Non-resident taxpayers were also unable to invoke the application of the imputation system in full in respect of the profits distributed to them

by resident companies and could not therefore obtain a tax credit equal to the tax paid by the resident distributing company.

Had the contested legislation not been adopted, the German Government claimed that it would have been possible for non-resident taxpayers to obtain, without entitlement and in advance, the tax credit allowed only to resident taxpayers by having recourse to the following practice. Before the distribution of dividends took place, the non-resident taxpayer would sell his shares in a German company to a resident taxpayer at a price higher than its nominal value. In particular, that price would include the corporation tax paid by the resident company making the distribution. Accordingly, by obtaining the reimbursement of the amount of the tax already paid by that company, the non-resident taxpayer would make a capital gain which would not be liable to tax in Germany. For his part, the resident taxpayer would not only obtain the tax credit corresponding to the shares he had acquired, but would also be able to deduct from his taxable profits the reduction in value of those shares resulting from the distribution of dividends. If those shares were then sold back to the non-resident taxpayer, the same practice could then be repeated at the next distribution. To put an end to that practice, the German legislator decided to adopt the contested legislation which applied where a resident taxpayer had acquired his shares in a resident company from a non-resident shareholder at a price which, for whatever reason, exceeded their nominal value.

The facts of the case concerned the restructuring of the Glaxo Wellcome group which involved the acquisition of shares of GW-GmbH (a company established in Ger-

many) by GV-GmbH (a resident taxpayer) from GG-Ltd (a shareholder residing in the UK). As a result of that acquisition, GV-GmbH became the sole parent company of GW-GmbH. Similarly, that restructuring also involved the acquisition of shares of W-GmbH (a company established in Germany) by GW-GmbH (a resident taxpayer) from GG-Ltd and W-Ltd (two shareholders residing in the UK). Since GW-GmbH was the sole shareholder of W-GmbH, the latter was merged into the former. In spite of that merger, the German tax authorities took the view that GV-GmbH was not entitled to deduct from its taxable profits the losses resulting from the reduction in the value of the shares that GW-GmbH held in W-GmbH, given that those shares had originally been purchased from shareholders residing in the UK. GW-GmbH challenged that decision on the ground that it was incompatible with EU law.

At the outset, the ECJ examined whether the free movement of capital or the freedom of establishment applied to the case at hand. Given that “the application of [the contested legislation did] not depend on the size of the holdings acquired from the non-resident shareholder and [was] not limited to situations in which the shareholder [could] exercise definite influence on the decisions of the company concerned and determine its activities”, and that “[its] purpose [was] to prevent non-resident shareholders from obtaining an undue tax advantage directly through the sale of shares with the sole objective of obtaining that advantage”, the ECJ ruled that the legislation at issue in the main proceedings had to be examined in light of the Treaty provisions on the free movement of capi-

tal⁸⁴. Next, the ECJ went on to determine whether the contested legislation constituted a restriction on the free movement of capital. In that regard, it observed that “[a] taxpayer’s right to deduct from his taxable profits the losses resulting from the partial reduction in value of the shares held in the company, where the reduction in value of the shares results from the distribution of the profits, undeniably constitutes a tax advantage”⁸⁵. As the contested legislation limited the grant of such a tax advantage to a resident taxpayer who had acquired shares in a resident company from a resident shareholder, it made the acquisition of shares held by non-residents less attractive. In the same way, it dissuaded non-resident investors from acquiring shares in the resident company, representing an obstacle to that company’s accumulation of capital from other Member States⁸⁶. Thus, the ECJ ruled that the contested legislation constituted an obstacle to the free movement of capital.

Moreover, with regard to the losses resulting from a reduction in value of the shares held in a resident company, the ECJ found that “those shareholders are in a comparable situation, whether the shares are acquired from a resident or acquired from a non-resident”⁸⁷. “The distribution of profits”, the ECJ wrote, “reduces the value of a share, whether it was previously acquired from a resident or a non-resident, and in both cases that reduction in value is borne by the resident shareholder”⁸⁸. Accordingly, the contested legislation did not

⁸⁴ *Glaxo Wellcome*, *supra* note 8, paragraphs 49 and 50.

⁸⁵ *Ibid.*, paragraph 56.

⁸⁶ *Ibid.*, paragraph 57.

⁸⁷ *Ibid.*, paragraph 58.

⁸⁸ *Ibid.*, paragraph 73.

reflect an objective difference in the situations of those shareholders. This meant that in order for the contested legislation to be compatible with the free movement of capital, it had to be justified by an overriding reason in the public interest. In that regard, the German Government argued that the contested legislation pursued three objectives recognised as legitimate by EU law: it sought to preserve the coherence of the German tax system⁸⁹, to ensure the effective collection of revenue generated in German territory⁹⁰ and to prevent artificial arrangements whose purpose was to circumvent the scope of application of German legislation⁹¹. After rejecting the contention that the contested legislation was a proper means for ensuring the coherence of the German tax system⁹², the ECJ noted that it was “capable of achieving the objective of maintaining a balanced allocation of the power to impose taxes between the Member States and of preventing wholly

⁸⁹ See, e.g., Case C-204/90 *Bachmann* [1992] ECR I-249, paragraph 28; Case C-319/02 *Manninen* [2004] ECR I7477, paragraph 42).

⁹⁰ See, notably, *Marks & Spencer*, *supra* note 5, paragraph 46.

⁹¹ *Cadbury Schweppes*, *supra* note 6, paragraphs 51 and 55; *Thin Cap*, *supra* note 7, paragraphs 72 and 74; and *Jobra*, *supra* note 36, paragraph 3.

⁹² For an argument based on such a justification to succeed, the ECJ requires that a direct link be established between the tax advantage concerned and the offsetting of that advantage by a particular tax levy, with the direct nature of that link falling to be examined in the light of the objective pursued by the rules in question. However, the ECJ found that such a direct link did not exist, as ‘the disadvantages resulting from the legislation at issue in the main proceedings are suffered directly by the resident shareholder who has acquired those shares from a non-resident. For that resident shareholder, the impossibility of deducting from his taxable profits the losses resulting from the reduction in the value of the shares held in the resident company, where the reduction in value of the shares results from the distribution of the profits, is not offset by any tax advantage’. *Glaxo Wellcome*, *supra* note 8, paragraph 80.

artificial arrangements which do not reflect economic reality and whose only purpose is to obtain a tax advantage”⁹³. Indeed, such legislation prevented practices the sole objective of which was to make it possible for a non-resident shareholder, who was neither a taxable person in Germany nor entitled to a tax credit for corporation tax paid by the resident company, to obtain such a tax credit. In so doing, it also ensured that profits liable to tax in Germany were not unduly transferred to the national tax base of another Member State. Moreover, notwithstanding the fact that it was for the referring court to determine whether the contested legislation went beyond what was necessary to attain those twin objectives, the ECJ provided the national court with some guidance in that respect. It opposed general assumptions according to which “any increase in the selling price necessarily takes into account the tax credit and is made solely for that reason”, since it cannot be ruled out that “the shares were sold at more than their nominal value for reasons other than in order to obtain for the shareholder a tax credit for the corporation tax paid by the resident company or, in any case, that the undistributed profits and the possibility of obtaining a tax credit relating to those shares constitute only one element of their selling price”⁹⁴. When determining the existence of abusive practices, the ECJ held that the national court must embark on “a case-by-case examination, taking into account the particular features of each case, based on objective elements, in order to assess the abusive or fraudulent conduct of the persons concerned”⁹⁵. If the nation-

⁹³ *Glaxo Wellcome*, *supra* note 8, paragraph 92.

⁹⁴ *Ibid.*, paragraph 96.

⁹⁵ *Ibid.*, paragraph 99. In the view of AG Bot, the fact that shares are sold at a price higher than their

al court were to find that “[the contested legislation] cannot be limited to wholly artificial arrangements, established on the basis of objective elements, but covers all cases in which a resident taxpayer has acquired shares in a resident company from a non-resident shareholder at a price which, for whatever reason, exceeds the nominal value of those shares, the effects of such legislation [would exceed] what is necessary in order to attain the objective of preventing wholly artificial arrangements which do not reflect economic reality and whose only purpose is unduly to obtain a tax advantage”⁹⁶.

IV. Concluding remarks

Cadbury Schweppes, *Thin Cap* and *Glaxo Wellcome* provide national courts with useful guidance when they are called upon to determine whether a national measure prohibiting abusive practices complies with the fundamental freedoms. To that end, a national court must, at the outset, establish which of the fundamental freedoms applies. Next, it must examine whether the national measure at issue in the main proceedings constitutes a restriction on the relevant freedom. If that is indeed the case, it must look at the reasons that may justify such a restriction. It is thus at the justification stage that the national court must take

nominal value may be an indication of abuse, but is not in itself conclusive evidence of abuse. He posited that one should also examine the speed with which and the price at which those shares are sold back to the non-resident shareholder. In addition, whilst the national legislator may establish a presumption of abuse, it must allow the operator concerned to rebut such a presumption by showing economic or financial reasons or very specific circumstances justifying such a transaction. See Opinion of AG Bot in *Glaxo Wellcome*, *supra* note 8, paragraph 175 et seq.

⁹⁶ *Ibid.*, paragraph 100.

into account the concept of abuse developed by the ECJ in *Cadbury Schweppes*, *Thin Cap* and *Glaxo Wellcome*.

First, the fact that the company was established in a Member State for the purpose of benefiting from a more favourable tax treatment does not in itself suffice to constitute an abuse of the relevant fundamental freedom. It follows that tax mitigation which results from a legitimate exercise of the right to free movement is protected by EU law.

Second, EU law does not offer a shield to tax evaders, since Member States may prevent taxpayers from obtaining tax advantages resulting from “wholly artificial arrangements” which do not involve the genuine exercise of an economic activity. Those arrangements constitute abusive practices. In order to determine whether an arrangement is wholly artificial, *Cadbury Schweppes* tells national courts to examine the intention of the taxpayer concerned and to look at objective factors which are ascertainable by third parties. To state the obvious, those objective factors are not always the same but may vary in accordance with the arrangement in question. For example, regarding the setting up of a subsidiary for the purpose of obtaining a more advantageous tax treatment, *Cadbury Schweppes* indicates that those objective factors may, for example, relate to the physical existence in terms of premises, staff and equipment of the subsidiary concerned (as opposed to a mere “letter-box” subsidiary). As to anti-avoidance rules on thin capitalisation, in the light of *Thin Cap*, national courts are advised to examine the interest paid by the resident company. The fact that that interest exceeds the amount that would have been paid at arm’s length

between the payer and the payee of the interest, or between the companies of the same group and a third party, may imply the existence of abuse. Finally, regarding the offsetting reduction in share values, national court must look at the price at which shares are sold by the non-resident shareholder. However, in light of *Glaxo Wellcome*, that determination is not in itself conclusive evidence of abuse. In addition, national courts may, for instance, inquire how much time elapsed between the sale of those shares and their resale to the original shareholder. Moreover, it appears that the ECJ gives more weight to the existence of objective factors than to the intentions of the taxpayer concerned. Indeed, in *Cadbury Schweppes*, the ECJ ruled that, regardless of the motivation behind the exercise of the rights to free movement, in

the absence of objective factors proving the existence of a wholly artificial arrangement, there cannot be an abuse. However, it would be very difficult for the taxpayer concerned to demonstrate that he did not intend to obtain a tax advantage where objective factors indicate the contrary.

Last but not least, regarding the principle of proportionality, the national measure at issue must be sufficiently finely calibrated so that it aims only at prohibiting abusive practices. This means that general and irrefutable presumptions establishing that certain transactions constitute abusive practices fail to comply with the principle of proportionality. Procedurally, Member States must allow the individual or company concerned to rebut such presumptions and, in any event, national courts must be able to assess the existence of abuse on a case-by-case basis.

MOKESČIŲ PLANAVIMAS VS. MOKESČIŲ VENGIMAS EUROPOS SĄJUNGOS TEISINGUMO TEISMO PRAKTIKOJE

Koen Lenaerts

S a n t r a u k a

Šio straipsnio tikslas – apibūdinti sąvokos „piktnaudžiavimas teise“ turinį Europos Teisingumo Teismo (ETT) praktikoje, susijusioje su tiesioginiu apmokestinimu. Teisingumo Teismas, aiškindamas minėtą sąvoką, siekė nubrėžti konceptualią ribą tarp „mokesčių sumažinimo“ ir „mokesčių vengimo“. Viena vertus, „mokesčių sumažinimas“ siejamas su atvejais, kai asmuo (ar įmonė) siekia, laikydamasis teisės aktų nuostatų, sumažinti mokesčius, kuriuos jis (arba ji) privalo mokėti. Atsižvelgiant į tai, kad teisė įtvirtinti tiesioginius mokesčius palikta ES valstybėms narėms, jos gali taikyti skirtingus pajamų ir / ar pelno mokesčių tarifus. Taigi, žvelgiant iš tarpvalstybinės pozicijos, mokesčių susimažinimas yra galimas dėl reguliacinės konkurencijos tarp nacionalinių mokesčių sistemų. Todėl fizinis ar juridinis asmuo gali nuspręsti vykdyti ekonominę veiklą

kitoje valstybėje narėje nei jo (ar jos) gyvenamosios vietos (rezidavimo, įsisteigimo) valstybėje, tokiu būdu siekdamas gauti naudą dėl atitinkamų mokesčių sistemų skirtumų ar lengvatų. Kita vertus, ES pilietis negali remtis pagrindinėmis laisvėmis taip, kad tai sumažintų mokesčių sistemos valstybėje narėje, kurioje jis privalo mokėti mokesčius, efektyvumą. Laikas ir vėlgi ETT aiškiai pabrėžė, kad ES teisė nesaugo fizinių ar juridinių asmenų, siekiančių mokėti mažiau mokesčių, kurie sukuria teisingas situacijas, dirbtinai patenkančias į pagrindinių laisvių taikymo sritį. Šioje publikacijoje, remiantis ETT sprendimais bylose *Cadbury Schweppes*, *Thin Cap* ir *Glaxo Wellcome*, apibūdinami žingsniai, kuriais nacionalinis teismas turi vadovautis nustatydamas, ar konkretus asmens elgesys yra piktnaudžiavimas teise.

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