

Chaire de recherche en fiscalité et en finances publiques

Effective Responses to Aggressive Tax Planning

What Canada Can Learn from Other Jurisdictions

Instalment 2: European Union - Abusive Practice Doctrine

Photocopying, reprinting and electronic rebroadcasting prohibited. Permission to photocopy, reprint or electronic rebroadcast any part of this publication for distribution must be applied for in writing to Michael Gaughan, permission editor for Canadian Tax Foundation, e-mail: mgaughan@ctf.ca.

Gilles N. LARIN
Robert DUONG

This instalment is the second in a series that presents a detailed study on aggressive tax planning. It underpins the issuance of *Tax Paper No. 112* published in July 2009 by the Canadian Tax Foundation (CTF). As mentioned in the preface of the book in order to keep publishing costs reasonable and to avoid delaying its publication, the CTF has given us permission to publish this document in French and English on our Website.

July 2009

 UNIVERSITÉ DE
SHERBROOKE

The Mission of the Research Chair in Taxation and Public Finance

The **Research Chair in Taxation and Public Finance** (RCTPF) was formed on April 15, 2003 via an unconditional grant from the Québec Government, to whom we are grateful. We are specifically thankful to the Government for having given us total freedom in selecting topics we thought were important, thus expressing its confidence in the selection of our projects. In Québec, there are few official forums where practitioners, public-sector executives and researchers can discuss new issues in taxation and public finances. In addition, research in these fields generally focuses on a single discipline to the detriment of the multi-disciplinary aspect of relations between the state and its taxpayers. The **Research Chair in Taxation and Public Finance** was formed in response to these two realities. Its primary mission is to stimulate interdisciplinary research and training by bringing together professors and researchers interested in the political economy of taxation. For more information on the **Research Chair in Taxation and Public Finance**, visit its official Website at: <http://www.usherbrooke.ca/adm/recherche/chairefiscalite/>.

Gilles Larin holds the RCTPF. Robert Duong¹ contributed to this instalment while he was a research professional with the RCTPF.

We also wish to express our gratitude for their observations and suggestions to Gaston Bédard, Daniel Boudreau, and Gilles Paré, who acted as outside advisers, and to other readers who wished to remain anonymous. Of course, we assume full responsibility for the comments and interpretations in this study.

Copyright belongs to the RCTPF.

¹ Robert Duong, who is a lawyer, was a research associate with the Research Chair of Taxation and Public Finance at the University of Sherbrooke when this study was done. He is now working with the federal Department of Finance as a policy officer in the area of income tax. The views expressed in this publication are those of the authors and do not in any way represent the position of the Department of Finance of Canada. The material contained in this publication is not intended to be advice on any particular matter. No subscriber or other reader should act on the basis of any matter contained in this publication without considering appropriate professional advice. The publisher, and the authors and editors, expressly disclaim all and any liability to any person, whether a purchaser of this publication or not, in respect of anything and of the consequences of anything done or omitted to be done by any such person in reliance upon the contents of this publication.

Abstract

Instalment 2: European Union – Abusive Practice Doctrine

In 2005, the Research Chair in Taxation and Public Finance initiated studies on aggressive tax planning in light of concerns expressed by tax administrations, the courts, taxpayers and tax advisers (“**stakeholders**”). The studies analyze the tools developed by some of Canada’s major trading partners in response to aggressive tax planning schemes put into effect by taxpayers and tax advisers.

This study aims to spark thinking among the various stakeholders in Canada by taking a comprehensive and pragmatic approach to several issues inherent in aggressive tax planning. In view of the scope of the subject, its complexity and the specific features of the taxation systems of foreign jurisdictions, our study should be seen as a reflection on aggressive tax planning rather than an exhaustive analysis of each of the tools examined and all the associated issues. This project was written over a more than a two year period. As the underlying logic was the key element we wished to convey, we wish to emphasise that these documents do not necessarily represent the state of tax legislation or jurisprudence.

As part of this project, the Chair held a symposium in 2006 on the risks inherent in aggressive tax planning for all stakeholders and published a discussion paper detailing the major issues of these schemes.

This project is being pursued here by a study of the tools developed by Australia, United States, United Kingdom and European Union. Our goal is to assess whether it would be worthwhile for Canada to adopt one or more of these tools to safeguard its tax system. The assessment was carried out taking into consideration the point of view of each stakeholder, according to generally recognized principles of tax administration.

This study consists of ten instalments detailing the study framework that guided our analysis of the tools developed in other countries and our study of each of the selected tools. Our conclusions in relation to all of these tools and possible solutions for Canada were destined to be published as the 10th instalment. However, it is not published here, because it was recast and augmented to become *Tax Paper No. 112*, published in July 2009 by the Canadian Tax Foundation: *Effective Responses to Aggressive Tax Planning – What Canada Can Learn from Other Jurisdictions*.

We refer the reader to instalment 1, “Study Framework” for an overview of our thinking throughout the instalments.

This instalment deals with the European Union’s abusive practice doctrine, which has similarities with the general anti-avoidance rule in Canada. We begin by outlining the context of European Community law within which the abusive practice doctrine applies in tax matters. We identify the main criteria of the doctrine and the issues stemming from its application for each group of stakeholders. We then reach conclusions concerning the application of this tool.

In our view, the abusive practice doctrine illustrates the usefulness of a general anti-avoidance rule based on achieving the objects and purposes of the tax law as a whole. Such a measure makes it possible to strike a balance between protecting the integrity of the tax system and the taxpayers’ privilege of organizing their affairs to, if they wish, minimize tax payable. The courts within the European Union have played an important role in enforcing the abusive practice doctrine to curb tax avoidance arrangements despite the absence of a general anti-avoidance rule in Community directives.

However, the courts have not provided a precise definition of the parameters of an abusive practice. The doctrine, as applied by the courts, is ambiguous concerning the degree of an arrangement’s incompatibility with the objects and purposes of the tax law and concerning the importance of the tax purposes of a taxable person in relation to other aspects of the arrangement. We believe that defining such parameters in the tax law would improve predictability and uniformity for all groups of stakeholders in the application of a general anti-avoidance rule. In this sense, the abusive practice doctrine illustrates the importance of the role

of the tax administration in defining such parameters and the limits of the role played by the courts in tax avoidance matters.

The imposition of a penalty for under-stating tax payable on taxpayers who carry out an abusive tax avoidance arrangement may be an appropriate way to increase the risks for aggressive taxpayers. However, the details of such a penalty must be clearly expressed in law. In addition, these details must be adjusted to the action the taxpayer is blamed for and according to the degree of uncertainty regarding the objects and purposes of the tax law. The amount of the penalty should be large enough to act as a deterrent without being excessively onerous.

Table of Contents

The Mission of the Research Chair in Taxation and Public Finance	i
Abstract	ii
1 General Context of European Community Law	1
2 Context of the Abusive Practice Doctrine in European Community Law.....	6
3 Description	8
3.1 Application details.....	8
3.2 Withdrawal of tax advantages.....	8
4 Observations	9
4.1 The abusive practice doctrine applies both according to the purposes of the tax law as well as to those pursued by taxable persons in an arrangement.....	9
4.2 Taxable persons must exercise their privilege of minimizing their tax within the scope of the tax law	10
4.3 Possible ambiguity concerning the identification of the purposes of the tax law	11
4.4 Ambiguity regarding identification of the taxable person's tax purposes in an arrangement	15
4.5 Ambiguity as to the relative weight of a taxable person's tax purposes and that of his other purposes	16
4.6 Application of the abusive practice doctrine: how to reconcile the tax result of an arrangement with the ambiguity regarding the purposes of the tax law?.....	17
4.7 Lack of penalties for under-stating tax payable	18
4.8. According to the rules of evidence and of procedure of member states, taxable persons could bear the burden of proof that the abusive practice doctrine does not apply to their arrangements	21
5 Conclusion	22
Bibliography	25

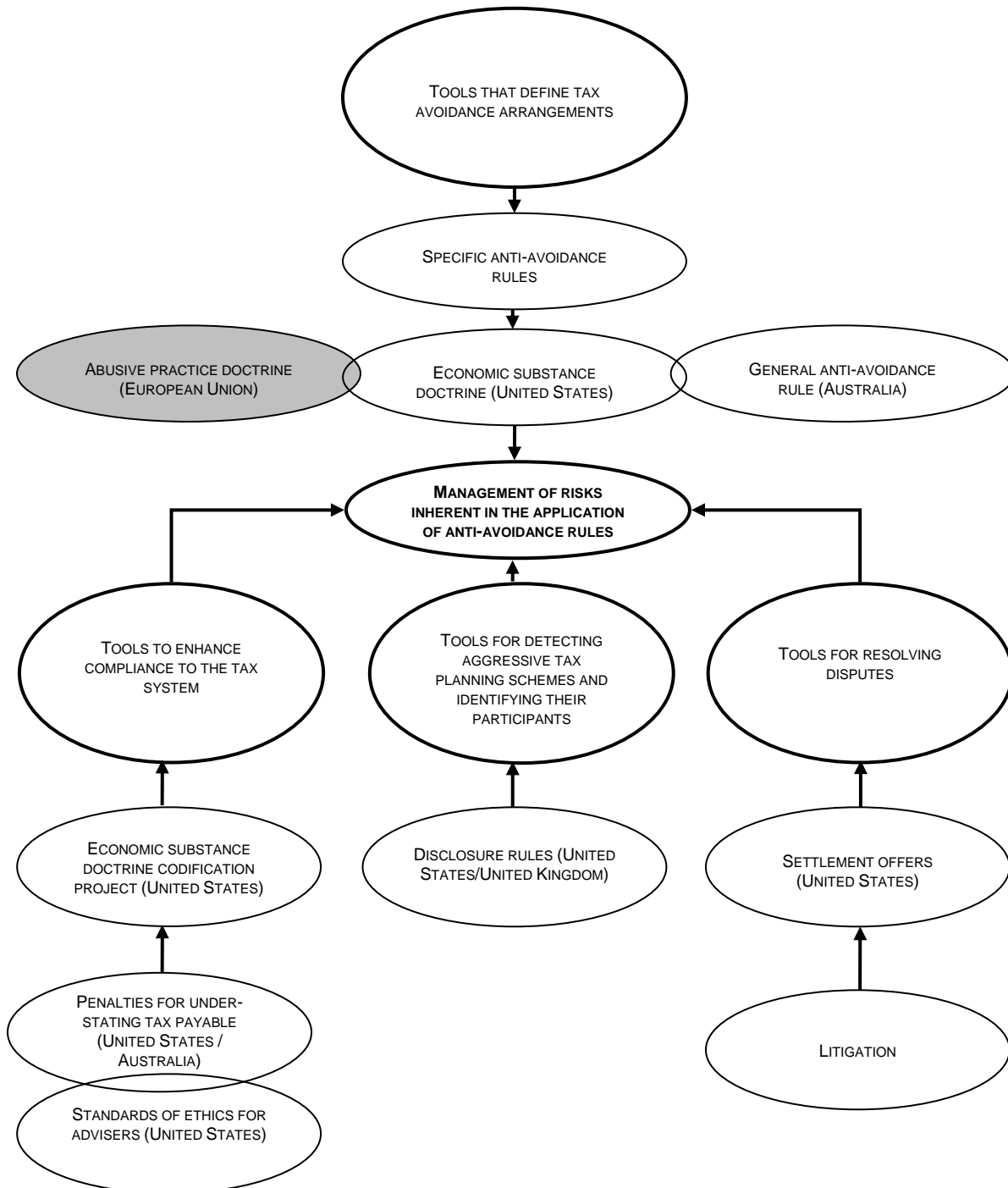
General Context of European Community Law

As discussed in Instalment 1, “Study Framework”, of this study, there are a number of tools available to the tax administration to better curb tax avoidance arrangements and increase the risk for aggressive taxpayers and advisers. These tools can be divided into four spheres of intervention of the tax administration:

- Tools that define tax avoidance arrangements.
- Tools designed to enhance compliance to the tax system.
- Tools designed to detect aggressive tax planning schemes and identify their participants.
- Tools that focus on resolving disputes.

Chart 1.1 on the following page provides a concise illustration of the relation between these spheres of intervention in managing the risks inherent in aggressive tax planning. Each sphere of intervention is shown in the chart using a bold border. The foreign tools selected for the purposes of the study are inserted in the appropriate spheres of intervention. The tool considered in this instalment, i.e. the abusive practice doctrine, is indicated by a grey background to position its role in the tax administration’s management of the risks inherent in aggressive tax planning.

CHART 1.1
SPHERES OF INTERVENTION OF THE TAX ADMINISTRATION REGARDING AGGRESSIVE TAX PLANNING:
SELECTED TOOLS USED BY SOME OF OUR TRADING PARTNERS -
ABUSIVE PRACTICE DOCTRINE WITHIN THE EUROPEAN UNION



Our Chart.

In general, member states of the European Union retain their independence in exercising their legislative, executive and judiciary powers. However, on a few occasions, members have agreed to harmonize their tax system both for the value added tax (VAT) and the income tax to achieve common goals. Each member harmonizes its national tax system accordingly to implement a Community directive. Taxable persons and taxpayers of a member state must then apply the directive's rules.²

In particular, member states can ratify a Community directive on taxation to reduce obstacles placed by tax rules to the free movement of individuals, businesses and capital within an internal market, while allowing healthy competition among member states at the tax level.³

In working towards these objectives, member states seek to protect the integrity of the tax system against aggressive tax planning by taxpayers or taxable persons exercising their privilege of organizing their affairs to minimize their tax.⁴

The courts of member states are called upon to reconcile the divergent interests of taxpayers or taxable persons and of the tax administration. To ensure that Community tax law is applied uniformly, national courts can refer a question to the Court of Justice of the European Communities (the "ECJ") for clarifications on the application of Community law.⁵ National courts

² For an illustration of the relationship between a community directive on taxation and the tax system of a member state, see *E.C.J. Judgement, Hans Markus Kofoed v. Skatteministeriet* (July 5, 2007), C-321/05 [*Kofoed*], points 37-49, and *E.C.J. Opinion, Advocate General Juliane Kokott* (February 8, 2007), *Hans Markus Kofoed v. Skatteministeriet* (July 5, 2007), C-321/05, [*Kofoed-AG*], points 62-67.

³ For more information concerning the tax policy strategy of the European Union, see E.U., Taxation and Customs Union Directorate-General of the European Commission, online: <http://ec.europa.eu/taxation_customs/taxation/gen_info/tax_policy/index_en.htm>.

⁴ See the respective preambles of the following directives: EC Directives, Sixth Council Directive, 77/388/EEC, May 17, 1977, on the harmonization of the laws of Member States relating to turnover taxes – Common system of value added tax: uniform basis of assessment, [1977] O.J. L. 145/1, as amended and in force until January 1, 2007 [*Sixth Directive*]; EC Directives, Council Directive 90/434/EEC, July 23, 1990, concerning the common tax system applicable to mergers, divisions, transfers of assets and exchanges of shares concerning companies of different Member States, [1995] O.J. L. 225/1 [*Merger Directive*]. The *Sixth Directive* was repealed on January 1, 2007 under EC Directives, Council Directive 2006/12/112/ of November 28, 2006 on the common system of value added tax, [2006] O.J. L. L 347/1, which codifies the provisions of the *Sixth Directive* without altering the substance: for more details, see the Website of the European Commission's Taxation and Customs Union Directorate-General, key document "VAT: Clearer overview of Community VAT legislation currently in force" at: <http://ec.europa.eu/taxation_customs/taxation/vat/key_documents/legislation_recently_adopted/index_en.htm> (site viewed by the authors on April 27, 2007). For the sake of simplification for the purposes of this study, the *Sixth Directive* refers to both the directive in existence prior to January 1, 2007 and the one in force since then.

⁵ This information is taken from the Website of E.U., Court of Justice of the European Communities: <www.curia.europa.eu> (consulted December 4, 2006).

must apply the tax principles set out by the ECJ to the facts of the case before them. A brief description of the role and operation of the ECJ within the European Union is given in box 1.1 on page 5.

A court in the United Kingdom referred the *Halifax* case⁶ to the ECJ. The case bore on the application of the abusive practice doctrine for the purposes of the *Sixth Directive*, mentioned above in note 4. Section 2 discusses the abusive practice doctrine in Community tax law in a VAT context.

⁶ E.C.J. Judgement, *Halifax, plc, Leeds Permanent Development Services Ltd, County Wide Property Development Ltd v. Commissioners of Customs & Excise*, C-255/02, [2006] E.C.R. I-01609, [2006] O.J. L. C 131/1 [*Halifax*].

BOX 1.1 : BRIEF DESCRIPTION OF THE ROLE AND OPERATION OF THE ECJ

Member states concluded treaties creating a European Union with institutions that adopt laws in specific areas. The ECJ is the judicial institution of the Community. The main task of the ECJ is to examine the legality of Community measures and ensure uniform interpretation and application of Community law.

The ECJ has identified an obligation on administrations and national courts to apply Community law in full within their sphere of competence and to protect the rights conferred on citizens (direct application of Community law), and to disapply any conflicting national provision, whether prior or subsequent to the Community provision (primacy of Community law over national law).

The ECJ cooperates with all the courts of the member states, which are the general courts in matters of Community law. To ensure the effective and uniform application of Community legislation and to prevent divergent interpretations, the national courts may, and sometimes must, refer to the ECJ and ask it to clarify a point concerning the interpretation of Community law, so that they may ascertain, for example, whether their national legislation complies with that law. A reference for a preliminary ruling may also seek the review of the validity of an act of Community law.

The ECJ replies with a reasoned judgement. The ECJ is assisted by advocates general (AG). The AGs are responsible for presenting, with complete impartiality, a legal opinion called “Opinion” in cases brought before them. The ECJ is not bound by the opinion of the AG.

A case is argued at a public hearing, before the bench and the AG who may put to the parties any questions they consider appropriate. Some weeks later, the AG delivers his conclusions before the ECJ in open court. The AG analyzes in detail the legal aspects of the case and suggests completely independently to the ECJ the response he considers should be given to the problem raised.

The national court to which it is addressed is, in deciding the dispute before it, bound by the interpretation given by the ECJ. The ECJ’s judgement likewise binds other national courts before which the same problem is raised.

The judges of the ECJ and the AGs are appointed by common accord by the governments of the member states for a renewable term of six years. They are chosen from among lawyers whose independence is beyond doubt and who possess the qualifications required for appointment, in their respective countries, to the highest judicial offices, or who are of recognized competence.

Source: Taken from the Website of the ECJ, *supra* note 5, consulted on December 4, 2006, and selected by the authors for the purposes of this study.

Context of the Abusive Practice Doctrine in European Community Law

The decision reached by the ECJ in the *Halifax* case⁷ provides an illustration of the application of the abusive practice doctrine in the field of taxation, for the purposes of the *Sixth Directive* concerning the VAT.⁸

Essentially, the VAT system of member states must comply with the *Sixth Directive*. This directive establishes a uniform VAT basis of assessment for all member states. It enacts the parameters that states must observe to subject economic actors to the VAT as well as the circumstances in which a taxable person may claim a refund of the amount of VAT paid in the course of his taxable activities.

Briefly, in *Halifax*, the ECJ had to decide whether the abusive practice doctrine applied to a series of arrangements between an exempt taxable person and its subsidiaries to deny the refund of the amount of VAT claimed by the group. The exempt taxable person wanted to obtain a refund of the VAT paid to construction contractors who were charged with building structures to be used in the course of its exempt supplies. Were it not for this series of arrangements, the exempt taxable person could have claimed only a fraction of the VAT paid to these contractors.

The ECJ concluded that the abusive practice doctrine could apply for the purposes of the *Sixth Directive* to deny the tax advantages claimed by taxable persons further to an arrangement that does not satisfy the doctrine's two application criteria. Briefly, the doctrine applies according to the degree of incompatibility between the purposes of the law and the results of an arrangement as well as according to the determination of the relative weight of a tax purpose in the arrangement. The task of applying this doctrine to the facts and circumstances of an arrangement lies with the trial courts of member states.

⁷ *Halifax*, *supra* note 6.

⁸ *Sixth Directive*, *supra* note 4.

The taxable person in *Halifax* withdrew its appeal lodged with the British court of referral that was to hand down a decision as to the application of the abusive practice doctrine to the arrangement in question in the case. The British tax administration expected other taxable persons that had entered into a similar arrangement to withdraw their notice of objection or their appeal, as the case may be.⁹ Unfortunately, the taxable person's withdrawal of the appeal it lodged in *Halifax* makes it impossible to analyze the application of the doctrine by the trial court in this case. However, certain decisions handed down by national courts subsequently shed further light on the scope of the doctrine.

The parameters of the abusive practice doctrine show similarities with the general anti-avoidance rule (GAAR) in Canada. However, application of this doctrine to a given arrangement could in principle lead to a different conclusion than the one arising from the application of the GAAR. In this sense, an analysis of the application by the ECJ of the abusive practice doctrine could shed additional light on the usefulness of such a tool. Should the ECJ's decision in *Halifax* bear on the application of the abusive practice doctrine regarding the VAT, we are of the view that the concepts formulated in this decision could just as well apply regarding income tax.¹⁰

The following sections lay out the broad principles of the abusive practice doctrine essentially emerging from the ECJ decision in *Halifax*, in light of the opinion of the AG. We will mention certain decisions reached by the ECJ and by national courts after *Halifax* that bear on the abusive practice doctrine or on related aspects.

⁹ See U.K., HM Revenue & Customs, Revenue & Customs Brief 30/07, "Outcome of Halifax Case" (28 March 2007), online: site of HM Revenue & Customs <<http://www.hmrc.gov.uk/briefs/vat/brief3007.htm>>.

¹⁰ According to statements attributed to the director general of HM Revenue & Customs (HMRC), the British tax administration could apply the abusive practice doctrine regarding income tax: see Chuck Gnaedinger, "Hartnett Reviews U.K. Compliance Initiatives" (February 2, 2007), 2007 W.T.D. 23-6. In a European context, the courts could consider the principles set out by the ECJ in *Halifax* for the purposes of community directives regarding income tax that make use of concepts similar to those of the abusive practice doctrine. Among others, see *Kofoed-AG*, *supra* note 2 and the *Merger Directive*, *supra* note 4. Under section 11 of this directive, a member state may withdraw the tax benefits claimed by a taxpayer if tax avoidance is the primary objective or one of the primary objectives of the reorganization in which the taxpayer participates. Moreover, the abusive practice doctrine could apply to various fees or taxes, including fees imposed by member states on capital transfers of corporations: see *E.C.J. Judgement, Commission of European Communities v. Hellenic Republic* (June 7, 2007), C-178/05 [*Commission*] and *E.C.J. Opinion, Advocate General Poiares Maduro* (June 21, 2007), *Firma Ing. Auer – Die Bausoftware GmbH v. Finanzamt Freistadt Rohrbach Urfahr*, C-251/06 [*Firma-AG*], application for preliminary ruling published in [2006] O.J. L. C 212/13.

3

Description

3.1 Application details

Under the abusive practice doctrine developed by the ECJ, taxable persons must not organize their affairs in such a way that would impair in an abusive way the purposes of a tax law of the European Community or a law that makes it applicable in a member state (“tax law”). A taxpayer exercises his privileges in an abusive way (“abusive practice”) where the following two criteria are satisfied:

- The result of the arrangements is that a tax advantage is obtained contrary to the purposes of the tax law; and
- it must be apparent from a number of objective factors that the essential aim of the arrangements in question is to obtain a tax advantage.¹¹

3.2 Withdrawal of tax advantages

Where the courts conclude that the arrangement constitutes an abusive practice, the taxable person is denied the tax advantages claimed and must therefore pay the taxes he would otherwise have had to pay. If necessary, the tax administration must re-determine the taxes payable by redefining the arrangements constituting the abusive practice to re-establish the situation that would have prevailed in their absence.¹² However, the taxable person suffers no penalty for under-stating the tax payable.¹³

¹¹ *Halifax*, *supra* note 6, point 99.

¹² *Ibid.*, points 94-99.

¹³ *Ibid.*, points 92 and 99.

4

Observations

On the face of it, the abusive practice doctrine shows certain similarities with the GAAR in Canada. However, it differs from it by the simultaneous application of criteria involving the purposes of an arrangement and the purposes of the tax law. Moreover, in the absence of specific parameters and objectives in community or national tax law, the application of this doctrine in tax law causes uncertainty notably regarding the following aspects:

- The extent of the privilege of taxable persons to arrange their affairs in order to minimize their tax within the realm of legal possibilities stipulated by the tax law.
- Identification of the purposes of the tax law.
- Identification of the tax purposes sought by a taxable person in an arrangement.
- The measure of the relative weight of the various purposes in an arrangement.
- The degree to which obtaining the tax advantages is compatible with the purposes of the tax law.
- The lack of penalty for under-stating tax payable.
- The division of the burden of proof between taxable persons and the tax administration regarding the components of an abusive practice.

4.1 The abusive practice doctrine applies both according to the purposes of the tax law as well as to those pursued by taxable persons in an arrangement

The abusive practice doctrine applies provided the courts conclude both that the obtaining of tax advantages by taxable persons goes against the purposes of the tax law and that the essential aim of taxable persons in the arrangement is of a tax nature.¹⁴ While the taxable person

¹⁴ *Ibid.*, points 74-75 and 99, as well as *E.C.J. Opinion, Advocate General Poireres Maduro (April 7, 2005), Halifax, plc, Leeds Permanent Development Services Ltd., County Wide Property Development Ltd v. Commissioners of Customs & Excise, C-255/02, [2006] E.C.R. I-01609, [2006] O.J. L. C 131/1, paragraphs 87-88 [Halifax-AG].* Also

assumes the burden of proof regarding the application of the abusive practice doctrine, he is entitled to the tax advantages only if he simultaneously proves that neither of the two criteria of the doctrine applies. Faced with the application of these two criteria, the taxpayer must first establish that the arrangement complies with the purposes of the tax law.¹⁵

A taxable person would then assume a more exacting burden of proof under the abusive practice doctrine than a taxpayer under the GAAR in Canada. In applying the GAAR, the courts must first decide whether the primary purpose of a taxpayer in an arrangement is of a non-tax nature. If so, the courts need not decide whether the arrangement complies with the purposes of the tax law read as a whole.

4.2 Taxable persons must exercise their privilege of minimizing their tax within the scope of the tax law

In *Halifax*, the AG expressed the view that the community VAT system applies to legitimate commercial arrangements in accordance with the array of choices the system allows. The AG's conclusions indicate that the principles of certainty and of freedom of taxpayers in arranging their affairs must be reconciled with the abusive practice doctrine. In the AG's view, these principles must yield where the purposes of an arrangement are contrary to the purposes of the *Sixth Directive*.

see U.K., *Nissan Motor Manufacturing (UK) Limited and The Commissioners for Her Majesty's Revenue and Customs* (March 1, 2007), Decision CO00236 (VAT and Duties Tribunal) [*Nissan*], points 44-45, online: Finance and Tax Tribunals Website <<http://www.financeandtaxtribunals.gov.uk/aspx/view.aspx?id=2991>>.

¹⁵ The allocation of the burden of proof between taxable persons and the tax administration in the context of the abusive practice doctrine is covered in sub-section 4.8 below.

Accordingly, taxpayers must exercise their privilege within the realm of possibilities stipulated by the law:

Definition of the scope of this Community law principle, as applicable to the common VAT system, is ultimately a problem of determining the limits applicable to the interpretation of the provisions of the VAT directives that confer certain rights on taxable persons. In this regard, *the objective analysis of the prohibition of abuse has to be balanced against the principles of legal certainty and protection of legitimate expectations that also 'form part of the Community legal system'* and in the light of which the provisions of the Sixth Directive must be interpreted. From those principles it follows that taxpayers must be entitled to know in advance what their tax position will be and, for that purpose, to rely on the plain meaning of the words of the VAT legislation.

Furthermore, *the Court has consistently held, in consonance with the position generally accepted by Member States in the tax domain, that taxpayers may choose to structure their business so as to limit their tax liability.* In BLP Group, the Court ruled that 'a trader's choice between exempt transactions and taxable transactions may be based on a range of factors, including tax considerations relating to the VAT system'. There is no legal obligation to run a business in such a way as to maximise tax revenue for the State. The basic principle is that of the freedom to opt for the least taxed route to conduct business in order to minimise costs. *On the other hand, such freedom of choice exists only within the scope of the legal possibilities provided for by the VAT regime. The normative goal of the principle of prohibition of abuse within the VAT system is precisely that of defining the realm of choices that the common VAT rules have left open to taxable persons.* Such a definition must take into account the principles of legal certainty and of the protection of taxpayers' legitimate expectations.

By virtue of those principles, *the scope of the Community law interpretative principle prohibiting abuse of the VAT rules must be defined in such a way as not to affect legitimate trade.* Such potential negative impact is, however, prevented if the prohibition of abuse is construed as meaning that *the right claimed by a taxable person is excluded only when the relevant economic activity carried out has no other objective explanation than to create that claim against the tax authorities and recognition of the right would conflict with the purposes and results envisaged by the relevant provisions of the common system of VAT. Economic activity of that kind, even if not unlawful, deserves no protection from the Community law principles of legal certainty and protection of legitimate expectations* because its only likely purpose is that of subverting the aims of the legal system itself.¹⁶

[our extracts and italics]

4.3 Possible ambiguity concerning the identification of the purposes of the tax law

The complexity of the rules and principles of a tax law that apply to an arrangement could cause ambiguity as to the purposes of the law. Consequently, the application of the abusive practice doctrine depends on how the purposes of the law are expressed. The courts must identify these

¹⁶ *Halifax-AG, supra note 14, 84-86.*

purposes and clarify them, if need be, in light of sources of interpretation that are extrinsic to the tax law.

In *Halifax*, the ECJ defined relatively clearly the *Sixth Directive's* neutrality purpose, in light of the opinion of the AG. The ECJ concluded that the taxable person received a tax advantage that was counter to this principle. In its view, the directive seeks to match the amounts of VAT owing and paid by a taxable person according to the nature of his activities:¹⁷

In that connection, it must be borne in mind that the deduction system under the Sixth Directive is meant to relieve the trader entirely of the burden of the VAT payable or paid in the course of all his economic activities. The common system of VAT consequently ensures complete neutrality of taxation of all economic activities, whatever their purpose or results, provided that they are themselves subject in principle to VAT [...]

According to settled case-law, [...] the existence of a direct and immediate link between a particular input transaction and a particular output transaction or transactions giving rise to entitlement to deduct is necessary before the taxable person is entitled to deduct input VAT and in order to determine the extent of such entitlement [...]

To 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.¹⁸

[our extracts]

While satisfying the neutrality principle, taxable persons could still organize their affairs to minimize the impact of the VAT on their business affairs. In particular, taxable persons that supply exempt assets or services could decide to lease goods used in the course of their activities rather than purchase them, to spread the financial impact due to the impossibility of claiming a refund of VAT paid on the purchase of an asset.

To illustrate, in the *Weald* case, the VAT and Duties Tribunal in the United Kingdom had to decide whether the abusive practice doctrine applied regarding leasing and sub-leasing arrangements carried out by corporations making exempt supplies in order to spread out their VAT expenses. The court concluded that these arrangements did not in themselves undermine

¹⁷ See *Halifax*, *supra* note 6, points 74-80, as well as *Halifax-AG*, *ibid.*, points 68-69, 83-91.

¹⁸ See *Halifax-AG*, *ibid.*, points 77-79.

the purposes of the *Sixth Directive*. According to the tribunal, a taxable person can choose to purchase or lease an asset used in the course of his activities. However, the details of the arrangements carried out by taxable persons had to comply with commercial standards and the price of the arrangement had to be consistent with fair market value. The following passages taken from the *Weald* decision illustrate these principles:

While it is clear that a trader is not entitled to credit for input tax attributable to exempt supplies and may not artificially avoid the burden of input tax attributable to such supplies, *we can find nothing in the Directive either expressly or by implication to show that an exempt trader may not defer or spread the burden of input tax by leasing. Leasing by exempt traders has been widespread without any suggestion that it is not legitimate; indeed that was the conclusion of the visiting officer in January 2001 [...]*

[...] Since it is clear that mere leasing by an exempt trader is not contrary to the purpose of the Directive, any abuse arose from leasing at less than market value and from the insertion of Suas as a party to the leases in order to prevent a direction under Schedule 6, paragraph 1. The redefinition required on that basis would be to re-establish the position which would have prevailed if the assets had been leased directly by Weald to CML and CARC at open market value. This of course is substantially different from the basis on which the original, further or protective assessments were based. It would involve allowing the input tax credited to Weald but would make Weald liable to output tax on the basis of open market rents. This in fact would seem to be the same basis as if the assessments had been based on a direction under Schedule 6, paragraph 1, although such a direction could not be given now for most of the periods under appeal because of the 3 year time limit. [...]

If we had concluded that the leases via Suas did constitute an abuse if they were at less than open market value, this would have necessitated evidence as to open market rentals. This might well have given rise to considerable difficulties in particular because it seems unlikely that a third party leasing the assets at arm's length would have agreed to leases which could be terminated at short notice without a penalty unless there was such an element of front loading as to be unattractive to a lessee. It is quite possible that one or the other party would have contended that it would be impossible to lease on such a basis. This would be a matter of evidence. *Any lease from an independent third party would clearly have to be at a rental which gave a commercial rate of return taking account of the capital tied up or the financing costs and the risks involved. It may [well] be that the*

*potential difficulty of such an exercise was a factor in the decision of Customs not to rely in the alternative on the level of rents.*¹⁹

[our extracts and italics]

However, the tax law has purposes other than neutrality that are not obvious from a reading of the tax rules as a whole. It could seek to achieve economic aims for the benefit of consumers. The courts would then have to seek to identify these objectives through these rules or by considering statements of principle formulated in the case-law or by the tax administration at the time of their enactment.

It is worth pointing out that a court in the United Kingdom in the *Nissan* case found in light of ECJ case-law that the *Sixth Directive* intends that the final consumer of a good acquired in the course of a series of arrangements pay an amount of VAT that is directly proportional to the value of the good, determined on the basis of the VAT savings arising from these arrangements. In the case, a company importing vehicles made abroad and subject to VAT in the United Kingdom carried out a series of arrangements by which it minimized the total amount of VAT applicable to arrangements usually allowing the transfer of a vehicle from the manufacturer located abroad to the individual acquiring the vehicle in the United Kingdom. However, the company did not reduce the final sale price for such acquirer. Consequently, the court found, among other things, that the arrangement undermined the purposes of the *Sixth Directive*. The court expressed its decision as follows: “[...] It was equally obviously contrary to the purposes of the Sixth Directive that the tax borne was not directly proportional to the price paid by the final consumer, and that NMGB should itself retain the advantage which it had artificially created.”²⁰

¹⁹ See U.K., *Weald Leasing Limited and Commissioners for HM Revenue & Customs* (February 6, 2007), Decision 20003 (VAT and Duties Tribunal) [*Weald*], points 135-136, 152 and 171, online: Finance and Tax Tribunals Website <<http://www.financeandtaxtribunals.gov.uk/aspx/view.aspx?id=3005>>. The tax administration appealed this decision: U.K., HM Revenue & Customs, Revenue & Customs Brief 39/07, “Weald Leasing Limited” (May 8, 2007), online: HMRC Website <<http://www.hmrc.gov.uk/briefs/vat/brief3907.htm>>. In the case, the court concluded in the alternative that, were its conclusion regarding the harm to the goals of the directive mistaken, the essential goal of the taxable persons in the arrangement was of a tax nature, such that the abusive practice doctrine would have led to the re-qualification of the arrangement in order to withdraw the tax advantages: in particular, see points 148-152 and 171. The tax administration appealed this decision to the High Court (U.K.) for the reason that the court had not applied the abusive practice doctrine correctly as formulated by the ECJ in *Halifax*. The hearing is scheduled for the period from November 27 to 30, 2007. See U.K., HM Revenue & Customs, *VAT Appeals Updates* (updated to June 27, 2007), online: HMRC Website <http://customs.hmrc.gov.uk/channelsPortalWebApp/channelsPortalWebApp.portal?nfpb=true&pageLabel=pageLibrary_TribunalReports&propertyType=document&columns=1&id=HMCE_PROD1_024644>.

²⁰ See *Nissan*, *supra* note 14, point 45. Also see points 17 and 18 of the decision where the court provides a factual illustration of this principle.

In the same vein, the courts could consider various economic factors underlying a Community income tax directive to define the purposes pursued therein. In a case bearing on the application of the Community directive regarding cross-border corporate reorganizations,²¹ the AG expressed the opinion that the directive sought to allow companies to stay abreast of changes in the economic market, become more productive and more competitive by eliminating the tax disadvantages that could otherwise emerge were it not for the directive – such objectives moreover being expressed in the directive’s preamble.²²

4.4 Ambiguity regarding identification of the taxable person’s tax purposes in an arrangement

It may be ambiguous to identify the essential aim of an arrangement without specific parameters for measuring the relative weight of the various purposes of the arrangement.²³

A taxable person could maintain that he could not achieve his business purposes without the arrangement. In his view, the abusive practice doctrine would not apply because the essential aim of the arrangement would be of a non-tax nature.

For its part, the tax administration will try to show that an arrangement violates the tax law by demonstrating its artificial nature according to legal or economic criteria, among others. It could argue that the tax law generally applies on the basis of a direct arrangement between two arm’s length parties, and ignore intermediate arrangements in a series of arrangements carried out to achieve a tax advantage. It would thus show that the essential aim in an arrangement is of a tax nature. The following parameters, identified by the trial court of the United Kingdom in *Halifax*

²¹ *Merger Directive, supra* note 4.

²² See *Kofoed-AG, supra* note 2, points 36 and 48, as well as the preamble to the *Merger Directive, ibid.*: “Whereas mergers, divisions, transfers of assets and exchanges of shares concerning companies of different Member States may be necessary in order to create within the Community conditions analogous to those of an internal market and in order thus to ensure the establishment and effective functioning of the common market; whereas such operations ought not to be hampered by restrictions, disadvantages or distortions arising in particular from the tax provisions of the Member States; whereas to that end it is necessary to introduce with respect to such operations tax rules which are neutral from the point of view of competition, in order to allow enterprises to adapt to the requirements of the common market, to increase their productivity and to improve their competitive strength at the international level”.

²³ The *Sixth Directive, supra* note 4, contains no specific criteria setting out the circumstances in which tax administrations can recover VAT refunds paid to taxable persons whose arrangements have been declared abusive by the courts. Member states can adopt specific rules in this regard provided they satisfy the principles of Community law and the principle of tax neutrality inherent in the directive. See *Halifax, supra* note 6, points 90-92.

before referral of the case to the ECJ, illustrate the preferred approach of the tax administration regarding a series of arrangements between the exempt taxable person, its subsidiaries and taxable contractors:

- The taxable person was the guiding mind behind the arrangements at issue.
- The taxable person provided funding for the arrangements on an interest-free basis.
- The taxable person retained possession of the goods covered by the taxable economic activities throughout and thus directly enjoyed the benefits of these activities.
- The taxable person had direct contractual links with the contractors in the form of warranties.
- None of the taxable person’s subsidiaries had substantial property interests in the goods covered by the taxable economic activities.²⁴ [our adaptation]

The courts may share the tax administration’s view of the artificial nature of an arrangement.²⁵ They could accept an arrangement that would allow the taxable persons to achieve the non-tax aim of the arrangement in the simplest and most direct way, without obtaining the tax advantage.²⁶ From this perspective, the tax administration would gain from issuing a notice of assessment on the basis of an arrangement entered into by arm’s length parties – subject to the inherent difficulties in establishing these details before the courts.²⁷

4.5 Ambiguity as to the relative weight of a taxable person’s tax purposes and that of his other purposes

The use of the adjective “essential” could cover schemes in which taxable persons have both tax and business purposes, with the tax purpose being of primary importance. In *Halifax*, the ECJ accepted the view put forward by the AG that the abusive practice doctrine does not apply

²⁴ *Halifax, ibid.*, points 87-89.

²⁵ *Ibid.*, point 81.

²⁶ The ECJ notes that the trial court seems to be of the view that the sole aim of the arrangements in *Halifax* was the attainment of a tax advantage: see *Halifax, ibid.*, paragraph 82. In *Weald, supra* note 19, the United Kingdom VAT and Duties Tribunal adopted this approach in so far as the abusive practice doctrine applies to the arrangements in dispute in the case: see points 152 and 171 of this decision as well as the summary of the court’s conclusions at the end of its judgement.

²⁷ See *Weald, ibid.*

where a taxable person engages in an economic activity that can have an explanation other than the attainment of tax advantages.²⁸ However, we note that in this case, the opinion of the AG on this specific point is based on the application of the doctrine where the taxable person’s “sole” aim is the attainment of a tax advantage.²⁹

Faced with these ambiguities as to the relative importance of the tax purpose, the Italian Supreme Court submitted a referral to the ECJ to clarify the scope of application of the essential aim criterion. The Supreme Court seems to have questions as to the possibility of applying this doctrine in a situation where a transaction has a number of goals and the tax goal of the taxpayer is the main one or one of the main ones.³⁰ The referral was formulated as follows:

1) Does the concept of abuse of rights, defined in the judgment of the Court of Justice in Case C-255/02 [the *Halifax* case] as *transactions, the essential aim of which is to obtain a tax advantage*, correspond to the definition of transactions carried out for no commercial reasons other than a tax advantage, or is it broader or more restrictive than that definition?³¹

[our extracts]

4.6 Application of the abusive practice doctrine: how to reconcile the tax result of an arrangement with the ambiguity regarding the purposes of the tax law?

According to the decision of the ECJ in *Halifax*, an arrangement becomes an abusive practice only if, in addition to tax advantages being the primary objective, obtaining such advantages in an arrangement is contrary to the purposes of the tax law. Stakeholders may hold differing opinions on the degree of incompatibility between the purposes of the law and the results of an arrangement.

We note that in the view of the AG in *Halifax*, the courts could conclude that there is abusive practice where the result of the tax treatment claimed by the taxable person is to empty the purposes of the tax law of their substance or where the practice is clearly contrary to such

²⁸ *Halifax*, *supra* note 6, point 75.

²⁹ *Halifax-AG*, *supra* note 14, points 87-91 and 102. Also see *Firma-AG*, *supra* note 9, where the same AG reiterated this view in point 17 of his opinion.

³⁰ Marco Rossi, “Italian Supreme Court Asks ECJ to Clarify Abuse of Law Doctrine” (November 24, 2006), 2006 *W.T.D.* 226-2.

³¹ *E.C.J.* Request for Preliminary Ruling, Corte Suprema di Cassazione (October 16, 2006) – Ministero dell’Economia e delle Finanze/Part Service srl, in liquidation, C-425/06, [2006] O.J. L. C 326/59.

purposes. In such circumstances, the expectation of predictability in the application of laws for taxpayers may have to yield to the principle of the integrity of the tax system.³²

We question the possibility that a court can rule that a practice is abusive on the basis of the balance of probabilities. We feel it would be more difficult for the courts to contemplate such a ruling if the tax treatment claimed by the taxpayer is as likely to comply with the purposes of the law as to run counter to them where there is ambiguity as to their scope.³³

4.7 Lack of penalties for under-stating tax payable

Taxable persons who are denied their tax advantages because of the abusive practice doctrine must then pay the taxes they would otherwise have had to pay. However, the under-statement of tax does not give rise to a penalty.³⁴ The ECJ has pointed out that for the purposes of the application of the doctrine, a penalty should not be imposed in the case of an abusive practice where there is no clear and unambiguous legal basis.³⁵ Neither the decision of the ECJ, nor the conclusions of the AG in *Halifax* provide more details as to the circumstances that might justify imposing a penalty arising from the application of the abusive practice doctrine. In our view, this conclusion must be read in the general context of European Community law.

In 1995, the Council of the European Union passed a regulation to protect the financial interests of member states.³⁶ Briefly, under the Regulation, an act committed by an individual or a company to obtain an advantage that is contrary to the objectives of the applicable Community law is likened to an irregularity leading to the withdrawal of the advantage unduly obtained – the withdrawal of such advantage not being likened to a penalty.³⁷ However, the irregularities may entail, in addition to the amount of the withdrawn advantage and interest, administrative penalties including payment of a monetary penalty calculated as a percentage, whether the

³² See *Halifax-AG*, *supra* note 14, points 68-69, 71, 74-79, 83-91.

³³ From a reading of the *Halifax* decision, *supra* note 6, the ECJ did not rule on the application of a test based on the balance of probabilities or based on patently unreasonable nature. For his part, the AG did not take a position on the possibility that the degree of incompatibility between obtaining tax advantages and the purposes of the tax law is established on the basis of the balance of probabilities.

³⁴ *Ibid.*, point 92.

³⁵ *Ibid.*, point 93.

³⁶ EC/EA Regulations, Council Regulation No 2988/95 of December 18, 1995, on the protection of the European Communities' financial interests, [1995] O.J. L. 312/1 [Regulation].

³⁷ *Ibid.*, article 4.

irregularities are intentional or not or are due to negligence.³⁸ No administrative penalty may be imposed unless a Community act has made provision for it prior to the irregularities.³⁹

According to the Regulation, the Community may introduce administrative penalties in so far as they are necessary to ensure proper application of Community law. Accordingly, an administrative penalty must be effective, proportionate and dissuasive so that it provides adequate protection for the Community's interests.⁴⁰ To do so, a penalty must take into consideration the advantage obtained, the nature and seriousness of the irregularity as well as the degree of responsibility of the persons who participated in it.⁴¹

Where a Community act stipulates the imposition of a penalty, the ECJ determines whether it satisfies the principles mentioned above as well as the legal principles recognized by European Community law that are not explicitly or implicitly mentioned in the Regulation. These principles include the foresight principle in the enforcement of tax rules.

Under the foresight principle, persons must be able to reasonably determine the criteria that define the acts covered by a given penalty and the consequences they entail. A penalty formulated according to objective criteria and in clear, precise terms would minimize its arbitrary nature.⁴²

To minimize the arbitrary nature of a penalty, member states could set objective guidelines while granting a degree of discretionary power to the entity charged with applying them. Such discretionary power could be granted for the sake of flexibility in view of changing circumstances

³⁸ *Ibid.*, article 5.

³⁹ *Ibid.*, article 2, section 2.

⁴⁰ *Ibid.*, article 2.

⁴¹ *Ibid.*, article 2, section 3 and article 7.

⁴² Some judgements reached by the ECJ in other fields of law provide an illustration of a penalty stipulated by various Community legal acts and that can be likened to a clear and precise legal basis: see *E.C.J. Judgement, Koninklijke Coöpratie Cosun UA v. Minister van Landbouw, Natuur en Voedselkwaliteit*, C-284/04, [2006] E.C.R. I-10211, [2006] O.J. L. C 326/4, which provides an illustration of the principles of legal security that apply regarding a penalty for the off-quota production of sugar in the sugar sector within the European Community; *E.C.J. Judgement, ED & F Man Sugar Ltd v. Hauptzollamt Hamburg-Jonas*, C-274/04, [2006] E.C.R. I-03269, [2006] O.J. L. C 143/10, bearing on the scope of an act covered by a penalty stipulated by a farm products export regulation; *E.C.J. Judgement, Emsland-Stärke GmbH v. Landwirtschaftskammer Hannover*, C-94/05, [2006] E.C.R. I-02619, [2006] O.J. L. C 131/35, concerning a monetary penalty stipulated by a Community rule dealing, among other things, with compensation payments made to potato producers.

to be taken into consideration to achieve the aims of a Community directive, as well as for the sake of fairness, to adjust the penalty according to the circumstances of each person subject to it. Accordingly, the amount of a penalty could be determined using a pre-established formula that provides a sufficient degree of predictability for persons who may risk being subject to it while avoiding a situation where they can estimate the opportunity cost of committing an act covered by the penalty.⁴³

Thus, in light of the Regulation and the foresight principle, a tax administration may impose a penalty for under-statement of tax payable only if a Community directive states clearly, precisely and unambiguously the criteria of such penalty arising from the application of the abusive practice doctrine, as well as its consequences. Lastly, in light of the principles developed by case-law, a penalty associated with the application of the abusive practice doctrine can satisfy the proportionality principle in so far as:

- Current financial consequences for taxable persons and penalties have no dissuasive effect on the latter in achieving the purposes of the law.
- A monetary penalty becomes necessary to ensure the integrity of the tax system, the amount of which does not exceed what is strictly necessary for it to be dissuasive.
- The penalty is determined using objective criteria, according to a percentage of the value of the withdrawn tax advantages.
- A penalty that ignores the good faith of the taxable person is justified only where the latter is fully responsible for reporting the information supporting the advantages he claims. In this situation, the taxable person must take appropriate control measures or come to terms with the advisers providing him with such information, on monetary indemnities in the event the tax advantages are withdrawn.

⁴³ See *E.C.J. Judgement, Britannia Alloys & Chemicals Ltd v. Commission of the European Communities* (June 7, 2007), C-76/06P [*Britannia*] and *E.C.J. Conclusions, Advocate General Yves Bot* (March 1, 2007), *Britannia Alloys & Chemicals Ltd v. Commission of the European Communities* (June 7, 2007), C-76/06P [*Britannia-AG*], points 121-152.

- The penalty is proportionate to the amount of the withdrawn tax advantage or to the weight of the taxable person's tax purpose in an arrangement. The amount of the penalty may be greater for an arrangement where the taxable person's sole purpose is to obtain a tax advantage.
- Taxable persons may avoid a penalty by relying on the principle of fairness where tax advantages are obtained in a way that is counter to the abusive practice doctrine as a result of abnormal and unforeseeable consequences that lie beyond usual business risks and outside the control of a prudent and diligent person under the same circumstances.⁴⁴

4.8. According to the rules of evidence and of procedure of member states, taxable persons could bear the burden of proof that the abusive practice doctrine does not apply to their arrangements

According to the ECJ decision in *Halifax*, national courts must determine whether the abusive practice doctrine applies to the facts of a given arrangement according to the rules of evidence of national tax law, in so far as these rules do not undermine the effectiveness of Community law.⁴⁵ However, in that decision, the ECJ provides no further details as to the division of the burden of proof between the taxable person and the tax administration. Nonetheless, under a self-assessment system, taxable persons may bear the burden of proving that the two components of the doctrine do not apply, contrary to the conclusions of the tax administration. In that regard, in a decision on the application of the abusive practice doctrine, the United Kingdom VAT and Duties Tribunal expressed the opinion that and the taxpayer must establish the evidence to cancel the tax administration's notice of assessment: the tax administration might nevertheless have to assume at a minimum the burden of establishing *prima facie* evidence of the presence of the two component criteria of this doctrine⁴⁶

⁴⁴ The authors formulated this illustration based on *E.C.J. Judgement, Käserei Champignon Hofmeister GmbH & Co. KG v. Hauptzollamt Hamburg-Jonas*, C-210/00, [2002] Re. E.C. I-06453, [2002] O.J. L. C 233/8 in which the ECJ ruled on the proportionate nature of a monetary penalty stipulated in the application rules of the system of export refunds on agricultural products.

⁴⁵ See *Halifax*, *supra* note 6, point 76.

⁴⁶ See *Nissan*, *supra* note 14, points 31-32.

Conclusion

The abusive practice doctrine is an important tool for the tax administration in managing the inherent risks in aggressive tax planning schemes, but does not by itself offer a complete solution to all of these issues. The doctrine illustrates the usefulness of a general anti-avoidance rule to reconcile the taxpayers' privilege of organizing their affairs with the protection of the tax system's integrity. The approach taken by the ECJ could provide ideas for adjustments to the GAAR in Canada, considering that both the abusive practice doctrine and the GAAR require the determination:

- of the purposes of the tax law;
- of the compliance of the arrangements with these purposes;
- of the taxable person's purposes; and
- of the arrangements that would have to be substituted for those carried out by a taxable person in a given situation.

In our view, the ECJ's approach in applying the abusive practice doctrine by first identifying the purposes of the tax law helps bring into sharper focus the relative importance of the various purposes of a taxable person in an arrangement. The prior identification of the purposes of the tax law appears to make it easier to identify an alternative arrangement for determining whether the taxable person's arrangement is one whose essential aim is to obtain a tax advantage. The purposes of the tax law must emerge clearly from the law, either in specific provisions or in an explanatory preamble. The courts play an important role in identifying these purposes.

In so far as the taxable person bears the burden of claiming the cancellation of the national tax administration's notice of assessment, he must bear a burden of proof that appears more exacting under the abusive practice doctrine than under the GAAR in Canada. In particular, the requirement that a taxable person demonstrate that an arrangement complies with the purposes of the tax law and that he has a legitimate purpose could provide greater protection for the integrity of the tax system. On the other hand, this requirement does not deprive taxable persons of the privilege of organizing their affairs to minimize their tax payable.

In principle, the taxable person's burden of proof is heavier under the abusive practice doctrine than under the GAAR in Canada concerning the relative importance of the non-tax purposes of an arrangement. Under the abusive practice doctrine, the taxable person must objectively establish that the non-tax purpose he was trying to achieve in an arrangement was the essential aim. The adjective "essential" appears to require that the importance of the non-tax purpose must be greater in an arrangement compared to the qualifier "main purpose" or "one of the main purposes". The ECJ will have to clarify the scope of the "essential" aim criterion.

Like the GAAR in Canada, measuring the relative weight of the various purposes of an arrangement raises difficulties in applying the abusive practice doctrine. Under this doctrine, the courts will examine an arrangement from a legal or economic perspective to identify whether a tax avoidance arrangement is present. Such criteria are already taken into consideration to various degrees by the courts in Canada in applying the GAAR. Parameters expressed by the courts in general terms are flexible, but create uncertainty over the qualification of the essential aim if, among other things, these indicators are not expressed in an objective, precise and consistent way throughout the tax rules.

For taxable persons, application of this doctrine to arrangements that have both tax and business purposes carries the risk that the tax administration and the courts could assign an arbitrary weight to the predominance of a tax purpose. Identification of the essential aim of an arrangement based on an objective analysis mitigates the possibility of an arbitrary evaluation of the relative weight of these purposes by all stakeholders. An examination of the simplest and most direct way to carry out the arrangement that taxable persons at arm's length would normally use would facilitate this approach.

It is normal that the ultimate responsibility for specifying the purposes of the tax law and the features of arrangements that comply with it lies with the tax administration rather than the courts. The tax administration could take the position that the tax law is established regarding a direct arrangement between two parties, in light of business standards recognized at the time a taxable person carries out an arrangement. Such an approach would help reconcile the principles of foresight, flexibility and simplicity in the application of the tax system. In so far as the tax administration assumes a *prima facie* burden of proof of the components of an abusive

practice, taxable persons should then file the necessary information in their information return to enable the tax administration to target arrangements with a high risk of tax avoidance. That way, the tax administration could more effectively distinguish tax avoidance arrangements from those that satisfy the criteria of arrangements carried out by taxable persons at arm's length.

In our view, the uncertainty surrounding the purposes of the tax law and the application of the abusive practice doctrine are not an obstacle to member states' eventually adopting a monetary penalty where this doctrine applies, in so far as such penalty is proportionate to the action the taxable person is accused of and is adopted by member states in a clear and unambiguous way. Member states will have to decide on the necessity of stipulating, in a Community directive, a penalty for under-statement of the tax payable determined according to the weight of the tax purpose in an arrangement, or the degree of incompatibility between the tax advantages claimed and the purposes of such directive.

In addition to the abusive practice doctrine, member states could pass specific anti-avoidance rules or a general rule within the limits allowed by a Community directive.⁴⁷ Member states should set sufficiently precise, objective, and flexible parameters to delimit situations where taxable persons carry out tax avoidance arrangements.⁴⁸ According to decisions of the ECJ, the anti-avoidance rules adopted by member states may undermine the privilege of taxable persons and taxpayers of organizing their affairs in such a way as to minimize their tax. However, the undermining of the privilege of taxable persons and taxpayers must be proportionate to the object of the tax law.⁴⁹ Again according to the ECJ, the tools developed by tax administrations must not in practice prevent taxable persons and taxpayers from carrying out genuine economic activities in the member state of their choice in a context of mobility of businesses, to the degree that they make a permanent contribution to the economic health of such member state.⁵⁰

⁴⁷ *Halifax*, *supra* note 6, point 81 as well as *Halifax-AG*, *supra* note 14 points 83-91.

⁴⁸ See *E.C.J. Judgement, Cadbury Schweppes plc, Cadbury Schweppes Overseas Ltd v. Commissioners of Inland Revenue*, C-196/04, [2006] E.C.R. I-07995 [*Cadbury*], point 46. Also see *E.C.J. Opinion, Advocate General Philippe Léger (May 2, 2006), Cadbury Schweppes plc, Cadbury Schweppes Overseas Ltd v. Commissioners of Inland Revenue* (September 12, 2006), C-196/04, [2006] E.C.R. I-07995, [2006] O.J. L. C 281/5 [*Cadbury-AG*], point 92.

⁴⁹ See *Cadbury*, *ibid.*, as well as *Cadbury-AG*, *ibid.*, points 85-151.

⁵⁰ See *Cadbury*, *ibid.*, as well as *Cadbury-AG*, *ibid.*, points 111-114, 117-119, 126-143.

Bibliography

Legislation and regulation

EC *Directives*, Council Directive 90/434/EEC, July 23, 1990, concerning the common tax system applicable to mergers, divisions, transfers of assets and exchanges of shares concerning companies of different Member States, [1995] O.J. L. 225/1.

EC *Directives*, Council Directive 2006/12/112/EC, November 28, 2006 on the common value added tax system, [2006] O.J. L. L 347/1.

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

EC/EA *Regulations*, Council Regulation No 2988/95 of December 18, 1995, on the protection of the European Communities' financial interests, [1995] O.J. L. 312/1.

Case law

Court of Justice of the European Communities

E.C.J. Judgement, *Britannia Alloys & Chemicals Ltd v. Commission of the European Communities* (June 7, 2007), C-76/06P.

E.C.J. Judgement, *Cadbury Schweppes plc, Cadbury Schweppes Overseas Ltd v. Commissioners of Inland Revenue*, C-196/04. [2006] E.C.R. I-07995.

E.C.J. Judgement, *Commission of the European Communities v. Hellenic Republic* (June 21, 2007), C-178/05.

E.C.J. Judgement, *ED & F Man Sugar Ltd v. Hauptzollamt Hamburg-Jonas*, C-274/04, [2006] E.C.R. I-03269, [2006] O.J. L. C 143/10.

E.C.J. Judgement, *Emsland-Stärke GmbH v. Landwirtschaftskammer Hannover*, C-94/05, [2006] E.C.R. I-02619, [2006] O.J. L. C 131/35.

E.C.J. Judgement, *Halifax, plc, Leeds Permanent Development Services Ltd, County Wide Property Development Ltd. v. Commissioners of Customs & Excise*, C-255/02, [2006] E.C.R. I-01609, [2006] O.J. L. C 131/1.

E.C.J. Judgement, *Hans Markus Kofoed v. Skatteministeriet* (July 5, 2007), C-321/05.

E.C.J. Judgement, *Käserei Champignon Hofmeister GmbH & Co. KG v. Hauptzollamt Hamburg-Jonas*, C-210/00, [2002] E.C.R. I-06453, [2002] O.J. L. C 233/8.

E.C.J. Judgement, Koninklijke Coöpratie Cosun UA v. Minister van Landbouw, Natuur en Voedselkwaliteit, C-284/04. [2006] E.C.R. I-10211, [2006] O.J. L. C 326/4.

E.C.J. Judgement, Marks & Spencer plc v. David Hasley (Her Majesty's Inspector of Taxes), C-446/03, [2005] E.C.R. I-10837, [2005] O.J. L. C 36/5.

E.C.J. Opinion, Advocate General Yves Bot (March 1, 2007), Britannia Alloys & Chemicals Ltd v. Commission of the European Communities (June 7, 2007), C-76/06P.

E.C.J. Opinion, Advocate General Juliane Kokott (February 8, 2007), Hans Markus Kofoed v. Skatteministeriet (July 5, 2007), C-321/05.

E.C.J. Opinion, Advocate General Poiares Maduro (June 21, 2007), Firma Ing. Auer – Die Bausoftware GmbH v. Finanzamt Freistadt Rohrbach Urfahr, C-251/06, application for preliminary ruling published in [2006] O.J. L. C 212/13, adjourned to July 10, 2007.

E.C.J. Opinion, Advocate General Poiares Maduro (April 7, 2005), Halifax, plc, Leeds Permanent Development Services Ltd., County Wide Property Development Ltd v. Commissioners of Customs & Excise, C-255/02, [2006] E.C.R. I-01609, [2006] O.J. L. C 131/1.

E.C.J. Opinion, Advocate General Poiares Maduro (April 7, 2005), Marks & Spencer plc c. David Hasley (Her Majesty's Inspector of Taxes), C-446/03, [2005] E.C.R. I-10837, [2005] O.J. L. C 36/5.

E.C.J. Opinion, Advocate General Philippe Léger (May 2, 2006), Cadbury Schweppes plc, Cadbury Schweppes Overseas Ltd v. Commissioners of Inland Revenue (September 12, 2006), C-196/04, [2006] E.C.R. I-07995, [2006] O.J. L. C 281/5.

E.C.J. Application for preliminary ruling, Corte Suprema di Cassazione (October 16, 2006) – Ministero dell'Economia e delle Finanze/Part Service srl, in liquidation, C-425/06, [2006] O.J. L. C 326/59.

United Kingdom

U.K., *Nissan Motor Manufacturing (UK) Limited and The Commissioners for Her Majesty's Revenue and Customs* (March 1, 2007), Decision CO00236 (VAT and Duties Tribunal), online: Finance and Tax Tribunals Website
<<http://www.financeandtaxtribunals.gov.uk/asp/view.aspx?id=2991>>.

U.K., *Weald Leasing Limited and Commissioners for HM Revenue & Customs* (February 6, 2007), Decision 20003 (VAT and Duties Tribunal), online: Finance and Tax Tribunals Website
<<http://www.financeandtaxtribunals.gov.uk/asp/view.aspx?id=3005>>.

Doctrine

Government publications

U.K., HM Revenue & Customs, Business Brief BB 2/06, (February 27, 2006), online: HMRC Website
<http://customs.hmrc.gov.uk/channelsPortalWebApp/channelsPortalWebApp.portal?_nfpb=true&_pageLabel=pageLibrary_GuidesAndBusinessBriefs&propertyType=document&columns=1&id=HMCE_PROD1_025280>.

U.K., HM Revenue & Customs, Revenue & Customs Brief 30/07, “Outcome of Halifax Case” (March 28, 2007), online: HMRC Website <<http://www.hmrc.gov.uk/briefs/vat/brief3007.htm>>.

U.K., HM Revenue & Customs, Revenue & Customs Brief 39/07, “Weald Leasing Limited” (May 8, 2007), online: HMRC Website <<http://www.hmrc.gov.uk/briefs/vat/brief3907.htm>>.

E.U., Taxation and Customs Union Directorate-General, online: <http://ec.europa.eu/taxation_customs/taxation/gen_info/tax_policy/index_en.htm>.

E.U., Taxation and Customs Union Directorate-General, key document “VAT: Clearer overview of Community VAT legislation currently in force”, online: <http://ec.europa.eu/taxation_customs/taxation/vat/key_documents/legislation_recently_adopted/index_en.htm>.

Periodicals, conferences, symposiums and reviews

Ernst & Young Tax Services, “VAT Planning under the Microscope – ECJ Rules on VAT Avoidance Cases” (February 22, 2006), *Ernst & Young Tax Alert* VAT 01-06, online: Ernst & Young Website
<[http://www.ey.com/global/download.nsf/Ireland/VAT_Planning_under_the_Microscope_-_ECJ_Rules_on_VAT_Avoidance_Cases/\\$file/VAT%2001-06.pdf](http://www.ey.com/global/download.nsf/Ireland/VAT_Planning_under_the_Microscope_-_ECJ_Rules_on_VAT_Avoidance_Cases/$file/VAT%2001-06.pdf)>.

Gnaedinger, Chuck. “Hartnett Reviews U.K. Compliance Initiatives” (February 2, 2007), 2007 *W.T.D.* 23-6.

Van den Hurk, Hans et al. “EU Tax Review” (March 5, 2007) *Tax Notes Int’l* 875.

Manchia, Amy and Nias, Peter M.W. “EU Anti-Avoidance Principle-Indirect Tax” (March 20, 2006), *McDermott Newsletters*, online: McDermott Will & Emery Website
<http://www.mwe.com/index.cfm/fuseaction/publications.nldetail/object_id/1577e235-964a-4fef-8228-85db7db58a98.cfm>.

Maxwell, Robin et al. “VAT: ECJ Rules on VAT Avoidance” (2006) 17:6 *Journal of International Taxation* 11.

Rossi, Marco. “Italian Supreme Court Asks ECJ to Clarify Abuse of Law Doctrine” (November 24, 2006), 2006 *W.T.D.* 226-2.

Venables, Robert. “Abuse of Rights in EC Law” (October 2003) *Tax Adviser* 16, online: Chartered Institute of Taxation Website
<<http://www.tax.org.uk/attach.pl/1995/851/venables.pdf>>.

Sheppard, Lee A. “How Europe Stays in the Trouble It Is In” (March 19, 2007) *Tax Notes Int’l* 1040.

Other

U.K., HM Revenue & Customs, online: HMRC Website <www.hmrc.gov.uk>.

E.U., Court of Justice of the European Communities, online: ECJ Website <www.curia.europa.eu>.