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[2023] 149 taxmann.com 353 (Article)

From Doctrine to Principle: CJEU's Impact on EU Law Abuse

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1. Introduction

This paper will primarily deal with the effects of the CJEU judgements which held that the 'prohibition of abuse of EU law' is a 'general principle of EU law'. This general principle extends to both the primary and the secondary EU law. This paper also analyses key judgements made by the CJEU and how the concept of abuse of law has been transformed from a doctrine to a general principle of EU law. On the one hand, the taxpayers can set up their businesses in such a way that their tax burden is minimized i.e. the choice of the least taxed road. On the other hand, the right to utilize the internal market does not protect the taxpayer who attempts to pay less tax by artificially falling within the scope of the basic freedoms or secondary EU legislation. People who rely on EU legislation in an incorrect way are not protected by it. In other words, the prohibition of abuse is interpreted as meaning that the right or benefit offered by EU law and claimed by a taxpayer is excluded only when the relevant economic activity carried out has no other objective explanation than to artificially create such a right and recognition of that right would have a negative impact on legitimate trade[1]. Thus, the member states are free to enact measures that restrict the protection of the benefits obtained subject to the proportionality and necessity assessment.

2. Timeline

The abuse of the EU law doctrine was first coined in the case of *Emsland-Stärke*[2] which was related to agricultural levies, a two-prong test of abuse was developed in the above case. The test requires an objective and a subjective element to assess whether there is abusive behaviour. The objective test necessitates objective circumstances in which it seems that the intended goal of EU legislation has not been met notwithstanding strict adherence to the language of the law[3]. The subjective test requires that the ultimate intention of the arrangement set in place by the economic operator is to obtain the advantage from the EU rules, which can be deduced from the artificiality of the arrangement and evaluated in light of objective factors[4]. In other words, a combination of objective and subjective circumstances helps to establish that an economic operator intends to obtain a benefit under the EU law by setting up an artificial arrangement that observes the letter of EU law and not the spirit if that benefit is granted.[5]

Further, in the *Halifax*[6] case, the CJEU ruled about the abuse of EU law in a VAT case and also applied a test similar to the two-prong test of the *Emsland-Stärke* case. In the above case the court held that, in the case of VAT, it appears that an abusive practice exists only if, first, the transactions in question result in the accrual of a tax advantage that would be contrary to the purpose of the relevant provisions of the Sixth Directive and the national legislation transposing it, despite the formal fulfillment of the conditions laid down by the relevant provisions of the Sixth Directive and the national legislation transposing it. Second, a number of objective criteria must indicate that the primary goal of the transactions in question is to get a tax benefit. Also, if the economic activity has purposes other than just obtaining tax advantage then the prohibition of abuse is not relevant.[7]

Later the ECJ applied the principles of the two-prong test to the case of *Cadbury Schweppes*,[8] which relates to direct taxation. The court held that taxation of profits of a subsidiary resident in another Member State by a resident parent company, where those profits are subject to a lower level of taxation in the other Member State than in the parent's Member State, constitutes a restriction on the freedom of establishment unless it is applied only to wholly artificial arrangements intended to avoid the normally due national tax. Even though tax reasons played a part in its formation, a wholly artificial arrangement does not exist when a subsidiary engages in actual economic activity in the host Member State[9]. Through this decision, the CJEU indicated that it is willing to apply a unified definition of abuse to various areas of tax law.[10]

A distinct judgement was made by the CJEU in the case of *Kofoed*[11] where the court held that the applicability of EC law cannot be extended to transactions entered into purely to improperly receive EC law benefits. A Member State doesn't have to convert Article 11(1)(a) of the Merger Directive, an optional anti-abuse provision, into a particular legislative provision in order to deny the Directive's advantages. It suffices if its domestic law contains a general principle prohibiting abuse of rights or other provisions on tax evasion or tax avoidance that could be interpreted in accordance with the Merger Directive, as long as such principles or provisions are applied and interpreted in accordance with EC law, particularly the Directive's wording and objectives.[12]

However, in the recent Danish cases,[13] the CJEU held that even if there are no domestic or agreement-based provisions providing for refusal of benefits of the EU law, national authorities and courts must refuse a taxpayer the exemption from withholding tax on profits distributed by a subsidiary to its parent company, as provided for under the Parent-Subsidiary Directive, where there is a fraudulent or abusive practice. This means that the earlier position taken by the CJEU in the case of *Kofoed,* that a directive cannot be directly applied to disadvantage of a taxpayer has been overruled. Thus, the member states have a duty to deny the benefits of the primary as well as secondary EU law even in the absence of the national anti-abuse measures.

Also, a mix of objective conditions and a subjective aspect is required to prove an abusive practice.[14]

3. Prohibition of abuse of EU law is a general principle of EU law?

It is critical to comprehend the idea of 'general principles of EU law' and its ramifications. General principles of EU law are fundamental propositions of law from which concrete rules derive, and their function is essentially threefold, first, a gap-filling function to ensure, through the ECJ the autonomy and coherence of the EU legal system, second, an aid to interpretation of EU law and national law falling within the scope of EU law, and third, a basis for judicial review of the legality of secondary EU law and the compatibility of national law with EU law[15]. Although, there is no comprehensive doctrinal consensus on

what defines a general principle of EU law, the key features commonly attached to them, namely generality, weight, and non-conclusiveness, are all present in the CJEU's reasoning on the prohibition of abuse of law principle.[16]

When applied to tax law, if prohibition of abuse is considered as a general principle of EU law it might suggest that the Member States would be bound by such a concept and, as a result, would be obligated to prevent EU law misuse even if they lacked the legal authority to do so under their national laws.

Although various arguments have been made that prevention of abuse is not a general principle of EU law, the main arguments are as follows: first, it is argued that the principle is inconsistently applied by the Court, in response to which it has been opined that uniformity of application is not one of the features of a general principle of law[17]. The second argument is the risk of describing the prohibition of abuse as a universal principle is that it would undermine the general concept of legal certainty, but there is always a need to strike a balance between different principles which form part of community law[18]. Blind adherence to legal certainty and strict adherence to the letter of the law will result in unfairness and threaten the concept of 'legal congruence.' This is especially true when it comes to EU legislation.[19]

Although, there has been some ambiguity in the terminology being used by the court regarding that whether tax-saving intention should be sole or main or principal or predominant, these terms should not be interpreted very harshly as they have been used interchangeably by the CJEU in its case law and by the EC in its directives.[20]

It is reasonable to conclude from the above analysis of the CJEU case laws that the prohibition of abuse is a general principle of EU law and in the next section, the effects of such a conclusion will be discussed.

4. Effects of prohibition of abuse as a general principle of EU law

Firstly, from the *Danish*[21] cases, it can be observed that the general principle of law applies irrespective of whether the directive has been transposed into the domestic law of the member state, it is to be a source of primary law in its own right. Also, the general principle is also applicable to the primary EU laws as well along with the secondary EU law.

In other words, the member state should not necessarily enact anti-abuse measures where the primary EU law is relied upon to circumvent the unfavourable domestic tax law and where the tax benefits are claimed as per the directives.[22]

Secondly, as a result, the new General Anti-Avoidance Rule (GAAR), enshrined in Article 6 of the Anti-Tax Avoidance Directive, must be seen as just a partial formulation of the general principle of prohibition of abuse as applied to taxes[23]. Since, the general principle of prohibition of abuse stands as a primary EU law the GAAR (being secondary EU law) should be in line with the idea of abuse laid down by the CJEU.[24]

It is very well known that in a third country situation only the freedom of free movement of capital is applicable out of all the fundamental freedoms. Article 63 read along with Article 64 of the TFEU precludes any domestic measure which harms the free movement of capital between the EU and a third country; the freedom of capital movement protects the investment made through direct mode i.e. controlling shareholding and it equally protects the portfolio investments[25]. Further, the concept of abuse is to understood in a wider sense to include not just wholly artificial arrangements (as defined in *Cadbury*

Schweppes) but also artificial transfer of profits to low/no tax jurisdictions.[26]

Further, measures that discourage the residents of Member States from making investments in third states are prohibited by Article 63 of the TFEU. On the one hand, the national legislation is to be tested for the justification i.e. the rule of reason and it should be scrutinized under the necessity and the proportionality assessment by the court in order to determine the abuse (case by case assessment) and predetermined criteria should not be followed for such determination[27]. On the other hand, if an exchange of information is not possible with the third country or the tax authorities cannot verify the information required to give a relief to the taxpayer then a non-proportional anti-avoidance rule is also justified and acceptable.[28]

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145

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