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Anti-tax-avoidance Measures and Their Compliance with Community Law

How to treat taxpayers' transactions may differ according to whether, in applying tax norms, the tax administrator is directly guided by the institute in private law, or whether the existence of a taxable event becomes clear only after interpretation of the legal relationship. In the first case, there is no room for interpretation of the tax-related circumstances and the tax is levied directly by subsuming the facts of the transaction in compliance with the applicable tax norm. However, in many cases interpretation is necessary because no law can foresee all of the taxable situations and a casuistic tax law would allow easy avoidance of the realisation of the taxable event, e.g., through use of a wording that rules out the existence of any tax events described by said law. In order to apply an abstract norm, by contrast, one must be able to interpret it.

In applying tax norms, one must take into account the peculiarity of tax law, which does not proceed from the definitions and principles of other fields of law. If a transaction by a taxpayer is of a form that precludes, for example, the application of a taxable norm on the basis of grammatical interpretation, then the taxation shall still be based on the economic substance and result of the transaction. Tax avoidance purports to avoid the realisation of a tax norm or tax liability; thereby, the taxpayer benefits by having to pay less tax. Interpretation should enable a different assessment of the legal relationship, one aimed at a more favourable taxation regime. The rules of interpretation should be understood as measures that justify a tax authority's invasion of a taxpayer's private autonomy. States can be differentiated in their types of anti-tax-avoidance regulation.

As to their content and applicability, general anti-avoidance measures differ, depending on whether one proceeds from the provisions adopted by the legislator, which are of a general nature and can be used in the majority of cases, or from the rules (doctrines) that have evolved in judicial practice. In the first case, tax liability is determined on the basis of the criteria laid down in the legal norm, which enable assessment of a transaction under tax law. Examples of this approach can be found in the provisions of German, Austrian, Belgian, Spanish, Swedish, and Finnish tax laws. On the other hand, one can also see plenty of rules of interpretation that have evolved from judicial practice. In practice, principles have been developed over time to aid in interpreting the transactions of taxpayers. Such principles are used, for example, by the tax authorities and courts of the UK, the Netherlands, France, and Norway in determining tax liability.

The question, however, is whether a tax administrator needs special authorisation from the legislator in order to determine the existence of a taxable event with respect to transactions of taxpayers, which authorisation should also be proportionate in its accounting for the interests of the taxpayer while at the same time ensuring equal and uniform taxation. The author will analyse the measures employed by different states in order to prevent tax avoidance, how those measures have developed, and whether they comply with the stances adopted by the European Court of Justice.

1. Measures to prevent tax avoidance

1.1. Bases for the general measure

In most cases, tax avoidance measures have their beginnings in the *fraus legis* principle from Roman law. According to this, a person cannot rely on recourse to the law when he in bad faith aspires to gain benefit from the exercise of his subjective right. This principle, transposed from private law, has been successfully applied in developing measures to prevent tax avoidance, both in the form of a provision of law and as a doctrine evolving in judicial practice. Exceptions are Belgium and Italy, both of whom maintain that the concept of *fraus legis* is applicable only in civil law and not in tax matters.[*1] This principle means that exercise of rights arising from contract and law is always deemed abuse of the law where such rights are exercised contrary to the principle of good faith. This means that a court shall not, in a concrete case of *mala fide* tax behaviour, apply the provisions of the law or the contract concerned.[*2] Common-law countries, not influenced by Roman law, approach this issue a bit differently although possessing the principles of interpretation developed by the courts.

The principle of interpretation according to the substance of the transaction is widely used in examining the taxpayer's behaviour where tax avoidance is suspected. The substance is understood as the economic characteristics and results of a transaction, which are to be approached differently from the legal form of the transaction. The principles of uniformity and solvency are realised through the rule of economic interpretation.[*3] The tax administrator is required to treat all taxpayers equally in taxable situations; therefore, taxes cannot be avoided merely by taking advantage of formative options possible in civil law. The concept of proceeding from the economic substance points to a need to clarify whether the conditions agreed upon by the parties have been realised in that particular legal relationship, so that the type of the taxable event can be determined. The main expression of such a method of interpretation lies in detailed description of the essential circumstances in order to identify the characteristics of a sham transaction or an incorrect legal form that the taxpayer used to avoid taxes.[*4]

The general anti-avoidance rule is used by the legislator to express the intent to preclude manipulation of the tax incentives set out in law. The measure creates standards to be considered in interpreting transactions under tax law, which enable examining the compliance of a transaction in view of the meaning of the norm. Doctrines and legal norms undertake to limit tax avoidance in situations where such avoidance cannot be prevented by a special provision. In application of the measures, two important similarities can be observed:

1. the test of the business purpose; and
2. teleological interpretation of a tax norm in order to distinguish a forbidden transaction from one that is allowed.

The courts dealing with tax avoidance cases must be capable of coming to the right conclusions in order to recognise forbidden behaviour wherein the actors just proceed to realise the wording of the law, ignoring its spirit.[*5] The courts need to render their opinion as to the intent of the legislator and to form conclusions as to whether or not the taxpayer meets the conditions entitling him to the right. The general measure enables precluding a situation where a more beneficial tax regime is applied to transactions entered into with improper intent.

The test of purpose or the determination of the business goal of the taxpayer's actions refers to the desired results of the transaction, as, in principle, it is possible for the same economic result to be achieved with several legal forms.[*6] This may be referred to as a subjective element that attempts to identify the taxpayer's intentions in his tax planning activity. If a transaction carries no business goal, one may conclude that the form assigned to the transaction is incorrect and that characteristics of abuse of the law are present. Lack of a business goal is also seen with transactions that may bring about an economic result but in whose execution the tax aspects were the primary focus. Such an approach carries greater weight in those cases where a taxpayer wishes to choose between modes of actions that have different tax implications. To a certain extent, it is allowed to plan taxes, and therefore the tax administrator's activity might be seen as arbitrary if they treat a taxpayer's preference for a milder tax regime as automatically constituting tax avoidance on the taxpayer's part.

After identifying the business goals, the tax administrator is tasked with contrasting the result against the spirit of the tax norm. Tax avoidance should be understood as activity that abuses the rights set forth in the tax law.

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[1] F. Zimmer. – Form and substance in tax law. Studies on International Fiscal Law by the International Fiscal Association. Volume LXXXVIIa. Subject I. F. Zimmer (ed.). Haag: Kluwer 2002, pp. 41–42.

[2] P. Varul, I. Kull jt. Võlaõigusseadus I. Kommenteeritud väljaanne (Law of Obligations I. Commented edition). Tallinn 2006, p. 31, comment 4.3 (in Estonian).

[3] L. Lehis. Maksuõigus (Tax Law). Tallinn 2004, p. 63 (in Estonian).

[4] F. Zimmer (Note 1), p. 24.

[5] T. Edgar. Building a Better GAAR. – Virginia Tax Review 2006 (27) 833, p. 875.

[6] V. Thuronyi. Tax Law Design and Drafting. International Monetary Fund 1996, p. 51.

In interpretation of the norm, it should be clarified whether the result achieved by the concrete transaction is in compliance with the intent of the legislator. If there are several options, the administrator must evaluate whether the transaction has artificially been adjusted to fit the taxation scheme, with the substance of said transaction being more in line with the characteristics of another type of transaction.*[7] General measures help the tax administrator in preventing tax avoidance, subject to application in cases where the employment of a form under civil law hinders just taxation.

1.2. Differences between interpretation in civil law and tax law

The majority of the tax norms tie consequences in tax law to legal relations, which take a typical civil-law form; this might cause problems where the elements of a tax event are provided for too rigidly. In civil law, the economic effect actually desired by a taxpayer is also achievable through atypical activity. The more directly one relies on a certain type of contract, the more the interpretation should be based on the economic substance of the transaction.*[8] Contractual relationships that are similar but executed in an unusual form must be subjected to the same tax regime as is applicable to all analogous situations. Distinction should be drawn among the situations in which parties have built, taking into account individual specific characteristics, another kind of contractual relationship from a transaction whose form was changed in order to hide or obfuscate the actual legal relationship. Some taxpayers use such contracts to avoid payment of taxes or to gain tax incentives.

Where a tax administrator suspects tax avoidance, they should first explore the civil-law form of the transaction in order to identify whether the transaction was aimed at achieving a result in civil law. After that, the results of the transaction and the economic substance of the parties' agreement should be analysed.*[9] The tax authority's interpretation shall initially be guided by the civil-law approach, in assessment of the legal relationship of the parties under private law. In several countries, among them the United Kingdom, France, and Belgium, the attention is on the legal substance of the transactions, which is considered to be the correct method of providing an assessment under tax law.*[10] If the legal substance is deemed to be beyond reproach, there will be no need for further interpretation. Problems arise in situations where there are doubts regarding the correctness of form and where the application of the rule contained in the general measure intensely offends the private autonomy of a taxpayer. The question is this: Does interpretation under civil law prevail over the tax-law approach?

Approaching a transaction on the basis of its legal substance allows solving those cases where it is clear from the civil-law form of the transaction that the contractual relationship is ostensible only, with the parties feigning another legal substance or just creating an impression of having contractual relations. Interpretation under civil law proceeds from the intent of the parties and from the parties' perception of what is to be achieved by their agreement. This is based on so-called *Innentheorie*, a teleologically oriented approach relying on the civil-law treatment of the validity of a transaction in which any result at all could be achieved thereby.*[11] The legal substance approach can be used to solve cases where the form is, in view of the circumstances, obviously unsuitable and where the transaction is incorrectly qualified under civil law in order to avoid taxes.

The issue of whether the form of the taxpayer's transaction is correct or not must be resolved separately in each specific case, and it is very difficult to find a universally applicable rule. Employment of a civil-law form may be unsuitable if the parties to the contract would not have chosen that form for the purpose of achieving their economic goal. Unsuitable also are forms that are tax-evasive, wrong, and deceitful, where the aim is to arrive at the desired final result via indirect methods.*[12] Taxation of a transaction is directly dependent on the objective circumstances that come about in life — i.e., on the facts of life. Wrong qualification occurs in the cases where the taxpayer hides actual circumstances behind an incorrect form of contract.

The tax-law approach to a transaction foresees such interpretation as does not consider the form of the transaction and renders new meaning to the taxable circumstances. This means that the tax administrator re-qualifies the legal relationship, detecting the elements of a hidden legal relationship that are sufficient to determine the legal relationship under tax law. Prevention of abuse of freedom of contract by way of interpretation according to economic reality is a general principle that precludes the parties' options of entering into mutual arrangements to reduce or completely avoid state-imposed tax obligations. The rule of interpretation based on the general provision allows the tax administrator to exercise wider regulative options because where a

[7] T. Edgar (Note 5), p. 900.

[8] K. Tipke, J. Lang. Steuerrecht. Köln 1998, p. 165.

[9] T. Edgar (Note 5), p. 877.

[10] F. Zimmer (Note 1), p. 24.

[11] *Ibid.*, p. 41.

[12] K. Tipke, J. Lang (Note 8), p. 167.

tax is levied in consequence of abuse of freedom of contract the related administrative act can be justified by all facts that refer to an abuse of freedom of contract.*[13]

Tax laws do not restrict a taxpayer's right to choose the form of contract and exercise the right to alter the contract (*Gestaltungsrecht*), nor do they set out conditions precedent to the validity of a contract. The consequences of civil-law transactions and activities in civil and tax law may differ because tax law is public law wherein private autonomy is invalid.*[14] In other words, the parties in a legal relationship have the right to determine the substance of their agreements but they cannot determine the *causa* of the transaction recognised by law, because this is not a freedom of legal qualification of a contract.*[15] In such cases, a transaction is a means to achieve a goal, where the taxpayer is applying it to create an incorrect picture of the actual taxable circumstances so that ultimately he will benefit considerably from reduced payment or from non-payment. However, the identification of a tax obligation occurs during tax proceedings and is tied to the rules of interpretation, which take into account the special position of the tax law in the legal system.

2. Different approaches

2.1. Countries with general measures provided by law

2.1.1. The German and Estonian approach

Germany and other countries in the Germanic legal family have since 1919 been moving toward tax-law interpretation (*Wirtschaftliche Betrachtungsweise*), and such interpretation is not guided by the meaning set forth by the definitions of civil law. Interpretation of a taxpayer's activities according to economic reality as a rule of law is set out in the German General Tax Act (AO)'s § 42, pursuant to which abuse of the options of legal form does not allow avoidance of the tax obligation. This section of the law provides for the following rule of interpretation:

> (1) The tax statute shall not be avoided by an abuse of the arrangement opportunities of the law. If there is an abuse, the tax claim originates as it does from a legal arrangement that adequately reflects the economic substance of the transaction.*[16]

This particular regulation is distinctive in that it combines the economic substance of a transaction and the correct legal substance while many other tax systems concentrate, in deciding whether taxes are avoided, just on exploring the business sense of a taxpayer's behaviour.

In German judicial practice, AO § 42 has been used in different circumstances. Court practice allows distinguishing among four important elements whose existence allows application of AO § 42. First, the legal form of transaction chosen by the taxpayer is not adequate. A transaction should be deemed inadequate if an impartial third party would not have entered into the transaction under the same conditions. Second, the form chosen by the taxpayer clearly brings about a more favourable tax regime when compared to an adequate transaction. Third, there is no acceptable justification of the choice of form. The fourth is a subjective element that follows the actual intent and motivation of the taxpayer to reduce his tax burden.*[17]

This section of the tax law may be applied to transactions that, although formalised incorrectly, still carry an economic substance as well as to transactions that are both inadequate and entered into solely for the purpose of avoiding taxes. Where all four elements exist, the transactions of taxpayers can be interpreted for taxation purposes. However, the German courts do not treat the rule of economic interpretation as the highest rule, as the customary methods of interpretation (grammatical, systematic, etc.) should be employed first and foremost. First the norms of the tax law are interpreted and special circumstances are subsumed. Only after this fails is the actual substance of the transaction explored in order to determine the taxable event.*[18] Thus, such an interpretation has been used in Germany only in those cases where there is reasonable doubt that the taxpayer is avoiding taxes.

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[13] MKS eelnõu seletuskiri (Explanatory Memorandum to the Draft Taxation Act). Available at http://web.riigikogu.ee/ ems /plsql/motions.active (in Estonian).

[14] Eesti maksuseadused koos rakendusaktidega. Õigusaktide kogumik seisuga 15. märts 2007. Lasse Lehise kommentaaridega (Estonian Tax Laws and Their Implementation Acts. Collection of Legal Acts as of 15 March 2007. Commentary by Lasse Lehis). M. Huberg, M. Uusorg (ed.). Tartu: Casus 2007, p. 19 (in Estonian).

[15] V. Lopman. Majandusliku lähenemise põhimõte Eesti maksuõiguses (The Principle of Economic Approach in Estonian Tax Law). – Juridica 2005/7, p. 491 (in Estonian).

[16] Abgabenordnung. – Steuergesetze. Textsammlung mit Verweisungen und Sachverzeihnis. München 1999.

[17] Z. Prebble, J. Prebble. Comparing the General Anti-Avoidance Rule of Income Tax Law with the Civil Law Doctrine of Abuse of Law. – Bulletin of International Taxation, April 2008, p. 153.

[18] M. Schiessl. – F. Zimmer (Note 1), p. 311.

Estonia has followed Germany's example and also employs the rule of interpretation according to economic reality; i.e., in interpreting economic transaction subject to taxation, the tax authorities proceed primarily from the economic and not legal substance of the transaction. The reason is that economic actions, usually in fulfilment of a contract, are the object of taxation, and not legal relations. Also where actual economic actions occur without a contractual relationship, the object of taxation still exists and tax liabilities are still incurred.*[19] This principle has been laid down in § 84 of the Taxation Act (TA), which has been established according to the example of AO § 42 and provides a legal basis for using the method of economic interpretation. Pursuant to TA § 84, if it is evident from the content of a transaction or act that said transaction or act is performed for purposes of tax evasion, conditions that correspond to the actual economic content of the transaction or act apply for taxation. Those provisions reinforce the position that tax law is a part of public law and that, in taxation, the principle of uniform taxation should be observed and that taxpayers cannot modify tax obligations at their own discretion.*[20]

The German and Estonian legislators have provided for a possibility to interpret the agreements of a taxpayer and identify the taxable event that necessitated the taxation of the transaction in question. It is possible for the tax administrator to come to a conclusion that, in view of the circumstances of the transaction, it is taxable because of its economic substance. There is, however, a danger of the tax administrator treating civil-law relations too 'economically', which may lead to use of analogies and unacceptable exploitation of loopholes in tax law. The tax administrator is nevertheless required to observe the principle of legality and to apply the tax law in accordance with its spirit and purpose, giving consideration to the civil-law definitions used by the taxpayer in the contract as well as to the actual economic actions that have taken place.

2.1.2. The Belgian approach

The countries that acknowledge a special rule for the purpose of interpreting tax relations are appreciative of legal clarity and recognise the principle of lawfulness in that only written law can be the basis of burden-encumbering administration. In Germany, a tax administrator may re-assess taxable circumstances and ignore the civil-law form, which is not something that is allowed in all of the countries employing a general tax rule. Belgium represents the countries that, while having a general rule, still require that the legal substance be explored in identification of the tax liability.

According to the principle adopted by Belgian tax law, the definitions and transactions in private law must be recognised by the tax law because tax proceedings cannot interfere with civil-law treatment. This position is based on Article 170 of the Belgian Constitution, pursuant to which taxes to the benefit of the state can only be introduced by a law. Because said rule is interpreted narrowly, in order to identify tax liability, tax authorities must directly rely on the provision allowing taxation. Such a favourable situation for the taxpayer is possible because of the positions adopted in the judicial practice of the Belgian Supreme Court, which precludes the application of the doctrines of *fraus legis* and economic substance. The court maintains that in ascertaining of tax liability, the taxpayer's transaction should not be reassessed but, rather, it should be identified whether or not the transaction is ostensible.*[21] This transposes the civil-law concept of the ostensibility of a transaction, according to which a transaction cannot have legal consequences if the declarations of intent made upon entry into the transaction were either ostensible or sham.

By recognising the form of a transaction by which at least some kind of goal can be achieved, one gets a chance to plan taxes. Under Belgian law, tax avoidance schemes are successful as long as a tax administrator ascertains that the transaction is ostensible and that the taxpayer intended to avoid taxes. This means that where a transaction is correct, the civil-law approach shall prevail over the tax-law approach. In several instances, the Supreme Court has dismissed tax authorities' attempts to restrict the sphere of applicability of the free choice principle to prevent excessive tax planning. The application of the previously mentioned principle led to a situation that in 1993 necessitated the addition of a general rule to the Belgian tax law.*[22] Pursuant to Article 344 (1) of the Belgian Income Tax Code (BITC):

> The legal characterisation given by the parties to one act or to separate acts which together realise the same operation is not binding on the income tax authorities when those authorities determine, by means of presumptions or other proof admitted by Article 340, that this characterisation aims at avoiding taxes, unless the taxpayer proves that his characterisation is justified by legitimate needs of a financial or economic nature.*[23]

[19] L. Lehis (Note 3), pp. 62–63.

[20] *Ibid*., p. 63.

[21] L. De Broe. International Tax Planning and Prevention of Abuse. Amsterdam 2008, pp. 68–69.

[22] *Ibid*., pp. 75–76.

[23] BITC — Belgian Income Tax Code was implemented by a royal decree of 9 November 1992.

By adding a general rule, the Belgian tax law now codifies the principle of the abuse of rights whose purpose is to prevent tax avoidance stemming from the taxpayer's motives. It was the legislator's attempt to use the principle of interpretation for identifying the circumstances that are important for taxation, and for ignoring transactions that are legally correct but are triggered by the intent to avoid taxes. The general rule should be disregarded if the taxpayer can prove the economic goal of the transaction; the level of proof to be provided is not high.[*24] Belgian judicial practice has been governed by the understanding that, in concert with the principle of lawfulness, the taxation rule should be relied on directly and not through interpretation. Reliance on the civil-law norm has caused application of the principle of the legal substance of a transaction. The tax administrator must identify the correct legal form on the basis of which tax could be levied directly on the basis of the provision of tax law.

The tax authorities and the courts do not have the discretion to ascertain the content of a transaction and to identify the economic substance; thus, is it not possible to proceed from the concept of substance and form. As a rule, the legal form prevails over the economic substance and the courts do not regard economic interpretation as the preferred method. The positions of the European Court of Justice have influenced Belgium to move closer to the understanding that through employment of a general tax rule, the doctrine of *fraus legis* is applied to interpretation in tax law. In order to definitively adopt the doctrine, Belgium needs to change principles that have been developed in the judicial practice of the high court and have been applied for more than a hundred years.

2.2. Countries with general measures settled in judicial practice

2.2.1. The Dutch and French approach

In cases of tax avoidance, the interpretation principle provided by law is generally applicable to the interpretation of facts, but there are countries that mainly abide by principles created by the courts. One of these is the Netherlands, where there is a legal provision to combat tax evasion but the *fraus legis* doctrine has been created by the Supreme Court through abundant practice. In Dutch judicial and administrative practice, an acceptable solution is an interpretation under which factual circumstances have more decisive meaning than does form in ascertaining tax-related legal relationships (the 'substance over form' principle). To prevent tax avoidance, the following measures are applied:

1) AWR Art. 31 (*richtige heffing*) enables looking beyond the scope of a transaction that is carried out mainly for the purpose of tax avoidance. This provision is applied upon the approval of the Dutch Ministry of Finance and therefore requires good administrative organisation. This is seldom applied, because of excessive bureaucracy.
2) The principle of *fraus legis*, dealing with abuse of rights, is not contained in the tax law but has been created by judicial practice. According to this principle, the meaning of the law is of greater importance than its precise wording is.[*25]

On the basis of the opinion of the Dutch Supreme Court, the legal substance of a transaction must be set to the side if a tax avoidance motive prevailed in the conducting of the transaction.[*26] The court believes that tax evasion can be assumed if acts of a taxpayer did not have a business motive and gaining of tax incentive is in conflict with the meaning of the law.[*27] Contested transactions may be revalued on the basis of the closest possible legal substance that would lead to removal of doubt concerning abuse of rights. In the Dutch approach, factual circumstances are to be analysed in order to obtain assurance as to whether the essential circumstances correspond to the elements that are taxable by law.

To identify the content of activities of a taxpayer, the circumstances must be subject to so-called review. In particular, this means interpretation of a transaction or act. During this process, it is established whether the form of the transaction or act is in compliance with the principles of civil law and then the economic substance of the transaction is identified. Business objectives must provide a basis for making a decision as to whether a transaction with correct legal substance was actually carried out with the motive of tax avoidance.[*28] Such a principle enables judging acts on the basis of a correct form that obstructs the granting of tax incentives in events other than the situations specified in the legislation.[*29] Hence, irrespective of what the transactions or

[24] D. Garabedian. – F. Zimmer (Note 1), p. 154.

[25] R. Ijzerman. – F. Zimmer (Note 1), p. 453.

[26] G. te Spenke. Taxation in the Netherlands. Deventer, Boston 1995, p. 14.

[27] C. Change. Netherlands: Deductibility of interest on intra-group debt from external acquisition clarified. Available at http://www.internationaltaxreview.com/?Page=10&PUBID=35&ISS=14051 &SID=494332&SM=&SearchStr= (10.04.2008).

[28] R. Ijzerman. – F. Zimmer (Note 1), pp. 452–453.

[29] Proposition of the European Court of Justice Advocate-General Damaso Ruiz-Jarabo Colomer in the case *Belgium v. Temco Europe SA*, C-284/03, pp. 46, 37.

acts look like, no rights can derive from them if this is in conflict with the meaning of a legal provision granting tax incentive on the basis of evidence established with the aid of objective facts.

In comparison of the Dutch interpretation rule with the French positions, it appears that the objective elements of the transaction and the setting of the intention of the taxpayer have a decisive meaning in both countries for addressing doubts concerning tax avoidance. The interpretations of both countries are based on a principle arising from civil law under which the authority is to exercise its rights in good faith and avoid abuse of rights. The difference lies in the fact that interpretation of the tax authority in France may be applied only on the basis of Article 64 of the French code of tax proceedings, which is limited to events wherein the only objective of the taxpayer is to a avoid tax, and to taxation objects specified by law (e.g., application is precluded in the case of real-estate taxes).[*30] According to Article 64, a tax authority may

1) ignore a legal substance the objective of which is to hide income and other earnings and
2) provide a transaction with a new meaning that corresponds to its actual content.[*31]

The principle established in Article 64 has entered into use through judicial practice. For example, in the *Janfin* case it was found that the doctrine of abuse of rights is a general legal principle that is also applicable in tax law. A tax authority is provided with an instrument that enables it to prevent behaviour motivated by tax avoidance and identify the actual tax liability. This is subject to limitations.[*32] Limitation of the possibilities in interpretation by a tax authority or the courts has been proved necessary by cases of excessive interference with the contractual freedom of a taxpayer. Therefore, the application of Article 64 is subject to conditions that should ensure legal clarity, because otherwise forecasting the scope of tax liability would be very difficult.

The French approach recognises the principle of the content and form of transactions, but theory for management of abnormal situations has been additionally developed by judicial practice, to allow taking into account, substantiation, in cases where tax avoidance must be determined, of behaviour that in the same situation would be considered unusual in the eyes of an average undertaking.[*33] Comparison of the interpretation principles created by the judicial practice of the two countries reveals overlapping solutions and possible results, but the French rule is subject to stricter requirements because the meaning of a transaction under private law is given greater recognition in consequence of the cultural background involved.

2.2.2. The Anglo-American approach

The United Kingdom and the USA are countries that, owing to the peculiarity of their legal systems, have abundant judicial practice and have developed doctrines that are applied in cases of suspicion involving tax avoidance. The approaches of these countries are similar to some extent, but they have different views as to the importance of private law in identifying tax law relationships. Their interpretation principles that have been developed through judicial practice, enabling provision of the tax authority, as necessary, with new possibilities to prevent tax avoidance, have been taken as an example by several countries (e.g., Norway and Sweden).

In the judicial practice of the United Kingdom, the prevailing position involves a principle under which legal substance must be relied upon in identifying circumstances that are subject to taxation. The function of that position is to establish whether transactions are ostensible or sham, and whether the wrong form was selected with the purpose of tax avoidance. In the judicial practice, the interpretation of such transactions has led to the creation of sham-transaction-related doctrine originating from the 1936 court judgment *IRC v. Duke Westminster*, in which the court clarified the right of each person to freely organise his or her business transactions, provided that the transaction is not sham and yields a financial result.[*34] A tax authority must accept transactions that are not ostensible or sham. Doubts of the correctness of transactions arise only if the parties that have entered into contracts do not intend to perform them in the manner one would expect from the documents.[*35] For reliance upon this doctrine, it is not sufficient that the contractual relations be artificial, which would show the sham nature of the transactions. It is necessary to establish the receipt of benefits by way of a taxpayer creating a false impression with transactions, as a result of which the tax burden would decrease.

Since 1980, judicial practice in the United Kingdom has been paying more attention to the objective and economic content of transactions. In parallel with the sham-transaction doctrine, principles were developed that did not rely only upon identifying the circumstances and legal substance of a transaction. Implementation of

[30] Z. Prebble, J. Prebble (Note 17), pp. 159–160.

[31] Code général des impóts (General Tax Code). Loi n° 92-40 du 09 juillet 1992 publié dans le Journal Officiel du Sénégal sous le n° 5476 du 11 juillet 1992.

[32] L. Leclercq. Interacting Principles: The French Abuse of Law Concept and the EU Notion of Abusive Practices. – Bulletin for International Taxation, June 2007, p. 239.

[33] F. Zimmer (Note 1), p. 44.

[34] Z. Prebble, J. Prebble (Note 17), p. 167.

[35] J. VanderWolk. Purposive Interpretation of Tax Statutes: Recent UK Decision on Tax Avoidance Transaction. IBFD 2002, p. 71.

the conception provided by the provision on taxes was involved as well.[*36] According to the principle added via the *Ramsey* case, the conclusion of interrelated transactions with the purpose of creating possibilities for tax avoidance does not have more favourable consequence in terms of taxation.[*37] In the opinion of the court, the series of transactions concerned must be considered as a set, which circumvents the issue of transactions without independent economic content and identifies the actual objective of the transactions in relation to the conceptions of the provisions on taxes. In order for one to rely upon the Ramsey, or 'step transactions', doctrine, the following elements must be present:

1) there must be transactions that are interrelated in terms of both time and space, which have been agreed upon previously and are carried out as planned, and
2) the interim transactions do not have any independent business objective; they, taken together, facilitate tax avoidance.[*38]

The Ramsey doctrine is partially congruent with the principle of economic content and form, because in order to identify the business objective it is necessary to find the factual circumstances that would correspond to the economic content underlying taxation. The principle of economic content and form, which has been the main measure in the USA to prevent tax avoidance, allows a tax authority to avoid strict attention to legal substance and to offer a new assessment of the factual circumstances. Furthermore, the USA has an abundant complex of doctrines to judge taxable transactions, the most important being those concerning sham, related transactions and the business objective.[*39]

The business objective or achievable results of a transaction determine needs as regards whether to rely upon the rule on tax avoidance or recognise the form selected by the taxpayer. With the use of these rules, also those factors influencing a taxpayer should be taken into account that do not directly yield economic results but may create new value in view of the interests of the relevant undertaking (e.g., reorganisation for better management of a company).[*40] The US approach in interpretation of transactions carried out for the purpose of tax avoidance is more subjective than that of the United Kingdom, enabling the transactions to be assessed in a manner that does not take into account design under civil law and that ensures uniform taxation.

3. Compliance of tax avoidance rules with European Community law

3.1. Proportional measures

Application of the general tax avoidance rules must be proportional and mindful of the balance of different interests. The tax authority cannot have unlimited rights in resolving tax issues: it has to respect constitutional rights and freedoms, and it may not excessively suppress taxpayers' operations or cause undue trouble.[*41] The ECJ has established certain principles through case law for judging when tax avoidance measures are to be considered proportional. The principle of proportionality is of considerable weight in Community law and as such must be respected as part of the aims and basic values of the EC Treaty.

The principle of proportionality involves seeking to establish whether it is possible to achieve a legal result of higher value while bearing in mind all related interests. The effort put into prevention of tax avoidance should be proportional to the consequences of intervening in taxpayers' economic activity.[*42] Loss of tax revenue cannot by default be declared the dominant public interest to justify measures that do not respect fundamental freedoms. If fundamental freedoms may be compromised, the interest in opposition to them should be weighed with extra care.[*43] The ECJ judgment in the case *Leur v. Bloem* noted that the tax authority should assess tax liability according to the specific details of the transaction, taking into account the individual nature of each case, which must be open to judicial review.[*44] The court also noted that the measure should not be exploited beyond the prevention of tax avoidance.

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[36] Z. Prebble, J. Prebble (Note 17), p. 167.

[37] *Ramsay v. IRC*; *W. T. Ramsay Ltd. v. Inland Revenue Commissioners, Eilbeck (Inspector of Taxes) v. Rawling*, [1982] A.C. 300.

[38] R. M. Ballard, P. E. M. Davison aut. – F. Zimmer (Note 1), pp. 579–580.

[39] W. P. Streng, L. D. Yoder. – F. Zimmer (Note 1), p. 608.

[40] B. Banoun. Tax Avoidance Rules in Scandinavian and Anglo-American Law. – IBFD, September 2002, p. 489.

[41] L. Lehis. Means Ensuring Protection of Taxpayer´s Rights in Estonian Tax Law. – Juridica International 1999 (4), p. 104.

[42] A. Zalinski. Proportionality of Anti-Avoidance and Anti-Abuse Measures in the ECJ's Direct Tax Case Law. – Interfax 2007 (35) 5, pp. 320–321.

[43] ECJ judgments, 13.12.2005, case *Marks & Spencer plc. v. David Halsey*, C-446/03, p. 44.

[44] ECJ judgments, 17.07.1997, case *Leur-Bloem v. Inspecteur der Belastingdienst/Ondernemingen*, C-28/95.

Any rules that justify violation of fundamental rights deriving from the EC Treaty are in contradiction with Community law. Member States cannot apply indefinite measures that allow loose interpretation of transactions and serve the purpose of tax collection only.*45 General tax avoidance provisions have to be specific enough for taxpayers to predict the amount of the tax obligation. The measure must be usable for the prevention of tax avoidance and should not involve significant deterioration of economic activity — i.e., the taxable person's legitimate expectations and state fiscal interests should be in balance. Taxpayers need the tax obligation to be predictable, which means that greater legal clarity should be ensured by legal measures and consistent administrative practice.

Tax avoidance measures are not proportional if they do not consider specific details of transactions and are based only on predetermined circumstances. The measure taken must be usable as a general provision and be relevant to a variety of situations, provided that the transaction bears no economic substance and its only aim is to obtain a tax advantage.*46 Prevention of tax avoidance should not consist of prohibitions, and it cannot rely on the 'allow all or nothing' principle, which excludes certain types of transactions or operations. Interests under public and private law have to be taken into account equally. The principle of proportionality requires that the measures be appropriate, necessary, and reasonable, to be used only in cases of sham transactions and tax avoidance.

3.2. Limitations in application

Measures must be concrete yet ensure flexible interpretation of relations under tax law. This means that the use of a measure has to be within the established legal or doctrinal framework. Application of the measure could be restricted. For example, in Dutch tax practice there is an *ultimum remedium* principle applied, which means that the content of the taxpayer's operations can be reviewed only after standard interpretation remedies are exhausted.*47 Rules of interpretation may be problematic if they set assumptions and limit the definition of tax avoidance to certain transactions or operations.

The first thing to determine is when reasonable doubt of tax avoidance applies. With that established, one knows when to start interpreting the taxable person's operations for the purpose of re-evaluating a transaction under tax law. In the *Halifax* case, the ECJ considered the existence of a violation to be determined by whether the operations involved are motivated by obtaining of a tax advantage. The court noted that a national court must determine the substance and actual meaning of such transactions.*48 The court handed down a similar judgment in the *Part Service* case in its answer to the question of whether an abuse of rights is defined by the essential aim of obtaining a tax advantage, without any other commercial reasons. The ECJ found that, for application of the measures, the taxable person's activity has to go against the intent of the tax norm, which mainly involves taxation aspects.*49

Use of measures against tax avoidance is justified in cases of sham transactions, when legal, economic, and personal relations between operators show that the main aim of the transaction is to obtain tax advantages. In the *Part Service* case, the ECJ set forth guidelines for national courts for interpreting interrelated transactions. The court found that it is necessary to look beyond the contractual façade to assess whether the evidence shows one single transaction, if the transactions involved are not clearly independent.*50 These ECJ positions coincide with practical application of measures in most Member States that consider the economic substance of transactions, not the artificial form.

Measures cannot be taken only because of suspicion of tax avoidance and a wish to prohibit the taxable person from exercising that tax advantage. The interpretation should not cause harm to normal, legal operations, and the following criteria should be used:

1) the interpretation must adhere to fundamental Community principles, and
2) the interpretation must be relevant to the aim of prevention of tax avoidance.

All EU member states must ensure that the fundamental freedoms of the EC Treaty are transposed into national legislation. The same applies to rules governing prevention of tax avoidance, which must not violate or undermine the rights and freedoms provided for in the treaty. The ECJ ruled in the *X&Y v. AB* case that a state cannot impose rules that differentiate between transactions with national and foreign companies to the

[45] Z. Prebble, J. Prebble (Note 17), p. 163.

[46] A. Zalasinski (Note 42), p. 316.

[47] R. IJzerman. – F. Zimmer (Note 1), p. 455.

[48] ECJ judgments, 21.02.2006, case *Halifax plc., Leeds Permanent Development Services Ltd., County Wide Property Investments Ltd v. Commissioners of Customs & Excise,* No. C-255/02, p. 81.

[49] ECJ judgments, 21.02.2008, case *Ministero dell'Economia e delle Finanze v. Part Service Srl*, No. C-425/06, p. 44, 45.

[50] *Ibid*., p. 54.

etriment of the latter.*[51] Similarly, the court found in the *Cadbury Schweppes* case that mere establishment of a subsidiary in another Member State by a resident company cannot give rise to a general assumption that tax fraud is involved or justify measures that hinder the exercise of the fundamental freedoms.*[52] Rules must be effective and suitable for ascertaining the tax obligation, but the measures must avoid erosion of other legal rights.

In the *Marks & Spencer* case, the ECJ found that a restrictive measure may not go beyond what is necessary to attain the objectives pursued.*[53] Thus, application of said measure must comply with the principles of legal certainty and proportionality, since a suspicion of tax avoidance cannot involve it being an insuperably difficult task to prove the contrary, beyond what is necessary to protect one's rights.*[54] In order to protect all legitimate interests, measures are applicable within clear boundaries, which take into account the regularity of tax proceeds, on one hand, and legitimate business interests, on the other. This should ensure equal treatment of taxable persons.

4. Conclusions

The common denominator of tax avoidance prevention measures is that they cover most cases wherein the aim of the transaction is to reduce tax liability. These transactions also include contracts aimed at creating a more favourable fiscal status or concealing the tax object.*[55] Such measures require courts to interpret tax law in a broad and economically oriented sense; a transaction must be evaluated against tax law, free of artificial legal constructions and on the basis of the actual economic performance of the taxable person. The aim in both instances (legal derogation and court interpretation) is to identify the legal circumstances as provided in the tax norms for purposes of achieving uniform taxation.

Case law shapes and sets boundaries for the ascertaining of relations under tax law, based on transactions' economic substance and form. In many countries, rules of interpretation are set by Supreme Court doctrine, which over time has made its way into legislation. It can be said that also in Estonia a Supreme Court judgment has for the first time established a requirement to consider the economic substance of a transaction over the form chosen by the taxpayer. Principles established via case law have helped to improve tax avoidance prevention measures and provided options for reaction to different tax optimisation tricks. Yet a measure based only on case law offers poor legal certainty, since it is often impossible to foresee whether a transaction will be taxable.

General anti-tax-avoidance measures determine a certain standard as to the situations in which one should suspect tax avoidance and possible creative interpretation of tax law. The general rule aims to ensure application of the principle of legality in relations under tax law and set boundaries to the tax authority's investigations. Under the principles of legal certainty and proportionality, a taxpayer must be able to assess the circumstances it should take into account in the calculation of its tax liability. The ECJ has taken the position that intervention in a taxpayer's economic activity and re-evaluation of transactions are possible only in cases of misapplication, if normal economic relations are not undermined.

[51] ECJ judgments, 21.11.2002, case *X&Y AB v. Riksskatteverket*, No. C-436/00, p. 63.

[52] ECJ judgments, 12.12.2006, case *Cadbury Schweppes plc v. Commissioners of Inland Revenue*, C-196/04, p. 50.

[53] ECJ judgments, 13.12.2005, case *Marks & Spencer plc. v. David Halsey*, C-446/03.

[54] ECJ judgments, 11.05.2006, case *Commissioners of Customs & Excise v. Federation of Technological Industries et al.*, C-384/04, pp. 32, 33.

[55] T. Edgar (Note 5), p. 839.