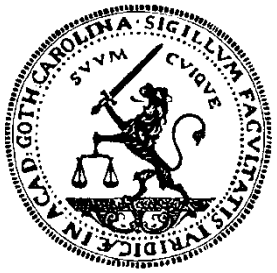

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"Artificiality"

A study of the concepts of Abuse and Economic Reality in the field of EU VAT

Master thesis
30 credits

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Contents

Summary

One of the explicit objectives for the common VAT-system is to prevent tax evasion, -avoidance and -abuse. These concepts are related in the sense that all three concepts aim to prevent that the provisions of the system are applied in a manner that conflicts with the purpose of the system and the provisions. There are however substantial, inherent differences between the concepts and the way that they are applied.

By the decision in the *Halifax*-judgment the Court once and for all settled that the doctrine of abuse is fully applicable in the field of VAT in order to ensure the correct application of the system. Further the Court, following the rationale set out in *Emsland-Stärke*, established that the doctrine is to be applied as a two-part test. This two-part test is constructed by a comparison between the purpose of the procedure set out by the taxpayer and on the other hand the purpose and objectives of the VAT-system. The *Halifax*-decision has been followed by a series of decisions further defining the implications and applicability of the concept. I several of these decisions reference has been made to the significance of "artificial transactions" or "lack of economic reality" and the Court has held that the objective of the application of the concept of abuse is to prevent these types of transactions

When examining the decisions delivered on the assessment of abusive procedures the significance and meaning of the these terms and their relation two-part test is difficult to establish. On one hand the Court advocate a strict application of the two-part test, in relation to which the existence of "artificial elements" can be relevant. On the other the existence of such elements seem to act as a third, implied criterion when assessing possibly abusive procedures.

The concept of "economic reality" has further been actualized in a different line of cases, the "*DFDS*-line. Here the concept is addressed as a fundamental benchmark for the interpretation of the provisions of the directive. This line of cases to some extent over-laps the *Halifax*-line but should be regarded as separate. This is since the *DFDS*-line primarily relate to the interpretation of the provisions of the directive, whilst the *Halifax*-line aims to assess the correct application or invocation of the provisions.

Sammanfattning

Ett av de uttalande målen för det gemensamma systemet för mervärdesskatt är att förhindra skatteflykt, skatteundandragande och missbruk. Dessa koncept besläktade i den bemärkelse att de alla hindrar att skattesystemet tillämpas på det sätt som det avsetts att göra. Dock finns det betydande, inneboende skillnader i koncepten och hur de tillämpas.

Genom avgörandet i *Halifax*-domen slog Domstolen en gång för alla fast att doktrinen om förfarandemissbruk är fullt ut tillämplig inom mervärdesskatteområdet i syfte att försäkra systemets korrekta tillämpning. Vidare slog Domstolen fast att doktrinen om förfarandemissbruk inom mervärdesskattesystemet ska tillämpas som ett tvådelat test, inriktat på att undersöka å ena sidan syftet med lagstiftningen och å andra sidan den skattskyldiges syfte med transaktionerna. Efter *Halifax* har följt en rad avgöranden som ytterligare definierar doktrinens innebörd och tillämpning på området. I flera av dessa avgöranden har referenser gjorts till ”artificiella transaktioner” eller ”ekonomisk verklighet” och det har uttalats att det är doktrinens syfte att förhindra just artificiella transaktioner som inte motsvarar ekonomisk verklighet.

Innebörden av dessa begrepp är svår att definiera utifrån de avgöranden som avkunnats inom ramen för tillämpningen av doktrinen om förfarandemissbruk. Å ena sidan förespråkar Domstolen en relativt strikt tillämpning av det tvådelade testet, i förhållande till vilket förekomsten av artificiella element kan vara relevant. Å andra sidan andra sidan famstår det emellanåt som om förekomsten av artificiella element eller ”brist på ekonomisk verklighet” agerar som ett tredje, underförstått kriterium för tillämpningen av doktrinen.

Dock har begreppet ”ekonomisk verklighet” refererats till i en annan linje av domar (*DFDS*-linjen). Här har begreppet betraktats som en generell måttstock för mervärdesskattesystemet. Denna linje överlappar till viss del *Halifax*-linjen, men ska dock betraktas åtskild från denna. *DFSD*-linjen relaterar primärt till tolkningen av direktivens bestämmelser, medan *Halifax*-inriktar sig på att bedöma tillämpningen av dessa.

Preface

There are some points in life that, even if you don't realize it until later, comes to change the direction of where you're heading. These points exist in every aspect of life. I call these points decisive moments. One my decisive points was when I decided to follow the advise to apply for what my friend referred to as "the best course ever", the European Moot Court Competition. The Moot Court challenge introduced me to European media law, which introduced me to the concept of abuse through which I was introduced to the field of VAT-law.

As I've examined the prohibition of abuse I've been fascinated by the large diversity of perspectives put on the topic. It is clear to me that it's a long way until we are able to fully understand the concept in a uniform manner. The ambition of this essay is consequently not to provide any definite answers, but rather to add my perspective to an issue, in my opinion often over-looked.

I would like to thank all the persons who has stood by and inspired me, but especially my patient employer, Skatteverket and my patient supervisor, Oskar Henkow.

Abbreviations

AG	Advocate General
CAP	Common Agricultural Policy
ECR	European Court Reports
ECJ	European Court of Justice
Eight directive	Eighth Council Directive 79/1072/EEC
EU	European Union
VAT	Value Added Tax
RVD	Council Directive 2006/112/EC on the common system of value added tax
Sixth Directive	Sixth Council Directive 77/388/EEC
TFEU	Consolidated version of the Treaty on the Functioning of the European Union
13th directive	Thirteenth Council Directive 86/560/EEC

1 Introduction

"*Any legal order which aspires to achieve a minimum level of completion must contain self-protection measures, so to speak, to ensure that the rights it confers are not exercised in a manner which is abusive, excessive or distorted*."

Advocate general Tesarou in case C-367/96 *Kefalas*[1]

Measures that prohibit procedures that, even though formally compliant with the letter of the law, conflicts with the purpose of the legislation or the common values of the legislative system can be found throughout the Member States. These measures have taken different shapes in the different legal traditions of the different Member States, being expressed in Court-made principles, general clauses and specific anti-avoidance legislation. After the creation of the European Community in 1957 I didn't take long to establish that such a self-protective measure was needed in this new legal order as well. How and when this measure is triggered and applicable has however been subject for discussion ever since the decision in *Van Binsbergen*[2] in 1974.

Even though this prohibition of abusive invocation of provisions of EU-law today is to some extent through legal codification in some of the legislative acts of the Union, [3] the concept of has primarily been developed through case law.

In 2006 the ECJ definitely established the applicability of the prohibition of abuse in the field of EU VAT by its' decision in *Halifax* where the Court established that the assessment of abuse should be done by an application of a formalized, two-part test.[4] Despite the Courts' rather thorough elaboration of the concept and its' applicability in *Halifax* the decision has been followed by a series of judgments regarding this "new" phenomenon in the area of VAT. In one of these decisions the Court recently stated that "*the effect of the principle prohibiting abuse of rights is therefore to prohibit wholly artificial arrangements which do not reflect economic reality*"[5]. This

[1] Case C-367/96 *Alexandros Kefalas and Others v Elliniko Dimosio (Greek State) and Organismos Oikonomikis Anasygkrotisis Epicheiriseon AE (OAE).* [ECR] 1998 I-02843. (Cit. Kefalas). Para 24, see also Opinion of AG Poires Maduro in case C-255/02 *Halifax plc, Leeds Permanent Development Services Ltd and County Wide Property Investments Ltd and others v Commissioners of Customs & Excise.* [ECR] 2006 I-01609.(Cit Halifax). Para 73.

[2] Case 33/74 *Johannes Henricus Maria van Binsbergen v Bestuur van de Bedrijfsvereniging voor de Metaalnijverheid* [1974] ECR 01299 (cit. *van Binsbergen*)

[3] An example where the concept of abuse has been codified in Union law is article 54 of the Charter of Fundamental Rights of the European Union, OJ 2007, C 303/1

[4] See section 5.2

[5] Case C-504/10 *Tanoarch s.r.o. v Daňové riaditeľstvo Slovenskej republiky* [2011] n.y.r (cit *Tanoarch*), see also Case C-162/07 *Ampliscientifica Srl and Amplifin SpA v Ministero*

reference to “artificial arrangements” or “lack of economic reality” can be seen in several of the Courts decisions on the subject.

Reference to the concept of “economic reality” as a benchmark for the assessment of the provisions of the VAT-system was however not a novelty introduced by the *Halifax* decision. Almost ten years earlier, in *DFDS*[6], the Court had established that “*consideration of the actual economic situation is a fundamental criterion for the application of the common VAT system*”[7] This fundamental criterion has been applied in a line of cases, not directly connected to the *Halifax*-line and the aim of this essay is to examine whether it is possible to reconcile these two lines of cases.

As shall be developed in section 3.3.1 the Court has shown an inconsistency in the terminological reference to the concept of abuse, using terms like circumvention, abuse, abuse of rights, abuse of law etc. For this essay the concept will, for the sake of consistency, be referred to as “abuse”, unless explicitly mentioned.

1.1 Purpose

The purpose of this thesis is to examine and compare the concepts of abuse and economic reality and to examine how they relate to each other. What is the role has the element of “artificiality” or “lack of economic reality” in relation to the concept of abuse? If these elements have an affect for the application of the concept of abuse, can any guiding conclusions be drawn from the case law concerning the concept of economic reality?

1.2 Method

In order to examine the current legal situation a traditional legal dogmatic method[8] will be applied. As the analysis is delimited to only cover the application of the concepts in EU law the assessment will emanate from a study of the case law of the ECJ. In order to deliver a comprehensive analysis of the topic it has been my ambition to fully cover the case law delivered by the ECJ regarding the concepts of abuse and economic reality as applied in relation to EU VAT-law. The material circumstances of the referred cases will however be described to a various extent.

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dell’Economia e delle Finanze and Agenzia delle Entrate [2008] ECR I-04019 (cit. *Ampliscientifica*)

[5] Art. 11 RVD

[6] Case C-260/95 *Commissioners of Customs and Excise v DFDS A/S* [1997] ECR I-01005 (cit. *DFDS*)

[7] Ibid. para 23

[8] “rättsdogmatisk metod”, see Lehrberg, Bert, *Praktisk Juridisk Metod* 4th ed., Iustus förlag 2001 pp. 38-39

In order to identify common elements in the case law comments from the legal doctrine will be added to add perspective. Analysis of the referred cases and personal reflections will, in order to increase comprehensiveness, be made continuously throughout the essay. Concluding remarks will however also be made at the end of each section and at the end of the essay. Since the concept of abuse, its role, and functioning is heavily discussed throughout the doctrine several different perspectives on the concept will be presented in relation to different parts of the analysis.[9] These perspectives will be independently commented and analyzed, but will also be used in order to promote the analysis.

If the concept of abuse has been subject to intense review the concept of economic reality as a general criterion is on the other hand scarcely discussed in the doctrine. When discussed, the analysis is primarily made in relation to the material circumstances or the referred question in the case at hand, not in relation to the concept itself.[10] Therefore the analysis fourth part of the essay is almost exclusively based on the Courts' reasoning in cases settled under the concept. The presentation of the concept of economic reality will emanate from a presentation of selected cases that I perceive as figurative for the concept. Additional case law relating to the subject will however be added in relation to the analysis of the concept.

1.3 Disposition

The thesis is divided in four sections. The first section aims to give the reader a brief orientation of the functioning of the VAT-system. No deeper analysis will be made in this section as it only aims to promote a general understanding for the subject. In the second part the functioning of abuse as a general concept is discussed. In this part the prohibition of abusive (tax law) procedures is examined by a comparison to the concept of tax avoidance. This section also includes a study of the concept of tax avoidance as applied in relation to Union law. This study is included to provide an increased understanding for the legal context where the cases on abuse are delivered and to promote an understanding for the functioning of tax law and the concept of tax avoidance in the field of EU-law This part to some extent overlap the third part where the application of the concept of abuse to the area of VAT is closer examined and analyzed. Lastly an analysis of the case law relating to the concept of economic reality will be made. This analysis is primarily done in order to evaluate the concept in

[9] See esp. section 4 below

[10] See eg. Norberg, Karin, Pettersén, Franciska, *Förfarandemissbruk inom mervärdesskatteområdet*, Skattenytt 2008 Issue 1-2. (cit Norberg 2008) pp. 7-9, De Broe *Cross-border leasing of cars into Belgium: issues of VAT and the freedom to provide services - analysis of and comments on the European Court's holding in Aro Lease* EC tax review, volume 7 issue 4 Kluwer Law international 1997 p. 215 (cit. de Broe 1997) pp. 222-223

relation to the conclusions and analysis made in section two and three. The analysis will include an examination of the legal nature of the concepts as well as a study of their legal functioning and applicability Comments and analysis will be made continuously but concluding remarks in relation to the purpose of the essay will be made at the end of the thesis.

2 A brief introduction to the field of VAT

Although the Member States still enjoy a large amount of fiscal autonomy the TFEU strictly prohibits any discrimination by means of levying indirect taxes.[11] In order to avoid distortions of competition and to promote the free movement of goods and services a harmonization of the indirect tax-systems of the Member States has been regarded as a necessary step.[12] In 1967 the council adopted the first and two directives concerning the harmonization of VAT, replacing the national turnover taxes with VAT.[13] Ten years later the VAT-system was further harmonized by the enactment of the Sixth directive.[14] The Sixth Directive served as a foundation of the common system, complemented by several other legislative acts for almost thirty years until the revision of the system resulted in the RVD 2006. The RVD is to a large extent a development of the Sixth Directive and the case law delivered in relation to the provisions of the Sixth Directive is mainly to be regarded as applicable to the provisions of the RVD. The common VAT-system is today thoroughly harmonized and is to a large extent subject to full harmonization. The essence of the system is effectively distilled in the first article of the RVD:

"The principle of the common system of VAT entails the application to goods and services of a general tax on consumption exactly proportional to the price of the goods and services, however many transactions take place in the production and distribution process before the stage at which the tax is charged."[15]

In order to achieve this effective tax on consumption, the VAT-system taxes each supply or transaction made within the scope of the system. In order to prevent that the burden of tax is increased for each step in chain of supplies operators within the scope of the system are allowed to deduct the VAT incurred on the supplies made to the supplier from the amount of VAT levied on the supplies made by the operator. If the Input VAT exceeds the output VAT the operator shall be granted a refund of the exceeding difference.

[11] Art 110 TFEU
[12] Recital 5 RVD
[13] Lenoir, Veronique *April 1954-April 2004 VAT Exemptions. The Original Misunderstanding*, European taxation, October 2004, IBFD p.456 (cit. Lenoir 2004) p. 456
[14] Ibid.
[15] Art 1.2 RVD

2.1 Scope

The VAT-system can be said to have a dual scope, a territorial scope, and a "material" scope (i.e. field of application).[16] This dual scope makes all supplies of goods and services made for consideration, by a taxable person acting as such, within the territory of a Member State, subject to VAT.[17] The scope also includes the importation of goods and, under certain circumstances, intra-community supplies of goods.[18] Whilst the territorial scope is rather straight-forward, being limited to the territorial borders of the Member States,[19] the "material" scope, composed by several independent factors, is more complex being composed of several independent prerequisites.

2.1.1 Supply of goods and services

The definition of supplies of good and services are defined in art. 14-23 and art. 24-29 RVD. The rules include several provisions regulating specific procedures and specific types of goods and services. The general definition of a supply of goods is however defined as "*the transfer of the right to dispose of tangible property as owner*"[20]. In Case C-320/88 *Shipping and Forwarding Enterprise*[21] the Court established that this definition is to be regarded as an autonomous concept, not to be made reliant on the national rules concerning legal transfers.[22] The supply of services is negatively defined as "*any transaction which does not constitute a supply of goods*"[23]

2.1.2 For consideration

The prerequisite that supplies made within the scope of VAT must be made for consideration limit the application of the system to the economical sector of the society. Supplies that are in all events free of charge consequently falls outside of the scope and persons providing such services cannot be regarded as taxable persons.[24] That money is received in connection with the supply however not sufficient to fall within the scope.[25] There has to be

[16] Terra, Ben, Wattel, Peter, *European Tax Law* 6th ed. Wolters Kluwer 2012 (cit. Terra/Wattel) 2012 p. 307
[17] Ibid.
[18] Art. 2.1 RVD
[19] This however is not without exemptions as some territories within the Member States has been expressly exempted from applicability of the directive under art 5-6 RVD and art 349 TFEU
[20] Art. 14.1 RVD
[21] Case C-320/88 *Shipping and Forwarding Enterprise Safe* [1990] ECR I-00285 (cit. *Shipping and Forwarding Enterprise)*
[22] Ibid. para 7, see further Terra, Ben, Kajus, Julie *A Guide to the European VAT Directives Volume 1 Introduction to European VAT*, 2011, IBFD, 2011 (Cit. Terra/Kajus 2011) pp. 443-444
[23] Art. 24 RVD
[24] Case 89/*81 Staatssecretaris van Financiën v Hong-Kong Trade Development Council*. [1982] ECR 01277 (cit. *Hong-Kong trade*) para 10
[25] Terra/Wattel 2012 p. 309

a "*direct link between the service provided and the consideration received*"[26]

The issue of whether supplies made by public bodies for consideration in the form of tax money is effectively solved by the exclusion of activities carried out by public bodies from the field of VAT.[27]

2.1.3 Taxable person

A taxable person is according to art. 9.1 RVD any person who independently carries out an economic activity for what ever purpose or result of that activity. An economic activity is in turn defined in art. 9.2 RVD as, in particular, covering exploitation of tangible or intangible property for the purposes of obtaining income therefrom. This material scope has been interpreted by the Court as very wide, covering a broad range of activities.[28] The definition of the concept "economic activity" has repeatedly been deemed inherently dependent on the prerequisite *purpose*, centering the assessment of an activity on the motives for the activity, rather than the outcome thereof.[29]

2.2 Exemptions

Some areas of business activity has been deliberately left outside of the scope of VAT,[30] although materially constituting "economic activity". The motives for these exemptions are various. Some areas, such as financial activity and transactions related to real estate have been regarded as ill-suited for the application of VAT. Other areas, has been made exempt from taxation in order to promote the functioning of the system. It is in this context important to distinguish between transactions, exempt from VAT that does not give right to deduction of input VAT and exempt transaction that allow deduction of input VAT (which in fact are taxed activities, subject to a zero-rate tax).[31] Exempt transactions that give right to deduction of input VAT are usually a necessary consequence of the system of cross-

[26] Case C-40/09 *Astra Zeneca UK Ltd v Commissioners for Her Majesty's Revenue and Customs* [2010] ECR I-07505 (cit. *AstraZeneca*) para 27
[27] Art. 13 RVD
[28] Case C-260/98 *Comission v. Greece* [2000] ECR I-06537 (cit. *Comission v. Greece 2000)* para 24-26, *Halifax* para 49, 55, see also: *The Ins and Outs of Classifying Turnover for VAT*, Bernaerts, Yves & Nathoeni, Sandhya, *The Ins and Outs of Classifying Turnover for VAT*, EC Tax Review, volume 20 issue 6, Kluwer law International 2011 p. 291 (cit. Bernaerts 2011) p. 291

[29] Case 268/83, *D.A. Rompelman and E.A. Rompelman-Van Deelen v Minister van Financiën*. [1985] ECR 00655 (cit. *Rompelman*) para 23, see further Case C-110/94 *Intercommunale voor zeewaterontzilting (INZO) v Belgian State* [1996] Page I-00857 (cit. *INZO*), Joined cases 110/98 to C-147/98 *Gabalfrisa SL and Others v Agencia Estatal de Administración Tributaria (AEAT)* [2000] ECR I-01577 (cit. *Gabalfrisa*)
[30] Art. 131-165 RVD
[31] Terra/Wattel 2012 p. 354

border supplies.[32] These supplies are exempt in the land of exportation and taxed in the land of importation (where the supply is effectively consumed).

The existence of exemptions has been criticized for creating anomalies within the system and leading to hidden taxation of consumers.[33] As shall be shown below, several of the cases regarding the prohibition of abuse in one way or the other relate to exempt activities. In this context it is also notable that the Member States under certain circumstances are allowed to apply different rates to different branches or types of transactions.[34] The introduction of reduced rates can, in the authors view, be regarded as creating similar anomalies in the system, since they, even if limited to a minimum rate of five percent,[35] infringe the neutrality of the system. Although compromising the neutrality of the system, by e.g. distorting consumer choice, the adoption of reduced rates does not, as a difference to exempt activates, distort the system by imposing a "hidden" VAT charge on the final consumer as the input VAT is deductable for the supplier.

2.3 Principle of neutrality

The principle of neutrality is an inherent and complex part of the VAT-system. Neutrality as a concept is inherently relative and whether a tax is to be perceived as neutral is dependent on what the tax is put in relation to. The neutrality has several aspects, and comes to expression in e.g. neutrality to international trade, neutrality to competition, neutrality to economic relations, but also in the aspect that the tax should provide equality of taxpayers.[36] The idea behind the principle of neutrality is to crate an effective tax on consumption without disturbing the mechanisms of the open market.

The need for neutrality can be divided into external and internal neutrality.[37] Internal neutrality include that the tax has to be neutral in relation to the price of the consumer.[38] In order to be so the amount of tax levied cannot be made dependent on the amount of transactions leading up to the final retail stage. In the VAT-system this problem is solved by allowing all suppliers to deduct the VAT incurred on the acquisition of the goods or services. Further the tax has to be neutral in the sense that is does not disturb competition and affect the pricing of products.[39] This neutrality is created by the application of a fixed, per-determined tax rate to all similar products and services. This solutions has been criticized since it makes the system of taxation

[32] Terra/Kajus 2011 p. 801
[33] Opinion of AG Ruiz-Jarabo Colomer in Case C-498/03 *Kingscrest Associates Ltd and Montecello Ltd v Commissioners of Customs & Excise.*[2005] ECR I-04427 (cit. *Kingscrest*) para 14-16, Terra/Kajus 2011 p. 801, Lenoir 2004 p. 258
[34] Art 98-101RVD
[35] Article 99.1 RVD
[36] Terra/Kajus 2011 p. 284
[37] Ibid. p. 284
[38] Ibid. p. 284
[39] Ibid. p. 285-286

regressive, since persons with high incomes use a smaller proportion of their income for consumption, the relative tax burden on these persons is perceived as lower.[40] Attempts have been made to avoid this regressivity by applying a lower rate of tax to basic necessities such as food and gas. Such moderation of the tax-system, just as the use of reduced rates in attempt to politically maneuver consumption-patterns has however proven to be ill-suited, favoring the high-consumer and consequently increasing the regressivity of the system and distorting consumer choice.[41]

The need for external neutrality give that domestic supplies cannot be favored over imported and vice verse.[42] In the European system this neutrality is created by the system of zero-rating, briefly described above at 2.2. There are several other aspects of the situations described above and several other areas where problems occur in relation to the need for neutrality of the systems. Some of these problems will be discussed later on.

2.4 Right of deduction

Promoting the neutrality and playing an important part in the creation of an effective tax on consumption the right of deduction has been described as "the essence of VAT"[43]. The main functioning of the right of deduction is described in art. 168 RVD, detailed modifications and restrictions are however laid out in art. 169-192. The main rule of the system give that taxable persons are allowed to deduct VAT incurred on purchases of goods and services intended to be used for taxable transaction. As been described above under 2.1 the scope of taxable activities is to be regarded as very wide. This delimitation however excludes a right of deduction of VAT levied on purchases made in relation to exempt supplies.

[40] Terra/Kajus 2011 p. 286
[41] Charlet, Alain, Owens Jeffery *An International Perspective on VAT*, Tax Notes International 2010 p 949 (cit. Charlet 2010) p. 949 and Lenoir 2004

[42] Terra/Kajus 2011 p 287
[43] Ibid. 999

3 Plan, Avoid, Fraud, Abuse

Both the Commission and the Council has pronounced that the prevention of tax avoidance is to be regarded as a part of the commitment to promote the internal market. Tax avoidance and evasion has been regarded to lead to budget losses, violations of the principles of fiscal justice and distortions of competition and movement of capital.[44] In an OECD-context single taxation is to be regarded as the standard and double- or non-taxation as unwanted deviations from this standard.[45]

The possibility and legality of the EU to interfere with the Member States' national tax legislation is heavily discussed throughout the doctrine and political arena. This discussion overlaps the whole field of taxation, addressing both direct and indirect taxation, as the fiscal autonomy of the Member States clashes often with the objectives pursued by the Union. Tax incentives and models for taxation can come to counter-act the objectives of the Union by e.g. amounting to obstacles for the fundamental freedoms, or by causing distortions of competition. Consequently this autonomy has been limited by the Union.[46]

The magnitude of the collision between EU law and national tax norms is clearly illustrated by the large amount of tax related cases referred to the ECJ.[47] The Court has on several occasions stated that the objective to prevent tax avoidance prevails in relation to almost all fields of taxation and in relation to all forms of legislative acts. The Court however carefully balances the interests of the Member States and the Union to prevent harmful tax behavior against the objectives of the relevant legislation and the need for foreseeability and the taxpayers' right to rely on legitimate expectation.[48] This has lead to a situation where the invocation of the concept has been given different implications and limitations depending on in what context and in which area of law the concept was invoked.[49] As a consequence the limits for what activities that are to be regarded as legitimate planning, as opposed to unacceptable avoidance appears to be rather vaguely defined.[50] In order to examine the requirements and

[44] Merks, Paulus *Tax Evasion, Tax Avoidance and Tax Planning.* INTERTAX volume 34, issue 5, 200g Kluwer Law international p. 272 (cit. Merks 2006) p. 277
[45] Ibid. p. 274
[46] An evident example is art 110 TFEU specifically aimed at preventing such harmful effects of indirect taxation and measures adopted under it such as adoption of the VAT-directives.
[47] In 2006 12,5 percent of the cases resolved by the ECJ dealt with tax-orientated problems. Pistone, Pascal, *Abuse of Law in the Context of Indirect Taxation (Before) Emsland-Stärke 1 to Halifax (and Beyond) in Prohibition of abuse of law : a new general principle of EU law?* in Rita de la Feria and Stefan Vogenauer (ed.), Oxford: Hart, 2011 p.381 (Cit. Pistone 2011) p. 382
[48] For a further analysis in relation to the field of VAT see below at 3.3.
[49] O'Shea, Tom *Tax avoidance and abuse of EU law*, The EC Tax journal, Volume 11, 2010-11 p.77 (Cit. O'Shea 2011) pp. 114-115
[50] Merks 2006 p. 279

implications of the application of the concept in relation to the field of VAT I will start out by trying to distinguish the foundational characteristics of the concept of tax avoidance as an independent concept. For this purpose I will separate the concept from the specific requirements regarding its application in relation to specific fields of law. I will then continue by assessing the interpretation and application of the concept in relation to the specific field of VAT.

3.1 A general division

Several attempts have been made to give a clear definition for the concept tax avoidance, especially in order to distinguish (unacceptable) tax avoidance from (legitimate) tax planning. It has been suggested that tax avoidance should be defined as "a way of removing, reducing or postponing a tax liability than by means of tax evasion or tax planning"[51]. This definition is on one hand accurate in the sense that it is exhaustive, but rather blunt when it comes to demarcating the concepts from each other.

In the Ruding report[52] the committee of independent experts defines unacceptable tax avoidance as "the use of devices that the legislation does not actually prohibit, but intended to cover."[53] This separates the concept from fraud or evasion, which involves elements of fraud or misrepresentation which is explicitly prohibited, and tax planning[54] which relate to situations not intended to be covered by the legislation.

This perception of tax avoidance consequently makes the assessment of the behavior or procedure an issue of interpretation of the legislation and its motives. Since tax avoidance, separated from evasion or fraud, does not prescribe a subjective element the concept becomes solely dependent on the very meaning of the relevant norm. The occurrence of tax avoidance has been described as emerging when there is a tension between purpose or objective of a norm and the outcome of the literal application of said norm.[55] To settle this tension, in order to achieve a correct application of the norm, the Court is obliged to, instead of applying the norm in its' literal sense, apply a teleological or analogical approach. Thereby the norm is applied in a manner that does not follow the logical consequences of the identification of the required prerequisites.[56]

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[51] Merks 2006 p. 276
[52] Ruding, Onno, *Report of the Committee of Independent Experts on Company Taxation, Commission of the European Communities*, Official Publications of the EC, 1992 (cit. The Ruding report)
[53] Ibid. p. 138
[54] This concept is sometimes referred to as "acceptable" tax avoidance, but in order to increase clarity "tax planning" will systematically be used throughout this essay to describe procedures where a tax payer by legal means reduces his burden of tax.
[55] Karimeri, Rami *A Critical Review of the Definition of Tax Avoidance in the Case Law of the European Court of Justice*, INTERTAX, volume 37, issue 6/7, Kluwer Law international 2011 p. 296 (cit. Karimeri 2011) p. 297
[56] Ibid.

In the classic design of taxation the burden of tax is usually put on an economic reality that has already been described or characterized through other parts of the legal system.[57] Levying private law concepts to corporate structures or transactions does not always give an accurate description of the economic effects by said structure or transaction.[58] Given that the intention of the legislator is to effectively tax the economic result, the problem when formulating legal rules in order to achieve this objective is that it is hard to balance these rules neither over- nor under inclusive in their application.[59] As a result the judge is, in order to comply with the objective sought by the legislator, at some point forced to switch subject for the assessment from the legal codification to the economic substance.[60] Regardless of how this change in perspective is made there is a need for a legal device that in a foreseeable way allows us to distinguish the legal realities that constitute the foundation for the legal-, and thus also the tax system, and the legal realities that are ignored in order to achieve the economic result sought by the legislator.[61]

Such legal devices can be found in different forms through out the jurisdictions of the Member States in shapes of legal principles, legal doctrines or general clauses.[62] Even though these concepts differ in formulation and application a great amount of common elements can be found.[63]It has however been found difficult to reconcile these different traditions into a unitary definition.[64]

3.2 The definition of the concept of tax avoidance in the field of VAT

In the area of VAT the objective of preventing tax avoidance can find clear support in the RVD. Several provisions of the directive directly address the possibility to fight tax avoidance, evasion and abuse.[65]

The Court has, in *Direct Cosmetics*[66], stated that tax avoidance, in relation to VAT legislation, should be regarded as a concept of Union law,

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[57] Almendral, Violeta Ruiz, *Tax avoidance and the European Court of Justice: What is at Stake for European General Anti-Avoidance Rules?* INTERTAX volume 33, issue 12 Kluwer Law international 2005 p. 562 (cit. Almendral 2005) p.564

[58] Freeman, Judith *The Anatomy of Tax Avoidance Counteraction: Abuse of Law in a Tax Context at a Member State and European Union Level* in de la Feria, Rita and Vogenauer, Stefan (ed.) *Prohibition of abuse of law : a new general principle of EU law?*, Oxford: Hart, 2011 p. 365 (cit. Freeman 2011) p. 372

[59] Karimeri 2011 p. 298
[60] Freeman 2011 p. 372
[61] Ibid.
[62] Ibid. p. 365
[63] Almendral 2005 p. 263
[64] The Ruding report p. 139
[65] RVD recital 27, 42, 59 of the preamble, and article 11, 19, 80, 131, 158.2, 394 and 395
[66] Case 138/86 *Direct Cosmetics Ltd and Laughtons Photographs Ltd v Commissioners of Customs and Excise* ECR 1988 Page 03937 (cit. *Direct Cosmetics*) Para 20

autonomous from the different legal traditions of the Member States. The question posed by the national court essentially concerned the interpretation of the concept of tax avoidance as described in art. 27.1 of the Sixth Directive[67]. The national court sought guidance regarding whether a Member State could use the procedure laid out in art. 27.1 of the Sixth Directive to adopt a rule that prevented the non-taxation of certain suppliers, even though the non-taxation emerged from a direct and objective application of the legislation and the suppliers could not be said to have an intent to circumvent the liability to taxation. The Court answered that tax avoidance is to be regarded as a purely objective phenomenon[68] and held that "*Intention on the part of the tax payer, which constitute essential element of evasion, is not required as a condition for the existence of avoidance*"[69]. Consequently the Court concluded that the system of VAT focuses primarily on the objective consequences of the transaction and if these consequences oppose the objectives of the directive. If so, the Member State is allowed to adopt counter-measures under art. 27.1.[70] This reasoning bring the conclusion that within the area of VAT tax *evasion* is distinguished from tax *avoidance* by the fact that the latter is an inherently "objective phenomenon" not reliant on the subjective intent of the tax payer. Tax *avoidance* can further be distinguished by the objective consequences of the procedure and the conformity of these objective consequences with the objectives of the legislation. This division of the concepts corresponds nicely to the one made in the Ruding report.[71]

The division of tax avoidance and tax evasion was later confirmed in *Garage Molenheide.*[72] The case concerned the possibility for the Member States to withhold VAT-refunds in situations where the tax agencies suspected that incorrect or misleading information was provided by the taxpayer. In its' assessment Court elaborated the concept of evasion and gave example of four distinct situation giving raise to tax evasion, thus distinguishing it from avoidance.[73]

3.3 The application of the concept of tax avoidance in relation to VAT

In their application of the provisions of the RVD the Member States are both obliged and encouraged to adopt measures in order to prevent tax

[67] Art 395 of the RVD
[68] *Direct cosmetics* para 21
[69] Ibid. para 22, see also Terra/Kajus 2011 p. 53
[70] *Direct Cosmetics* para 23-24
[71] See above at 3.1
[72] Joined cases C-286/94, C-340/95, C-401/95 and C-47/96, *Garage Molenheide BVBA* (C-286/94), *Peter Schepens* (C-340/95), Bureau *Rik Decan-Business Research & Development NV (BRD)* (C-401/95*) and Sanders BVBA* (C-47/96) *v Belgische Staat,* [1997] ECR I-07281 (cit. *Garage Molenheide*). The cases all related to situations where the taxpayers had deliberately provided untruthful VAT-reports in order to obtain incorrect VAT-refunds
[73] Pistone 2011 p. 386

avoidance.[74] The possibilities for the adoption of such measures are however restricted. In the RVD reference to the Member States possibility to enact rules in order to prevent tax avoidance is made in two typical situations. First, the Member States have the possibility to maintain and enact anti-avoidance rules by undergoing certain specific procedures.[75] Second the Member States are allowed to adopt such rules in relation to certain situations and types of transactions.[76]

The issue of in what way the Member States are allowed to counter-act tax avoidance was addressed in *Holin Groep*. The case originated form an attempt from the Dutch legislator to counter act a wide-spread type of tax planning, arising from the Dutch rules regarding the Dutch rules for taxation of transactions of immovable property. In order to do so the Dutch government enacted a law limiting the possibility for the parties in a transaction to opt for taxation. The law was enacted on the 29 December 1995 but entered into force earlier by being applicable to all transactions made after the time of the announcement of the enactment of the law (31 of March 1995). The questions referred and the discussion of the Court mainly related to whether this law was compromising the principle of legal certainty and the taxpayers right to rely on legitimate expectation due to its retroactive character. However, the Court made notable statement regarding the interpretation of the concept of tax avoidance and the possibility of the Member States to react to such behavior:

"*As regards tax avoidance, although, under the law of a Member State. A taxpayer cannot be censured for taking advantage of a provision or lacuna in the legislation which, without constituting an abuse, has allowed him to pay less tax, the repeal of legislation from which a person liable to VAT has derived an advantage cannot, as such, breach a legitimate expectation based on Community law*"[77].

This statement could be interpreted as narrowing down the earlier established concept of tax avoidance as illustrated in *Direct Cosmetics* and "accepting a conceptual difference between *abuse* and *elusion*"[78]. If so, the Court would accept procedure counter veining the objectives of the legislation as legal unless these procedures amounted to abuse in the sense

[74] C-25/07 *Alicja Sosnowska v Dyrektor Izby Skarbowej we Wrocławiu Ośrodek Zamiejscowy w Wałbrzychu* [2008] ECR I-05129 (cit. *Sosnowska*) para 22, joined cases C-439/04 and 440/04 *Axel Kittel v Belgian State* (C-439/04) and *Belgian State v Recolta Recycling* (C-440/04) SPRL [2006] ECR I-06161 (cit. *Kittel*) para 54 Joined cases C-487/01 and C-7/02 *Gemeente Leusden* (C-487/01) *and Holin Groep BV cs* (C-7/02) *v Staatssecretaris van Financiën*. [2004] ECR I-05337 (cit. *Holin Groep*) para 76

[75] Recital 59 of the preamble, and art. 11, 394 and 395 RVD

[76] Recital 27 and 42 of the preamble, and art. 19, 80, 131 and 158.2 RVD

[77] *Holin Groep* para 79

[78] Cerioni, Luca, *The "abuse of rights" in EU company and EU tax law: A rereading of the ECJ case law an the quest for a unitary notion*, European Business Law Review, volume 21 issue 6, Kluwer Law international 2010 p. 783 (cit. Cerioni 2010) p. 797

described in *Emsland stärke*[79].[80] It is therefore, in my opinion, important to distinguish this statement from the reasoning of the Court in *Direct Cosmetics* due to the different contexts in which the questions are referred to the Court. In *Direct Cosmetics* the questions referred relates to the implementation of a directive and the application of art. 27.1 of the Sixth Directive whilst the questions in *Holin Groep* related to the conformity of a legislative measure in relation to a general principle of EU law (legal certainty). It is also important to note the nature of applicable norms of the Sixth Directive, in *Direct Cosmetics* the questions concerned the implementation of a specific legal measure, a certain rule aimed to fill a gap in the legislation. In *Holin Groep* the nature of the implemented norm itself was only discussed briefly, since the question posed related to the *method* by which the new legislation had been implemented. The correct conclusions to be drawn from the statement made by the Court in *Holin Groep* are therefore in my opinion: A) that the taxpayers right to rely on the letter of the law conferred by the general principles of legal certainty and right to rely on legitimate expectation is limited by the doctrine of abuse.[81] B) that the mere accrual of a tax advantage, or a lower tax, is not sufficient to deviate from the stipulated provisions of the law.[82] And C) that the Member States are however allowed to adopt rules that impede procedures that lead to un-wanted consequences for the taxation.[83] By this interpretation the decision in *Holin Groep* does neither conflict the definition of tax avoidance laid out in *Direct Cosmetics*, nor does it narrow the possibility (and obligation) of the Member States to lay down specific legislation in order to counter tax avoidance or un-wanted tax results.

The delicate issue of the Member States' possibility to lay down anti avoidance rules, on one hand being restricted on the other being encouraged[84] was further addressed *Sosnowska*. The proceedings regarded a provision of national law prescribing a mandatory qualifying period for newly registered business operator in order for the operator to obtain VAT-refunds. Even though the Court admitted that the Member States possess a certain amount of autonomy to enact rules preventing tax avoidance, as long as this is done in a manner that is "*…the least detrimental to the objectives and principles laid down by the relevant Community legislation*"[85] The possibility for the Member States to derogate from the provisions in order to prevent tax avoidance is however limited to the application of the specific procedure laid out in art 27.1 of the Sixth Directive.[86] As the national legislation had not been adopted in accordance with the procedure laid out in art 27.1, and since the qualifying period was deemed incompliant with the right of deduction and the principle of proportionality the Court found the

[79] Case C-110/99 *Emsland-Stärke GmbH v Hauptzollamt Hamburg-Jonas* [2000] ECR I-11569 (cit. *Emsland-Stärke*)
[80] See below at 4.1
[81] Holin groep para 78
[82] Ibid. para 79
[83] Ibid. para 77
[84] See e.g. art. 131 RVD
[85] *Sosnowska*. para 23
[86] Ibid. para 34-38

adoption of the national rules to violate the provisions of the Sixth Directive.[87] From the Courts reasoning it can be established that the Member States are more or less bound by the procedure set out in art. 395 RVD[88] when adopting anti-avoidance rules. Consequently, the Member States possibility to invoke the prevention of tax avoidance is severely limited, unless done in relation to the specific provisions of the directive.[89]

3.3.1 The linguistic dilemma

Unfortunately, the linguistic treatment of the concept cause an unnecessary confusion. Even though the Court has provided clear distinction between the stipulated concepts, since the different concepts of avoidance, evasion, fraud and abuse are often referred to in an interchangeable way.[90] This is clearly illustrated by the case *Garage Molenheide* where the English version of the case refers to evasion, the French version to "eluder"[91] and the Swedish version refers to "skatteundandragelse" which should, following the terminology of *Direct cosmetics*, correspond to "avoidance". This somewhat confused use of terms like abuse, fraud, avoidance and circumvention is spread over almost all areas of Union law where the Court has referred to disloyal use of provisions of the treaties or secondary law.[92] Further confusion is added by the fact that tax avoidance in relation to direct taxation is to be regarded as a similar concept but with different implications. Further the Court has, in relation to direct taxation, shown the same inconsistent use of the terminology.[93]

3.4 Tax avoidance in relation to direct taxation

The possibilities of the Member States to restrict the fundamental freedoms in order to protect their national tax base has been subject to extensive discussion and review. The Court has on several occasions assessed the Member States' possibilities to enforce national anti-avoidance or –evasion rules in relation to rights conferred to the tax payer by acts of EU legislation. In this context the ECJ has been very reluctant to allow the Member States to justify restrictions of the fundamental freedoms by

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[87] Ibid. para 33
[88] Art. 27.1 Sixth Directive
[89] See further Case C-395/09 Oasis East sp. Z o.o. v Minister Finansów [2010] n.y.r. (cit. *Oasis East*) referred below under 5.3.2
[90] Pistone 2011 p. 386
[91] Ibid., according to Pistone "éluder" should be accurately be translated to "avoidance"
[92] De la Feria, Rita, *Prohibition of Abuse of (community) law: The creation of a new general principle of EC law through tax law*, Common market law review, volume 45 issue 2, Kluwer Law international 2008 p. 395 (cit. De la Feria 2008) p. 396, Piantavigna, Paolo, *Tax abuse in European Union Law: A Theory*, EC tax review 2011 issue 3, Kluwer Law International p. 134 (cit. Piantavigna 2011) p. 137

[93] Merks 2006 p. 280

invoking tax-protective incitements.[94] Since a person or a company using the fundamental freedoms will ultimately be subject to taxation in a Member State, the migration from a tax jurisdiction cannot in it self be regarded as sufficient in order to restrict the free movement.[95] Consequently tax jurisdiction shopping can, as a main rule, be regarded as a legitimate in relation to the fundamental freedoms.[96] Instead of making the intentions of the taxpayer a benchmark for the assessment of legitimacy of the exercise of the free movement the Court has examined the purpose and limits of the freedoms in themselves.

In *Cadbury-Schweppes*[97] the Court found that the freedom of establishment involved an "*actual establishment of the company concerned in the host Member State and the pursuit of genuine economic activity there*"[98]. Consequently court concluded that the Member States are allowed to counter tax avoidance schemes that involve "wholly artificial arrangements, not illustrating economic reality".[99]

The Court has however left the Member States with yet another possibility to restrict the fundamental freedoms in order to counter tax avoidance.[100] In *Marks and Spencer*[101] and later in *SGI*[102] the Court found that the objective to attain the objectives of the national tax legislation could constitute an overriding reason in the public interest. If so, in order to be applicable the measure must be proportionate,[103] and could only be accepted when the measure was necessary in order to balance the allocation of taxing rights between the Member States.[104]

In my view none of these clusters of cases give any substantial guidance when it comes to defining tax avoidance as a unitary concept. Due to the fiscal autonomy of the Member States the Court is neither directly empowered to do so, but only to assess the implications of the national rules to the rights provided by the Union.

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[94] Helminen, Marjaana, *EU Tax Lax Direct Taxation* , IBFD, 2009 (cit Helminen 2009) p. 116

[95] Case C-264/96 *Imperial Chemical Industries plc (ICI) v Kenneth Hall Colmer (Her Majesty's Inspector of Taxes)* [1998] ECR I-04695 (cit. *ICI*) para 26, O'Shea 2011 p 101

[96] Merks 2006 p 279

[97] Case C-196/04 *Cadbury Schweppes plc, Cadbury Schweppes Overseas Ltd v Commissioners of Inland Revenue*, [2006] ECR I-07995 (cit *Cadbury-Schweppes)*

[98] Ibid. para 54

[99] Ibid. para 75

[100] Helminen 2009 p 117

[101] Case C-446/03 *Marks & Spencer plc v David Halsey (Her Majesty's Inspector of Taxes)* [2005] ECR I-10837 (cit *Marks & Spencer*)

[102] Case C-311/08 *Société de Gestion Industrielle (SGI) v Belgian State [2010] ECR I-00487* (cit. *SGI*)

[103] *Marks & Spencer* para 55

[104] Ibid. para 44-45, O'Shea 2011 p 104-106

4 Abuse of law and Abuse of rights

4.1 Introduction to the concept of abuse in the case law of the ECJ

Most commentators agree that the first step towards the development of the doctrine of abuse of rights was taken in 1974 by the Courts' decision in *Van Binsbergen*.[105] The concept has since then been developed through several series of cases, concerning "circumvention" or "U-transactions"[106], EU CAP legislation, company law, migration- and citizenship cases, until finally making its definite impact on tax law in 2006 by the delivery of the two landmark cases *Halifax* and *Cadbury-Schweppes*.[107]

The legal status of the concept is discussed throughout the doctrine, and the perceptions of the functioning of the concept are inconclusive. [108] The Court has however expressively held that the concept is to be perceived as a general principle of EU law.[109] The general maxim on which the concept relies has been formulated as "*Community law cannot be relied on for abusive or fraudulent ends*".[110] The consequence of this is that the invoked provision of Union law is not regarded for the purpose of the assessment of the procedure, consequently nullifying the legal Union law consequences.[111]

Ben Terra and Julie Kajus identified four categories where the Court has ruled on abusive procedures.[112] Commentators have however held that the doctrine of abuse is fully applicable to all areas of EU-law.[113] The four fields presented by Terra and Kajus are:

- Where a person relies on EU law in order to circumvent or dispatch national law.

[105] see further De la Feria 2008 p 395, 399
[106] U-transactions are transactions characterized by the invocation of a fundamental freedom in order to dispatch national legislation, see further Cerioni 2010 p 789
[107]For a more thorough analysis of the development of the doctrine and the key cases on the matter, see De la Feria 2008
[108] Karimeri 2011 p 303
[109] Case 321/05 *Hans Markus Kofoed v Skatteministeriet* [2007] ECR I-05795. (Cit. *Kofoed*) para 38, Case 126/10 *Foggia - Sociedade Gestora de Participações Sociais SA v Secretário de Estado dos Assuntos Fiscais* [2011] N.Y.R (Cit. *Foggia*) para 50
[110] A statement originally made in *Kefalas* para 20 but that has been repeated by the court on several occasions, see e.g *Halifax* para 68, *Fini H* para 32
[111] case C-373/97 *Dionysios Diamantis v Elliniko Dimosio (Greek State) and Organismos Ikonomikis Anasygkrotisis Epicheiriseon AE (OAE)* [2000] ECR I-01705(Cit. *Diamantis*) para 34
[112] Terra/Kajus 2011p 46
[113] Cerioni 2010 p 784

- Where a person seeks to gain financial advantage from EU-funds by way of abusive use of EU-law.
- Where a person uses EU law in a manner contrary to a national abuse of rights provision
- Transactions designed solely to obtain a tax advantage

The concept has been found to have different implications and to be applicable in various extent to different fields of law.[114] Regardless of the differences surrounding these categories of rulings, none of them can be said to be constitute an isolated phenomenon, despite the fact that they possess certain individual characteristics. The overlapping influence between the different fields of law is significant, but for this essay will the focus will be put on the last category, especially in relation to the area of VAT.

Along the crooked path of the development of the doctrine of abuse *Emsland-Stärke* is often described as one of the most important mileposts.[115] The case concerned a practice performed by a German exporter of agricultural products (Emsland-Stärke GmbH) who exported potato-based starch products to a recipient outside of the Union. After discovering that the exported products where promptly re-exported back into the Union the German authorities demanded a repayment of export funds that had been granted the company. The question referred to the Court essentially concerned whether the provisions of the relevant regulation[116], could permit such a demand of repayment. Finding support in its earlier case law the Court repeated that the Union legislation cannot be relied on for abusive purposes[117] and laid a legal model for qualifying abusive practices. This legal model consists of two parts, an "objective" and a "subjective" and is, in *Emsland Stärke* formulated as follows:

"*A finding of an abuse requires, first, a combination of objective circumstances in which, despite formal observance of the conditions laid down by the Community rules, the purpose of those rules has not been achieved. It requires, second, a subjective element consisting in the intention to obtain an advantage from the Community rules by creating artificially the conditions laid down for obtaining it…*"[118]

According to the Court the application of these facts would provide a sufficiently clear ground to demand repayment of the issued funds.[119] This consequence would, in my interpretation, correspond to the at this point settled notion that the consequence of the establishment of an abuse is that

[114] De la Feria 2008 pp. 428-429
[115] Cerioni 2010 p. 787 De la Feria 2008 p. 408
[116] Council (EC, Euroatom) No. 2988/95 of 18 Dec, 1995 on the protection of the European Communities financial interests, O.J. 1995, L 312/1
[117] *Emsland Stärke* para 51
[118] Ibid. para 52-53
[119] Ibid. para 56

the national court is allowed to deny the abuser the benefit provided by the abused provision.[120]

The decision in *Emsland Stärke* has been regarded as significant for several different reasons. First by clarifying that the subjective purpose of the operator is relevant, but not exclusively determining, for the assessment of the operation.[121] Second because it structures the concept of abuse by laying down the complete test, later to be adopted and invoked in other areas of law.[122] This model for the assessment of possibly abusive practices was later repeated in both *Halifax* and *Cadbury-Schweppes*, and it has been consistently held that this model forms the general criterion for the assessment of abuse in the VAT area.[123] Third because the ruling shows that the establishment of abuse is in it self sufficient to preclude the consequence of a literal application of a provision of EU law.[124]

4.2 Different types of abuse?

In the context of transactions designed solely do obtain tax advantages Paolo Piantavignia has divided the concept of abuse into two categories. *Abuse of law* which symbolizes the displacement of national law by using the fundamental freedoms in a manner contrary to their purpose, i.e. abuse of primary EU law, and *abuse of rights* where provisions of provisions of EU-law in themselves are abused i.e. abuse of secondary legislation.[125] According to Piantavignia these two lines derive from the same legal origin, the prohibition of abuse, but are established in two manifestly different lines of case law.[126] Note that for this section the terminological distinction made in this section is made in correspondence with the terminological distinction made by Piantavignia.[127] No such distinction of the use of the terms "abuse of law" and "abuse of rights" can be said to have been done by the Court.[128]

Piantavignia derives this distinction from a statement made by the Court in *Centros*[129].[130] In *Centros* the Court stated that: *"...a Member State is entitled to take measures designed to prevent certain of its nationals from*

[120] For this effect, see further *Diamantis* para 34
[121] Cerioni 2010 p. 789 for a similar view see de la Feria 2008 p 410
[122] See below, section, 4.3 and 5
[123] See below, section 5
[124] See further below, section 4.2.3
[125] Piantavignia 2011 p. 137
[126] Ibid.
[127] Ibid.
[128] These concepts has been referred to in an apparently interchangeable way, see e.g. opinion of AG Mazak in *Case C-277/09 The Commissioners for Her Majesty's Revenue & Customs v RBS Deutschland Holdings GmbH* [2010] n.y.r. (cit. *RBS Deutschland*) para 67, 70
[129] Case C-212/97 *Centros Ltd v Erhvervs- og Selskabsstyrelsen* [1999] ECR I-I-01459 (cit *Centros*)
[130] Piantavignia p. 137

attempting, under cover of the rights created by the Treaty, improperly to circumvent their national legislation or to prevent individuals from improperly or fraudulently taking advantage of provisions of Community law…"[131].

This distinction was further upheld by the Court in *3M*[132] where the Court expressly stated that principles established in *Halifax* are not directly applicable when assessing non-harmonized taxes.[133] Further the Court in *3M* stated that the question of abuse is only relevant in relation to un-harmonized taxes when there is a possible infringement of the treaty freedoms and that the Member States have no obligation to counter abusive procedures in this area.[134] In this manner the Court distinguishes the situation where national law is displaced by wrongful application of EU-law (Abuse of law) from the situation where EU-law is applied contrary to its' purpose (Abuse of rights).

4.2.1 Abuse of law

The concept of *abuse of law* emanates from the fundamental freedoms as economic rights and should be assessed from the starting point of whether the national provision precluding the exercise of the freedom granted could act impairing on the exercise of said freedom.[135] Abuse may in this perspective be perceived as coinciding with the national concept of tax avoidance, judging from the Courts' decisions in *Cadbury-Scheppes* and *ICI*. But it is important to bear in mind that in these cases it is the limits of the freedom of establishment, not abuse of the (national) tax norm that is assessed. Ergo, in *Abuse of law* EU law is the tool used for the circumvention, and thus form the external limit for the applicability of anti-avoidance legislation.[136] It is not relevant for the ECJ if the procedure put out is to be regarded as abusive, avoidant or evasive from a national perspective. What is relevant is whether the national provision invoked, the internal limit, is to be regarded as wrongfully impairing on the freedom. This brings a wedge between the concepts of tax avoidance and *abuse of law*, where they often coincide but are not related.[137] Likewise the situation of abuse should be distinguished from the situation of fraud. Fraud inherently includes misleading elements or elements of misrepresentation, which don't represent neither legal nor economic reality.[138]

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[131] *Centros* para 24
[132] Case C-417/10 *Ministero dell'Economia e delle Finanze and Agenzia delle Entrate v 3M Italia SpA* n.y.r (cit *3M*)
[133] Ibid. para 30
[134] Ibid. para 31-32
[135] Piantavignia 2011 p. 137
[136] Ibid.
[137] Fore a different view see Karimeri 2011 p. 297
[138] Piantavignia 2011 p. 138, Pistone 2011 p. 391. Cases of fraud are however neither protected by EU-legislation, as "*Community law cannot be relied on for abusive or fraudulent ends*" , *Kefalas* para 20

4.2.2 Abuse of rights

The concept that Piantavignia refers to as *abuse of rights* is connected to abuse of secondary law and has been formulated through another line of cases, the "*Halifax*-line". This form of abuse is in the area of tax law distinguished by the fact that the abused tax law and the abused norm of EU law coincides.[139] Consequently the behavior is not to be regarded as abusive because of the lack of an economic justification but because of its incompliance with the principles and objectives of the secondary legislation.[140] Consequently the application of the doctrine is not reliant on a specific norm granting applicability.[141]

4.2.3 The difference between Abuse of law and abuse of rights

As an example the Abuse of law-situation in relation to tax law can be described as follows: National anti-avoidance rules are, when acting impairing on the treaty freedoms incompatible with Union law unless justifiable (as in the *Marks & Spencer*-situation). If, however, the practice falls outside the scope of the treaty freedoms, as abusive practices do under the C*adbury-Schweppes*-doctrine, Union law lack applicability to the situation. In this manner the abuse-situation reassembles strictly internal situations or cases of reverse discrimination. The national tax norm thereby gains applicability, not because the practice is contrary to the objectives of the invoked provision of EU-law, but because the lack of a conflict between EU-law and national law.

In the abuse of rights-situation on the other hand the establishment of abuse of the relevant provision of EU-law *in it self* affect the assessment of the legal nature of the procedure. As shall be further developed below the field of applicability does not only cover the direct provisions of the directive, but also provisions of national law that has been enacted as a part of the implementation of the directive.[142]

The invocation of the doctrine in relation to directives is however dependent on the existence of some kind of legal vessel in order to be applicable.[143] This is since the principle of legal certainty give that directives cannot independently create legal obligation on the citizen.[144] This lead, in the authors' view, to a difference in applicability of the concept in relation to different types of secondary legislation. Regulations are directly applicable in the Member States and consequently the concept of abuse gain direct applicability in relation to the provisions of the regulation. Directives on the

[139] Piantavignia 2011p 138
[140] Ibid. p. 142
[141] Ibid.
[142] See section 5.3.2
[143] *Kofoed* para 42-45
[144] Ibid. para 42

other hand, not being able to independently form obligations to the citizen, are reliant on the application of rules of national law. In cases where national law lack a direct implementation[145] of the Union concept of abuse it is for the courts of the Member States to examine the existence of national anti-abuse provisions that can be interpreted to include the concept.[146]

If the directive is correctly implemented the concept of abuse however seem to be applicable by a mere interpretation of the provisions. In the view of AG Maduro this is since the concept of abuse is to be regarded as a general principle of *interpretation*.[147] The AG has not received any direct support for this notion in the case law of the Court, but neither has the application of abuse been made dependent on the existence of specific legal rules implementing it.[148]

This division of the concepts appears rational considering the need for a uniform application of the Secondary legislation. If Union concept of abuse was not to form both the internal and the external limit of application of secondary legislation (such as the EU VAT-rules) the prevention of unwanted behavior would be made reliant on the national anti-avoidance-rules. This would promote an incoherent application of the directive, considering the differences in the legal traditions of the Member States. As it has been stated by the Court that the application of national anti-abuse ruled cannot deviate from the unitary concept of abuse,[149] the national rules restricting tax-abuse, and the Union concept of abuse as applicable in the relevant field of law, must be considered to be directly corresponding when operating within the field of secondary legislation.[150]

4.3 Concluding remarks

As shown in *Direct cosmetics* tax avoidance has, in the field of VAT, an objective character, solely determined by the purpose of the legislation. Abuse on the other hand is made dependent on both objective an subjective factors, being dependent on both the purpose of the legislation and of the procedure laid out.[151] It is important to stress that neither the concept of tax avoidance, nor the concept of abuse (as shall be further developed in the next section of this essay) aims to prevent tax savings or tax advantages, but

[145] In *Kofoed* the Danish state had not implemented the specific anti-abuse provision of the directive (90/434/EEC, the"merger directive").
[146] *Kofoed* para 46
[147] Opinion of AG Poires Maduro in *Halifax* para 68-69
[148] See further below, section 5.2.1.2
[149] *Pafitis* para 68 *Kefalas* para 22
[150] The applicability of the concept of abuse in relation to the national law implementing the VAT-system has been severely debated throughout the Swedish legal doctrine. See Von Bahr, Stig, *Skatteflykt i EG-rättslig belysning*, Skattenytt 2007 issue 11 p. 2, Norberg 2008
[151] See section 5 for a further analysis of the manifestation of the "subjective factor" of the test when the concept is applied in relation to VAT.

solely to ensure that the legislation is applied in compliance with its' purpose.

It has been argued that abuse of tax law (at least as interpreted as abuse of rights) form a type of tax avoidance and that the concept can be fit within the wider frame of tax avoidance as the effect of both concepts is ultimately derived from the purpose of the legislation.[152] Provided that the broad perception of the concept of "the use of devices that the legislation does not actually prohibit, but intended to cover"[153]. I don't see any point in objecting to such a position since the outcome of an established abuse is the prohibition of such a device. Neither do I see any point in coming to such a conclusion since first, the classification of tax avoidance can, in relation to un-harmonized areas be, made dependent on national law. Second since although both concepts strive to obtain similar purposes there is a material difference between the concepts in terms of their application.

The relevant difference of the concepts lies within their legal functioning and applicability. The prevention of tax avoidance is in my interpretation, an objective of the Union, coming partly to expression through legislative acts, but also through for example co-operation between the tax authorities of the Member States. This objective cannot however not be invoked in order to set aside a literal application of the legislation.[154] On the other hand, in relation to abuse, the dispatchment of the literal application of the legislation is to be regarded as a part of the concept, as a literal application is required already in the assessment of the procedure. Consequently norms aimed to prevent tax avoidance need to be specifically enacted, whilst the prohibition of abuse imbues the entire framework. Although dependent on some kind of legal vessel in order to be applicable, it lies within the character of each separate provision of the legislation that it cannot be applied in an abusive manner.

[152] Pistone 2011 387, Karimeri 2011 p 297
[153] The Ruding report p 138
[154] As shown in *Holin Groep,* see above section 3.3

5 The concept of abuse applied in the area of VAT

As described above the applicability of EU law does not stretch to cover situations where a right is exercised in a manner contrary to its purpose. Such a general policy must however, in order to comply with the need for legal certainty, be constructed in a manner that prevents the courts from applying it in an arbitrary and inconsistent way.[155] Today the assessment of possibly abusive behavior in the area of VAT is primarily made by an application the landmark case *Halifax* as a benchmark. The analysis in this section will therefore emanate for a thorough review of *Halifax* and fundamental elements of the decision will further examined by an analysis of the case-law that followed. In order to promote an understanding for the legal background in which *Halifax* was decided I will also briefly address some of the cases leading up to the *Halifax*-decision.

5.1 Introducing the concept of abuse to VAT.

The consequence of abusive and fraudulent behavior was briefly addressed in *Fini H*[156]. The case concerned the right of deduction of VAT levied on leasing fees for premises let by a restaurant (Fini H) that had ceased its business but still maintained the leased premises as the contract for the premises had not yet expired. The question referred to the ECJ essentially concerned if the leasing contract, originally entered as a part of an economic activity, on its own could qualify the ceased business as economic activity, allowing deduction of the VAT incurred on the leasing fee.[157]

The Court, relying on its broad interpretation of the concept "economic activity",[158] found that cost emerging from an economic activity, must just as cost arising in the start-up process of a business, must be regarded as occurring within the frame of an economic activity. Even if these costs do not actually arise until after the business has ceased. Since the costs where incurred within the frame of an economic activity the VAT would consequently be deductable if the requirement of a *direct an immediate link*[159] was satisfied.[160]

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[155] *Halifax* para 72
[156] Case C-32/*03 I/S Fini H v Skatteministeriet* (Cit. *Fini H*) [2005] ECR I-01599
[157] Ibid. para 15
[158] See above, section 2.1
[159] Case C-98/98 *Commissioners of Customs and Excise v Midland Bank plc* [2000] ECR I-04177(cit *Midland bank*) para 24
[160] *Fini H* para 30

Coming to this conclusion the Court, citing *Kefalas*, made the reservation that "*Community law cannot be relied on for abusive or fraudulent ends*"[161] This would, according to the Court be relevant if the restaurant owner for example used the premises for private use after the cessation of the business activity.[162]

This statement could appear as redundant and confusing in this context, since if the premises where to be used for strictly private use the use would automatically fall outside the scope of economic activity. Therefore the need for a direct and immediate link would not be satisfied, regardless of whether the practice would be found to be abusive or not. This however illustrates the essential functioning of the concept of abuse. Since the Court concluded that the costs had occurred within the scope of an economic activity, the deduction of the incurred VAT was consequently formally compliant with the provisions of the directive. If the however these formal compliance proved to be contrary to the purpose of the provision, the right of deduction is to be deprived.

Even though *Fini H* introduces the idea of the general concept of abuse being applicable in the VAT case law, the findings of the Court should primarily viewed as concerning the interpretation of the concept economic activity. Also *Halifax*, to some extent concerns the reach of the term "economic activity" and the scope of VAT, but a distinction between these cases has to be made. In case law relating to the concept of "economic activity" the Court has maintained the position that the scope is to be interpreted as extensive,[163] and that the purpose of the taxpayer is an important, decisive factor in the assessment of an activity. This wide scope is however limited by fraud or abuse.[164] In *Halifax* the Court however switch focus by instead of giving a "negative" definition, chisel out concept of abuse in the area of VAT itself.

The idea that abusive procedures in the area of VAT could be governed by the general concept of abuse was further addressed *Holin Groep*[165] where the Court for the first time in a VAT-context cited the two-part test formulated in *Emsland-Stärke*.[166] However, due to the nature of the questions posed by the national court in *Holin Groep* the Court was able to refrain itself from addressing the implications of the doctrine of abuse in relation to the behavior of the taxpayer. Instead the Court took notice of the need of a careful balancing of the concept in relation to the right of the taxpayer to rely on legitimate expectation.[167] In the end the Court found that the legislation implemented by the Member State did not compromise the

[161] *Fini H* para 32, *Kefalas* para 20
[162] *Fini H* para 32
[163] See above, Section 2.1.3
[164] *Fini H* para 24
[165] See further above , section 3.3
[166] *Holin Groep* para 78
[167] Ibid. para 77

right to rely on legitimate expectation in the first place and subsequently there was no need for a comprehensive analysis of possible abuse.

In connection to the conclusions presented above, in section 3.3, two relevant observations can be drawn from *Holin Groep* regarding the concept of abuse. First that the Court took steps towards the creation of a unitary concept of abuse, also applicable to the area of VAT. Second that a subjective criteria is necessary in order to break through the protection given to the tax payer by the right to rely on legitimate expectation.[168]

5.2 Halifax

In *Halifax* a bank (Halifax), usually only able too deduct a small proportion of its input VAT due to the exemption of financial activity from the scope of VAT managed, through a series of transactions through connected and independent companies, deduct almost the full input VAT for the construction of a number of call-centers. The practice was formally in compliance with the national rules implementing the provisions of the Sixth Directive and did not fall within the scope of any specific nationally adopted anti-avoidance legislation. Considering the development of the doctrine of abuse in related case law the national court asked first, if the activity put down by the parties qualified as economic activity[169], and second, if the appellants claim for recovery of VAT could be disallowed on the basis of the application of the doctrine of abuse.

5.2.1 Opinion of AG Maduro

5.2.1.1 Economic activity

The AG, Poires Maduro started out by establishing that, even if criminal activities are left outside the wide scope of VAT,[170] the purpose of a specific transaction cannot be seen as decisive for its qualification as a taxable activity. This is since the operators purpose isn't relevant and cannot change the objective nature of the transaction.[171] In the opinion of the AG the relevance of the taxpayers purpose is assessed in relation to the objective of undertaking economic activity i.e. purpose *to* pursue an economic activity.

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[168] Cerioni 2010 p. 797

[169] This question holds in my opinion equal significance as the second for the development of the concept of abuse, as the court had at this point indicated that an abusive procedure would not qualify as an economic activity (see *INZO* para 24). In my assessment the implication of the establishment of abuse would differ substantially depending on how the effects thereof where to be decided. If abusive procedures where to be found not constituting an economic activity this would preclude all consequences of a taxable activity, and would consequently deviate from the settled maxim that the consequence of abuse is to "deny the abuser the benefit of the abuse" (see *Diamantis* para 34).

[170] Opinion of AG Poires Maduro in *Halifax* para 45, see further case C-158/98 *Staatssecretaris van Financiën v Coffeeshop "Siberië" vof* [1999] ECR-I 03971

[171] Opinion of AG Poires Maduro in *Halifax* para 47-48

This should be distinguished from the discussion held in relation to the second question in *Halifax* which concerns the purpose *of* the economic activity.[172]

5.2.1.2 Abuse

Having established that the procedures laid out amounted to economic activity regardless of the taxpayers purpose of the transactions the AG continued to the second question. In his assessment the AG relies heavily on rule of law-based arguments, stating that every legal system need a "self-defense mechanism"[173] and that in the field of Union law this mechanism is, according to the AG, provided by the doctrine of abuse.[174] As such the AG perceives the doctrine of abuse as a general principle of *interpretation*, meant to ensure that Union law is not applied in a manner contrary to its purpose.[175] The notion of the concept as a general principle of interpretation would make concept inherent in every single provision. By applying the concept to the provision would then make it a question of interpretation of whether the assessed provision is applicable or not.[176]

According to the AG this principle is illustrated by the two-part test laid out in *Emsland-Stärke*. The AG however stresses need for objectivity when assessing procedures laid out in relation to the VAT-system.[177] The solution of the paradox of establishing abuse by applying the "*Emsland-Stärke*-test", which involves a "subjective element", in a context where the law operates in a totally objective manner is explained very carefully. According to the AG the solution lies in an establishment of a *purpose* of the transactions by an assessment of objective factors, excluding any other possible motives for the procedure laid out.[178]

My interpretation of the AGs solution is that the purpose of the taxpayer is examined by an application of a "negative business-purpose test".[179] Abuse can only be found if the practice, from an assessment of objective factors, is found to have no other purpose or motivation than the achieved advantage. "Purpose" must in this circumstance be expressively distinguished from

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[172] Opinion of AG Poires Maduro in *Halifax* para 50-51
[173] Ibid. para 74
[174] In relation to the discussion of abuse of law/abuse of rights as separate concepts, section 4.2, and the "linguistic dilemma", section 3.3.1, it is worth mentioning that the AG observes the un-systematic way of reference to the doctrine of "abuse" or abuse of rights". (para 61, 68). The AG also observes that the two typical situations of invocation of abuse, in relation to treaty freedoms/ secondary legislation but does however no deeper analysis of the different implications of the concept in different situations. (para 63)
[175] Opinion of AG Poires Maduro in *Halifax* para 68-69
[176] Terra/Kajus 2011 p. 59
[177] The need for objectivity should in this situation be observed with the conclusions made by the AG in relation to the first question of the court where he concluded that the objectivity of the VAT-system makes the subjective intention of the tax payer insignificant for the evaluation of the transactions.
[178] Opinion of AG Poires Maduro in *Halifax* para 70-71
[179] For a deeper definition of the "business purpose test" referred to in this passage, see Piantavigna 2011p. 135

both “consequence” and “intention”. The practice may have other, favorable or un-favorable, consequences but these are in my opinion to be regarded as “objective factors”. As such they are not independently decisive for the outcome of the assessment. Similarly the subjective intention of the taxpayer cannot be the decisive factor. This since the Court has repeatedly held that the common VAT-system put no obligation on the taxpayer to pay the highest possible amount of tax, [180] and that the objective outcome of a procedure that is to be the decisive factor for the VAT-system.[181] Further the AG raises the example of an unknowing business-operator who is adopting a certain tax-scheme presented by a well informed tax-advisor. This practice must, even though the business operator had no intention to avoid taxation be regarded as abusive if the purpose of the *practice* is to reach an outcome that lead to avoidance of tax in a manner contrary to the purpose of the legislation.[182] This proposed method does not only limit the procedural autonomy of the Member States’ courts, since it to a certain extent precludes national rules of evidence, but also limit the scope of application of the doctrine to very specific situations.

5.2.2 Assessment of the Court

In its’ assessment the Court agreed with the conclusions of the AG in relation to the first question. Stressing the objective nature and wide scope[183] of the system the Court found that, provided that the procedure does not involve evasive elements such as improper invoices or untruthful tax returns,[184] tax saving motives cannot deprive the activity of its nature as an economic activity.[185] [186]

Proceeding to the second question the Court starts of by referring its earlier statements regarding abusive practices.[187] The Court maintains the position that Union legislation, including the common VAT-system, cannot be extended to cover abusive practices. Practices that are not carried out in a normal economical context and that are solely performed to obtain an advantage from Union law.[188] The Court then continued by pointing out that the prevention of tax avoidance, evasion and abuse are objectives recognized and encouraged by the Sixth Directive.[189] Those objectives must

[180] Opinion of AG Maduro in *Halifax* para 85, see further *Holin Groep* para 79, Case C-4/94 *BLP Group plc v Commissioners of Customs & Excise*.[1995] ECR I-00983 (Cit. *BLP group*) para 26
[181] See above, section 3.2
[182] Opinion of AG Poires Maduro in *Halifax* para 70
[183] *Halifax* para 55
[184] Ibid. para 58
[185] Ibid. para 60
[186] The effect of the traders intention for the qualification of an economic activity is further clarified by a comparative study of the cases case C-354/03 *Optigen Ltd* (C-354/03), *Fulcrum Electronics Ltd* (C-355/03) *and Bond House Systems Ltd* (C-484/03) *v Commissioners of Customs & Excise* [2006] ECR I-00483 (cit *Optigen*) and *Kittel*
[187] *Diamantis, Fini H*
[188] *Halifax* para 68-70
[189] Ibid. para 71

however be carefully balanced against the need for foreseeablity, legal certainty and the traders right to organize their business however they see fit.[190]

In order to obtain this balance the Court stated that an abusive practice can only be found by a two-part test of "objective" and "subjective" factors. The test is formulated "*...first the transactions, notwithstanding formal application of the conditions laid down by the relevant provisions of the Sixth Directive an the national legislation transposing it, result in an accrual of a tax advantage the grant of which would be contrary to the purpose of those provisions. Second, it must also be apparent from a number of objective factors that the essential aim of the transactions concerned is to obtain a tax advantage*"[191]

Even thought this test is not an exact copy of the formulation in *Emsland-Stärke*[192] the essential functioning of the tests is the same. By reading the two tests together the obvious difference is that the Court in *Halifax* modified the "subjective" part of the test by stating that the aim of the transaction must *essentially* be to frustrate the purpose of the legislation. In my view this "relaxation" of the rather strict subjective criteria laid out in *Emsland-Stärke* adds a flexibility to the application of the doctrine as applicable as a principle rather than a strict rule.[193]

5.3 Further development

5.3.1 Aim of the transactions

The question of the interpretation of the prerequisite "essential aim" was further addressed in *Part Service*[194]. In *Part Service* an Italian leasing company, by dividing the services supplied in a car lease transaction into a lease supply, and a supply of a financial service, exempt from VAT, managed to reduce the burden of VAT incurred on the transaction. In order to examine if the practice was to be regarded as abusive the national court asked the ECJ whether the prerequisite "*essential aim which is to obtain a*

[190] For this effect see further e.g.. *BLP-group* and case C-17/01 *Finanzamt Sulingen v Walter Sudholz*, [2004] ECR I-04243 (Cit. *Sudholtz*)
[191] *Halifax* para 74-75
[192] See further *Emsland-Stärke* para 52-53
[193] Although the Court doesn't follow the AGs' reference to the concept as a "principle of interpretation" the Court applies the concept in an "independent manner", not being made dependent on interpretation of national legislation. This difference in application as compared to the need for at "legal vessel" later expressed in *Kofoed* (see above, section 4.3.2) is in the authors opinion difficult to explain. One possible explanation is however the different degrees of harmonization of the relevant fields of law. Whilst the VAT-system is almost fully harmonized, the harmonization of direct taxation is restricted to certain specific fields. For a similar reasoning, see Piantavignia 2011 pp. 145-146
[194] Case C-425/06 *Ministero dell'Economia e delle Finanze v Part Service Srl* [2006] ECR I-00897 (cit *Part Service*)

tax advantage"[195] was to be interpreted as "*carried out for no commercial reason other than a tax advantage*" or in a broader, or in a more restrictive way.[196] The Court answered that even though it had been stated in Halifax *Halifax* that a transaction performed with the sole aim to obtain a tax advantage would fulfill the second, "subjective" part of the test,[197] this should not be seen as a mandatory requirement. The formulation "essential aim" should according to the Court be interpreted as "principal aim" – i.e. in a broader sense than "sole aim" or "carried out for no commercial reason other than a tax advantage".[198] This formation of the criterion conflict with the formation proposed by AG Maduro in *Halifax*, where the AG stressed the importance of ensuring that the attainment of the tax advantage is the sole motivation of the taxpayer.[199]

5.3.2 Purpose of the legislation

In *Halifax* the Court addresses the question of the purpose of the Sixth Directive and the VAT-system rather briefly. First the Court note that the main purpose of the deduction system is that the burden of VAT incurred by costs emerging from the economic activity is removed from the business operator. The Court then repeat the established need for a direct and immediate link between the cost from which the input VAT arises and a corresponding transaction later on in the chain of supplies.[200] According to the Court it would consequently conflict with the principle of neutrality of the VAT-system "*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…*"[201] Thereby the Court find the first criterion fulfilled. Two interesting observations can in my interpretation be made from this statement.

First, the Courts' perception of the purpose of the legislation might appear a bit confusing considering its' earlier case law on the right of deduction. The Court has in several cases repeated that the financial outcome of an economic activity and consequently an eventual taxation of outgoing transactions is irrelevant for the right to deduction.[202] Further has the Court held that the right of deduction should be assessed individually in relation to each supply,[203] and that the right of deduction cannot be made dependent on whether VAT is paid on a supply made earlier or later in the chain of

[195] *Halifax* para 75
[196] *Part Service* para 32
[197] *Halifax* para 82
[198] *Part Service* para 45
[199] Opinion of AG Maduro in *Halifax* para 87, 89
[200] *Halifax* para 78-79
[201] Ibid. para 80
[202] See e.g. *Gabalfrisa* para 44, *Rompelman* para 19
[203] *Midland Bank* para 29, *Kittel* para 49

supplies.[204] Consequently the mere fact of non-existence of taxed, outgoing transactions cannot bee seen a decisive for the right of deduction.

In *Halifax* the Court however does not examine the transactions individually, but rather make an assessment of the overall scheme and its consequences. Doing so the Court conclude that the final outcome of the aggregated transactions is that Halifax, a business operator to a large extent exempt from VAT manage to avoid payment of the input VAT. Without going to much into the rather complex details of the scheme en examination of the material circumstances reveal a number of "key factors" and "key transactions".[205] Considering the case law referred to above I find the change of approach made by the Court in *Halifax* noteworthy. Why didn't the Court assess these transactions individually, recalling the need for a direct and immediate in order to obtain a right of deduction? Why is there a need for an introduction of the legal mechanism of abuse to achieve this preclusion?

These questions are in my opinion best answered by recalling the legal functioning of the concept of abuse. Regardless of if the concept is to be regarded as a general principle, a general principle of interpretation or something else it is crucial to remember that the essence of the concept lies within a purpose-orientated interpretation of the assessed provision. The novelty of the introduction of the concept of abuse lies however not in the observation that the Court applies a method of interpretation that observes the purpose of the legislation. What make the introduction of the concept notable is the way that the relevant provisions are applied *contra legem* and the consequences of this application. The introduction of the concept of abuse extends the possibility and applicability of interpreting the provisions in line with their purpose rather than their wording.

Due to the amount and complexity of the transactions made in *Halifax* it is difficult to pin-point one transaction that is ultimately decisive for the fiscal consequences of the scheme. Additionally any legal re-qualification of any of the "key transactions" would require a *contra legem* application of the provisions and would trigger consequences that would affect the chain of transactions as a whole. In order to fully create a legal situation where the legislation is applied in compliance with its' purpose the national court is allowed to re-define the entire scheme. This is since the central point of the abuse-concept is the achievement of the application of the rules where the rules are applied as they are intended to be applied. However, in order to not compromise the forseeability of the system and the legitimate expectation of the taxpayer this type of interpretation can only be applied in a certain manner. In order to observe these conflicting interests the Court consequently is obliged to carry out the full test.[206]

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[204] Case C-395/02 *Transport Service NV v. Belgische Staat* [2004] I-01991 (cit. *Transport service*) para 26
[205] *Halifax* para 30
[206] Ibid. para 71-73

Second, it is also important to observe that the *Halifax*-scheme was made possible by an internal rule of UK law. [207] Since the VAT-directives put an obligation on the Member States to implement the directives in a way that precludes evasive or abusive application,[208] the UK adoption of the national rules would consequently render the provisions of the EU rules ineffective.

This was further clarified a couple of years later, in *Weald Leasing*[209]. The case emerged from a situation where a British insurance company group (The Churchill Group), whose business-activities to a large extent was exempt from VAT, managed to divide their payments of VAT over time and consequently defer the financial burden of the tax. This advantage was obtained by the construction of an arrangement where the company instead of outright purchasing their assets instead leased them from a free-standing company owned by The Churchill Groups' VAT-consultant. The arrangement did not in itself give rise to any reduction of the amount of VAT incurred, but allowed the company to divide the costs over time. The British tax agency (Commissioners) held that the procedure was to be regarded as abusive since the only possible motivation for the adoption of the scheme was to achieve a tax benefit contrary to the purpose of the Sixth Directive. In addition the Commissioners held that the procedure also manifested an abuse of an anti-avoidance rule adopted under art. 27.1 of the Sixth Directive.[210]

In his opinion the AG (Jan Mazak), reformulated the rather complex questions posed by the national court. Holding that the doctrine of abuse is fully applicable to the area of VAT in the manifestation of the two part test established in *Halifax* the AG stressed the cumulative nature of the test.[211] In relation to the first part of the test the AG repeated the notion that since a business operators are generally free to choose how to organize and finance their business in terms of buying or leasing assets. Therefore the deferral of the liability of VAT cannot, in it self, be regarded as contrary to the objectives of the Sixth Directive. This however, only applies as long as the arrangements reflect an open-market value and don't reduce the amount of VAT incurred.[212] Formulating this "arms-length principle" the AG found

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[207] Amand, Christian *Prohibition of Abusive practices in European VAT: Court Aid to National Legislations Bugs?*, INTERTAX, volume 36, issue 5, Kluwer law international 2008 p. 189 (cit. Amand 2008) p. 196. The most substansial tax saving in the Halifax-scheme was made due fact that the Halifax-subsidiary "Leeds development" was able to deduct in put VAT to a value exceeding 7 055 000 GBP connected to an exempt supply (lease of immovable property) (*Halifax* para 30)

[208] Amand 2008 p 198

[209] Case 103/09 *The Commissioners for Her Majesty's Revenue and Customs v Weald Leasing Ltd.* [2010] n.y.r (cit. *Weald Leasing*)

[210] The national rule concerned was a transfer-pricing clause, designed to counter sub-market value transfers between connected parties. Since the Churchill group and Suas where not legally connected , though the companies most likely had a mutual interest concerning the taxation of the Churchill group the scheme also effectively side-stepped the national transfer pricing rule. (see *Weald leasing* para 6)

[211] Opinion of AG Mazak in *Weald leasing* para 13

[212] Ibid. para 20-21

that the scheme could possibly circumvent the national anti-avoidance-rule, in the price was set at an artificially low level.[213]. According to the AG there could be no difference of the application of the doctrine of abuse in relation to the national legislation transposing the directive compared to the application of the doctrine to the directive itself. To make such difference would according to the AG undermine the effectiveness of the VAT-system.[214] The effect of this is that the doctrine can be applied to measures implemented under the directive, even if the rules adopted has no direct equivalent in the directive. The AGs' view on this matter was later shared by the Court, that stated that legislation adopted under the directive forms a part of the implementation of the directive.[215]

Considering this viewpoint the statement in *Halifax* appears more rational. To not include the national rules implementing the directive, including procedural rules such as the one relevant in *Halifax*, within the full scope of the VAT-system and consequently the doctrine of abuse would undermine the effectiveness of the common system. Consequently, if the national system, as in *Halifax*, gives rise where the application of a requirement of EU-law (direct and immediate link) is precluded, this short-coming could be solved by an examination of the possible abuse of the relevant norm. This is, since the need for a direct and immediate link is an expression of VAT-systems general objective of neutral taxation.

In this situation the invocation of the concept of abuse, regardless what legal label is put on it, must be regarded as an expression for the supremacy of EU-law. Consequently the Member States, in events of a wrongful or incomplete adoption of a directive, can (and are obliged to) rely on the supremacy of the underlying EU legislation to prevail and disregard the national rules. The prevailing objective or principle can in this context be a general and fundamental feature of the system, such as the neutrality of the system, or a more specific objective, such as the countering of tax avoidance.

This approach is similar to the approach taken by the Court in the case *R*[216]. In *R* a business operator (R) was addressed with criminal charges after the German tax agency had discovered that R had managed to lower his tax burden by the use of manipulated invoices. The invoices had however been used in relation too goods exported to another Member state (Portugal) and the supply was consequently exempt from tax in Germany du to art 28a of the Sixth directive[217]. The relevant provision of German criminal law required that the tax evaded was chargeable in Germany and consequently the relevant question was if the German authorities could deny the exemption (zero-rating) from taxation in Germany due to the disloyal procedure set out by R.

[213] Opinion of AG Mazak in *Weald Leasing*. Para 21
[214] Ibid para 24
[215] *Weald Leasing* para 42
[216] Case c-285/09 *Criminal proceedings against R* [2010] n.y.r (cit. *R*)
[217] Art. 138 RVD

Finding that it is for the Member States to set out the detailed provision for the taxation of intra-community supplies, ensuring the correct application of the system, the Court stated that when doing so, the Member States shall ensure that tax avoidance, -evasion and abuse is prevented.[218] Further the Court observed that the use of manipulated invoices could compromise the correct application of the system and that such procedures are to be regarded as more serious when put out in the context of intra-community supplies, where the system to a large extent is founded on the co-operation of the taxpayer.[219] Consequently the Court found that the national court could, contra legem, deny the exemption from tax in order to ensure the correct functioning of the system.[220] This application of the objectives of the system, despite not being made with an explicit reference to the doctrine of abuse, but rather in a case of fraud or evasion, reassembles the application made in *Weald Leasing* and *Halifax*. Recalling the need for a subjective moment in order to break the legitimate expectation of the taxpayer established *Holin Groep* it is noteworthy that the Court does not explicitly address this requirement in *R*. This can however, in relation to the material circumstances in *R*, be regarded as excessive as it was clear from the information provided by the national court that R had knowingly provided the German tax agency with the manipulated invoices.[221] Consequently it is my interpretation that the possibility for courts to apply provisions contra legem in order to comply with the purpose of the system is still requiring a subjective element, even after *R*.

The possibility to invoke the purpose of the legislation in relation to national law implementing or influencing the VAT-system is however not unlimited. In *Oasis East* the dispute regarded a provision of Polish law, limiting the deductibility of input VAT in relation to transactions involving operators established in certain low-tax jurisdictions. The provisions where adopted before Poland's affiliation to the Union and the Polish authorities subsequently tried to invoke the possibility for the Member States to retain national exceptions to the right of deduction adopted before the enactment of the Directive.[222] Finding that the national provision formed an unacceptable restriction to the right of deduction,[223] the Court stressed that the need for the Member States to adopt national rules in order to prevent tax avoidance is observed and fulfilled by the procedure of art. 27.1 of the Sixth Directive[224]. The application of the doctrine of abuse cannot in this circumstance be regarded as enabling the Member States to extend the existing limitations of the Directive, unless the extending rules are adopted under the directive.[225] Consequently the application of the concept of abuse in relation to national provisions require those provisions to hold a certain

[218] *R* para 47
[219] Ibid. para 48
[220] Ibid. para 50
[221] Ibid. para 47
[222] Article 17.6 of the Sixth Directive, article 176 RVD
[223] *Oasis East* para 28-29
[224] Art. 395 RVD
[225] *Oasis East*. para 31

connection to the provisions of EU law implemented. The concept of abuse cannot be applied to neither strictly internal rules of national law[226], nor, as has been shown above, to national rules, that even they are in some aspect connected to the implementation of EU-law, are not a direct consequence thereof.

5.3.3 Objective factors

Examining the second ("objective") part of the test in *Halifax* the Court proclaims that the national court may "*take account of the purely artificial nature of those transactions and the links of a legal, economic and/or personal nature between the operators involved in the scheme for reduction of the tax burden*"[227]. Since the final examination of the facts is a matter for the national court it is hard to draw any exact conclusions concerning the outcome of the final assessment in the specific case. A possible interpretation of this statement is that the Court intended to provide guidelines in order to ensure that the examination of the purpose of the transactions is based on objective factors. This is formulation of the second criteria stipulates yet another difference in how the test is applied in *Halifax* compared to the application in *Emsland-Stärke*. In *Emsland-Stärke* the element of artificiality is prescribed as a mandatory requirement for the fulfillment of the second criteria,[228] In *Halifax* the Court does not require an artificial element when formulating the abuse-test,[229] but speaks of obtaining the motives of the taxpayer by the assessment of "objective factors".[230] The artificial nature of the transactions may be one such factor[231] but should not be regarded as a mandatory such, but shall instead be regarded as one of many possible indicators.

The significance of the nature of the transactions has however been topic for discussion in several cases referred to the ECJ. Only a few months after the judgment in *Halifax* the Court delivered the decision in *Cadbury-Schweppes* where the detection of *wholly artificial arrangements* was described as an almost mandatory prerequisite for the establishment of an abusive practice.[232] The significance of the legal context in which the concept of abuse is applied has already been addressed above in section 4.1

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[226] See further Joined cases C-78/08 to C-80/08 *Ministero dell'Economia e delle Finanze and Agenzia delle Entrate v Paint Graphos Soc. coop. arl* (C-78/08), *Adige Carni Soc. coop. arl, in liquidation v Agenzia delle Entrate and Ministero dell'Economia e delle Finanze* (C-79/08) and *Ministero delle Finanze v Michele Franchetto* (C-80/08) [2011] n.y.r. (cit. *Paint Graphos)* para 40-41 and opinion of AG Jääskinen in *Paint Graphos* 41

[227] *Halifax* para 81

[228] "*It requires, second, a subjective element consisting in the intention to obtain an advantage from the Community rules by creating artificially the conditions laid down for obtaining it…" Emsland-Stärke* para 53

[229] *Halifax* para 74-75

[230] Ibid. para 75

[231] Ibid. para 81

[232] See above, 2.1.4

and 4.2. Nevertheless has the Courts' statements regarding "wholly artificial arrangements" lead to a certain amount of confusion regarding the application of the concept in other fields of law.

5.3.4 Artificiality and economic reality

This confusion to some extent explains the character and context of the questions referred in *Ampliscientifica*[233]. The question differ from the ones posed in *Halifax* and *Part Service* in the sense that the question posed does not directly concern a specific scheme laid out by a taxpayer but instead the compatibility of national rule implementing art. 4 of the Sixth Directive[234] with the Directive. In the implementation of the Sixth Directive the Member State (Italy) had chosen to make it possible for parental companies to, under certain restrictions, report and pay the VAT for their subsidiaries. Due to a dispute at the national court considering one of these restrictions, that the link between the companies was required to have existed for a certain amount of time, the national referred two questions. First, if the national provisions infringed art. 4.4 (the possibility for the Member States to enact rules for group taxation) the implementation of which required a specific procedure which had been omitted. And second, if the national rules where compatible with the general principles imbued in the system of VAT, the principle of fiscal neutrality, the principle of proportionality or the prohibition of abuse. Coming to the conclusion that it is for the national court to, in relation to a number of given criteria, assess if the national rules where of such a character that they fell under art. 4.4,[235] the Court went on to examine the second question.

Doing so the Court took the opportunity do develop the purpose and function of the prohibition of abuse. The Court stated that that the purpose of the principle is to ensure that Union law is not extended to cover practices not carried out in a normal commercial operation but with the sole intent to wrongfully obtain an advantage from the legislation.[236] Citing *Cadbury-Schweppes* the Court then stated that "*the effect of the principle is therefore to prohibit wholly artificial arrangements not illustrating economic reality*"[237]. This could be seen as a sign of an ambition of the Court to bring the two concepts of abuse[238] closer to each other.[239] In my opinion this however is a result of the difference of this case compared to the cases *Halifax* and *Part Service* where the Court perceived "artificial character" as one of many indicators for abuse.

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[233] Case C-162/07 *Ampliscientifica Srl and Amplifin SpA v Ministero dell'Economia e delle Finanze and Agenzia delle Entrate* [2008] ECR I-04019 (cit. *Ampliscientifica*)
[234] Art 11 RVD
[235] *Ampliscientifica* para 23
[236] Ibid para 26
[237] Ibid para 27, This statement was later repeated in *Tanoarch* where the Court however did not elaborate any further on the concept, simply stating that it is for the national court, in line with the case law of the ECJ, to examine whether an abusive practice is at hand. (*Tanoarch* para 53)
[238] See above 3.1 and Piantavigna 2011
[239] Pistone 2011 p 393

This difference in formulation could possibly be explained by the difference in the formulation of the questions. I perceive the questions in *Ampliscientifica* to have a "negative" character, fundamentally concerning the compatibility of national law with Union law and that the questions are consequently primarily concerned with the interpretation of national law.[240]

In its' answer to the questions in *Ampliscientifica* the Court does not assess the purpose of the VAT-directive in relation to a certain set of circumstances. Instead national legislation and its compatibility is the target for the assessment. Therefore the Court focuses on the purpose and objectives of the principle (and consequently the VAT-system) rather than the direct application of the principle and the two-part test. Since the legal background in *Ampliscientifica* concerns the overriding of national law by an invocation of an EU-provision, rather than a direct application of a provision this situation sooner reassembles the *Abuse of law*-situation than the *Abuse of right*-situation.[241] In that manner *Ampliscientifica* reassembles cases like *Cadbury-Schweppes*[242], *Sosnovska* and *Direct Cosmetics* rather than *Halifax* or *Part Service.* This is in the sense that the question at hand essentially concerns interpretation of the directive in relation to the implementation, and the national law's conformity with EU-law, rather than the application there of. Consequently the statements made concerning "artificiality" and "economic reality" is in this context made in connection to the first, objective, part of the test. This could, in the authors' opinion, be seen as an expression for the significance of economic reality as a fundamental benchmark for the VAT-system as shall be developed below[243].

The significance of "artificial arrangements" and "economic reality" in the application of the doctrine of abuse was further addressed in two cases concerning leasing transaction delivered in 2010, *Weald leasing* and *RBS Deutschland*[244].

In *Weald leasing*[245] the AG, in relation to the above mentioned application of an "arms-length formula"[246] stated that an transactions made at an artificially low price, consequently artificially reducing the level of VAT incurred would be contrary to the purposes of the directive.[247] Concerning

[240] Since the question is posed in this way I find it notable that the court doen not address the issue of admissibility, since the procedure under art 267 TFEU usually cannot be used to examine the compatibility of national legislation with EU law. (see further *Paint Graphos* para 34
[241] See above, 3.1
[242] In the sense that if the national provisions are conformant with the legislation transposed abuse is not relevant.
[243] See below, section 6
[244] *Case C-277/09 The Commissioners for Her Majesty's Revenue & Customs v RBS Deutschland Holdings GmbH* [2010] n.y.r. (cit. *RBS Deutschland*)
[245] Circumstances of the case are presented above. 3.3.3.2
[246] See above 2.3.2
[247] Opinion of AG Mazak in *Weald Leasing* para 21

the question referred by the national court concerning whether it held significance for the assessment of abuse if the concerned transactions took place within the "*normal commercial operations*"[248] the AG answered by repeating the statement of the Court in *Ampliscientifica* that "*the effect of the principle is therefore to prohibit wholly artificial arrangements not illustrating economic reality*"[249]. In the view of the AG the need for foreseeability prevents an examination of whether the transaction "fit in" within the frame of the business of the operator, but rather to identify purely artificial constructions established essentially to obtain a tax advantage rather than for other commercial reasons – i.e. a business-purpose test.[250]

The significance of artificiality in relation to the first part of the test is also the main topic for discussion in the judgment of the Court.[251] Coming to the conclusion that the sole deferral of the burden of VAT in time is not contrary to the objectives of the legislation,[252] the Court add that it would be contrary to the directive if the contractual terms would be unusually low or not reflecting economic reality.[253] In this context it is according to the Court irrelevant if the transactions are performed within the normal commercial operations of the company. This follows from the fact that the assessment of abuse should note be made from the nature of the economic activity of the taxpayer "*but from the object and effect of those transaction, as well as their purpose*"[254].[255] By this statement the Court reach the same conclusion as the AG, but taking a slightly different course. As the Court finds no relevance in further discussing the significance of "normal commercial operations" I find this as deliberate statement from the Court, advocating for a strict adoption of the two-part test.

In *RBS Deutschland* two independent companies managed to take advantage of a disharmony in the implementation of the Sixth Directive in two Member States (UK and Germany). This difference in implementation lead to a situation where the legislation of the two countries pointed out the other country as the place of supply (double non-taxation). Based on the ultimate non-taxation of the supply the UK tax agency (Commissioners) demanded payment of the VAT credited by the lessor, claiming that deduction of input VAT in this case would be contrary to art. 17 of the Sixth Directive[256] since no output VAT had been charged on the supply.[257]

In his assessment the AG (Mazak) thoroughly discussed the objectives of art. 17 and concluded that the right to deduct input VAT in an economic

[248] As referred to in *Halifax* para 69, 80
[249] Opinion of AG Mazak in *Weald leasing* para 31
[250] Ibid. para 32
[251] *Weald Leasing* para 32
[252] Ibid. para 45
[253] Ibid. para 39
[254] Ibid. para 44
[255] Ibid. para 44-45
[256] Art 168 RVD
[257] *RBS Deutschland* para 23

activity is an inherent aspect of the VAT-system.[258] Even though this right is linked to the eventual taxation of an output,[259] the right of deduction of VAT incurred in one Member State cannot be made dependent on whether an eventual output VAT is levied under the law of another Member State, if a corresponding transaction in the first Member State would be subject to output VAT.[260] [261]

Having come to this conclusion the AG took a similar position as the one taken in *Weald Leasing*, stressing the definition of the purpose of the principle as to prevent wholly artificial arrangements.[262] As the AG retained his position regarding the objectives of the legislation in relation of the assessment of whether the procedure was to be perceived as abusive,[263] any further examination of the practice could be perceived as redundant, as the procedure apparently did not infringe the first part of the test. However the AG continued by observing that the accrual of a tax advantage could not in it self be regarded as fulfilling the second criteria.[264] According to the AG the national court should instead pay attention to artificial elements in the sense that the procedure cannot be explained by any other motives than the obtainment of a tax advantage.[265]

Concerning the question if the practice would be contrary to the provisions of art. 17 of the Sixth Directive the Court followed the same line as the AG stating that the intention behind the system of deduction is to relieve the taxable person of the burden of VAT for transactions made in the context of an economic activity.[266] Once again I am of the opinion that the Court could have stopped its' assessment by making this statement, as this statement effectively answers the first part of the abuse-test. If the procedure is found to be compliant with the purpose of the legislation, the application of the concept of abuse is effectively precluded, as the incompliance with the purpose of the legislation form the very essence of the concept of abuse.

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[258] Opinion of AG Mazak in *RBS Deutschland* para 54
[259] Ibid. para 51
[260]Opinion of AG Mazak in *RBS Deutschland*. para 58
[261] This should in the authors view be seen as a distinct difference from the *Halifax*-situation where deduction of input VAT was made possible in relation to an exempt outgoing transaction. In RBS Deutschland the deduction was made in relation to a taxed outgoing transaction, if for example the cars where to be leased out on the national market or in another Member State, not giving raise to the same national legislative error, the outgoing transaction would be taxed. Thus the chain of transaction did, as a difference to *Halifax* never change character. In the authors view this clearly illustrate the significance of the fact that the *purpose* of the legislation, in relation to the assessment of possible abuse, is not equal to a prohibition of tax minimization. The purpose of the legislation is rather to be interpreted as promoting the effective functioning of the system, regardless of the economical consequences.
[262] Opinion of AG Mazak in *RBS Deutschland* para 71
[263] Ibid. para 75
[264] Ibid. para 78
[265] Ibid. para 79
[266] *RBS Deutschland* para 38

The Court however continued by addressing the questions of the national court concerning the applicability of the concept of abuse. Observing that the transactions took place between two independent companies the Court concluded that nothing in the proceedings is to be regarded as "artificial".[267] As the Court couldn't find any artificial elements in the proceedings, and the trader is generally free to organize his business the Court subsequently stated that the procedure could not be regarded as abusive.

I'm not entirely sure how to interpret these statements, as the significance of these findings are not explicitly attributed to any specific part of the assessment of the test. Considering that the Court in this assessment don't explicitly mentions the purpose of the legislation and that the Court states that "*…the nature and the relations between the companies that carried out those transactions contain nothing to suggest an artificial arrangement that does not illustrate economic reality and the sole aim of which is to obtain a tax advantage...*"[268] one could interpret the statements to be made primarily in relation to the second part of the test. This would imply that the Court, based on the information provided by the national court make a material assessment of the circumstances the second part of the test. A task that has earlier been explicitly allocated to the national court.[269] Doing so the statement of the Court could be interpreted as giving that an activity that constitute a "*genuine economic activity*"[270] automatically will "pass" the second part of the test.

This conclusion is however in my opinion debatable, as the bench mark for the assessment of the test is found in the first part of the test, namely in the purpose of the legislation with which the procedure conflicts. What would constitute a "genuine economic activity" would be inherently dependent on the purpose of the abused rule and what scenarios that rule seek to cover. If the "genuine economic activity" was to be "immune" to the application of the concept of abuse this would require an addition of a third, implicit criterion for the abuse-test, investigating the authenticity of the activity.

5.3.4.1 The consequence of abuse in relation to VAT

The consequence of the establishment of an abusive procedure is, as described above in section 4.1, and is, as displayed in *Emsland-Stärke,* to deny the abuser the benefit of the abuse. In *Emsland-Stärke* this consequence is achieved by the reclaim of the issued refunds and doing so by treating the procedure put by the exporting company as a legal nullity in relation to the relevant legislation.[271] In *Halifax* the Court however stresses the importance of creating a legal consequence that doesn't infringe the neutrality of the system.[272] This would be a risk if, for example, a denial of a

[267] Ibid. para 50-51
[268] *RBS Deutschland.* para 51
[269] *Halifax* para 76
[270] *Halifax* para 53, *Emsland-Stärke* para 54
[271] *Emsland-Stärke* para 56
[272] *Halifax* para 92

refund of levied VAT occurred at some point in the chain of transactions where the denial of the refund threatened to create a situation of double taxation of the final consumer. In order to avoid such distortions the Court states that an abusive procedure should be redefined in such away that the consequences for taxation are established as if the abusive transactions had not taken place.[273] Further the Court stresses that in order to maintain the neutrality of the system the national courts are obliged to take account of any VAT that the taxpayer has been "artificially liable" to under the adopted scheme when re-evaluating the situation due to the abuse.

In order to establish what transactions that should be disregarded for VAT-purposes the national court is consequently obliged to determine the factual outcome of the situation and to assess how it would have been taxed if the abusive transactions where not present. The Court does not however supply any substantial guidance on how this assessment shall be done.

[273] *Halifax* para 94, *Weald Leasing* para 51, see also section 5.3.2

6 Economic reality

All cases presented below concern, just as several of the cases presented in previous sections, the relation between legal models and economic structures. The main difference between this line of cases (the *DFDS*-line) and the *Halifax*-line is that whilst the *DFDS*-line primarily evolves from questions concerning the interpretation of a specific provision of EU law, whilst the *Halifax*-line concerns the applicability of EU-law. In the following section the concept of "economic reality" as a benchmark for interpretation will be described by a study of the application of the concept in the case law of the ECJ.

6.1.1 Application of the concept in relation to establishments

6.1.1.1 ARO lease

In *ARO lease*[274] a company (ARO), established in the Netherlands, provided car lease services to customers Belgium. The company was registered in the Netherlands where all of the company's own offices where situated and where the majority of the company's business took place. The supply of leased cars in Belgium was handled by self-employed contractors and contracted car sale companies. Since ARO had no employed personnel in Belgium the customer (lessee) and the intermediary (usually a car salesman) agreed on which car from the intermediary's stock that the customer should lease. The intermediary then sold that car to ARO who then leased the car to the customer. The benefit of this scheme was that Belgium charged a substantially higher VAT rate than the neighboring countries and only permitted a refund of 50% of the input VAT on leased cars. The question referred to the Court concerned in essence which of the two countries the cars, as a supply of service, should be regarded as being supplied in.

The AG (Fennely) begun his opinion by, ruling out the possibility that the leasing arrangement should fall under the complementary rule in regarding the letting of tangible property[275]. Consequently the supply should be regarded as being made in the country where the supplier was established[276].[277] The AG then continued by addressing the position taken by the Commission, that the place of supply should be determined by a "*focusing on the economic reality of the transaction*". By this statement the

[274] Case C-190/95 *ARO Lease BV v Inspecteur van de Belastingdienst Grote Ondernemingen te Amsterdam* [1997] ECR I-04383 (cit *ARO lease*)
[275] Art. 56.1 (g) RVD art. 9.2 of the Sixth Directive
[276] Art. 43 RVD art. 9.1 Sixth Directive
[277] Opinion of AG Fennely in *ARO lease* para 13, see further Case 51/88 *Knut Hamann v Finanzamt Hamburg-Eimsbüttel* [1989] ECR 00767 (cit. *Hamann*) which concerned the letting of ocean-going yachts for the purpose of sail racing where the court stated that *`all forms of transport are outside the scope of the exception laid down for the hiring-out of movable tangible property" Hamann,* para 13.

Commission sought to establish that the assessment of the place of supply should be based of an examination of where main part of the economic activity had taken place. In order to do so, objective circumstances of the transaction, such as the method and place of payment, should be examined. In this particular case that would, in the view of the Commission be the place where the company had, among other factors, established contact with the customers, drawn the agreements and received payment, i.e. in Belgium.[278]

In the view of the AG, such an interpretation would compromise the explicit will of the legislator, to tax the activities at the place of establishment.[279] As the Court in *Hamann* had expressly excluded the applicability of art. 9.2 to the leasing of means of transport the AG instead based his assessment around the definition of a fixed establishment, as the relevant criterion for determining the place of supply for the transactions at hand.[280] Referring to the judgment in *Berkholz*[281] the AG pointed out that since ARO did not have any human or technical resources in Belgium the company could not be regarded as having a permanent establishment in the country.[282] Even if the Court was to conclude that ARO was to have a fixed establishment in Belgium due to personal and technical resources supplied by a third party (the intermediaries) the leasing service still have to be regarded as independent and as supplied from AROs' establishment in the Netherlands. This since the essential parts of the service of AROs' leasing service is supplied from the Netherlands.[283]

The Court agreed with the AG, stating that the place of supply should be decided under art 9.1 of the Sixth Directive and that the relevant criterion for determining the place of supply is the location of the suppliers business or a possible fixed establishment.[284] Regarding if the resources and services provided to ARO by the third parties (the intermediaries) could give the effect that ARO was to be deemed as established in Belgium the Court held that "*It is clear from the aim of Art. 9 and from the context in which the concepts are employed that services cannot be deemed to be supplied at an establishment other than the main place of business unless that establishment has a minimum degree of stability derived from the permanent presence of both the human and technical resources necessary for the provision of the services*"[285] Hence the Court upheld the ruling in *Berkholz* and concurred with the view of the AG regarding the deciding criteria for a fixed establishment. Regarding the argument of economic reality raised by the Commission that the supply must be deemed to be supplied where the service is actually provided the Court answered that the

[278] Opinion of AG Fennely in *ARO lease* para 17
[279] Ibid. para 19
[280] Ibid. para 27
[281] Case 168/84 *Gunter Berkholz v Finanzamt Hamburg-Mitte-Altstadt* [1985] ECR 02251(cit *Berkholz*)
[282] Opinion of AG Fennely in *ARO lease* para 30, see for comparison *Berkholz* para 19
[283] Opinion of AG Fennely in *ARO lease* para 31
[284] *ARO lease* para 14
[285] See further *Berkholz* para 17 and 18

legislation already had addressed this criteria by providing a clear and practical criterion for deciding the place of establishment.[286] Consequently the concept economic reality does not refer to the place of taxation in relation to the actual off-set of the products, but to the criteria set by the system.

6.1.1.2 DFDS

In *DFDS*, which was pending for the Court simultaneously with ARO lease, a Danish company (DFDS AS) had established a subsidiary in the United Kingdom (DFDS Ldt.) which performed travel agent services on behalf of the parent company. The subsidiary acted on the initiative of the Danish company under a contract governing the relation between the companies. Even though the subsidiary did not act independently it possessed substantial human and technical resources in the UK and the British authorities held the company liable to VAT in the UK due to the company having a fixed establishment in the country. According to art. 26 of the Sixth Directive[287] a company performing travel agency services should be taxed at the place of establishment or fixed establishment of the agent unless the services where provided in such a manner that the agent where to be regarded as only acting as intermediaries. The referred questions consequently regarded under what circumstances the taxation should be done due to the existence of a fixed establishment.

The AG (La Pergola) started by examining the criteria put out for a fixed establishment and the requirements put down for agencies in the case law of the Court in order to examine if the subsidiary was to be regarded as a fixed establishment of the Danish company. Due to the lack of independence of the British company the AG found that the subsidiary was to be regarded as "*an auxiliary organ forming part of the Danish company from the economic point of view*." By guidance of *Berkholz* the AG further found that the subsidiary was to be regarded as a "fixed establishment" within the definition of the VAT-directive.[288] Following the rationale from *Berkholtz* the activities at a fixed establishment could only be taxed at the place of the fixed establishment when a taxation at the place of establishment (head quarter) could not be considered a rational result for tax purposes. According to the AG this alternative possibility should be applied since a taxation at the place of establishment (head quarter) would not lead to a rational result. Advocating this "rule of reason" the AG stated that the basic criterion for the VAT-system is that "*the VAT system must be applied in a manner as far as possible in harmony with the actual economic situation*".[289] In order to ensure the possibility of an effective application the AG found it impossible to follow the formalistic interpretation of the Danish company, that the criteria for taxation at the place of the fixed establishment should be subordinate to the criteria for taxation at the place of establishment (HQ)

[286] *ARO lease* para. 25-26
[287] Art. 306-310 RVD
[288] Opinion of AG La Pergola in *DFDS* para 27
[289] Ibid. para 32

The Court followed the reasoning of the AG, stating "*that consideration of the actual economic situation is a fundamental criterion for the application of the common VAT system*"[290]. Further the Court found that a system where the company could choose jurisdiction by incorporating the company under the most favourable regime could lead to distortions of competition.[291] Finding that the UK subsidiary was sooner to be regarded as an auxiliary organ of the Danish company than an intermediary or an independent supplier the Court concluded that the services by the Danish company through the UK subsidiary was to be taxable in the UK.

Aside from the definite acknowledgement the significance of the actual economic circumstances of the case and its relation to the objectives of the legislation, a comparison of the Courts' reasoning in these two cases also help to define the limitations and scope of this criterion. The main difference between the two cases emerges from the general nature of the questions posed by the national courts. In *DFDS* the question relates to the application of the alternative criterion of art. 26.2 (i.e. when can a fixed establishment be determined to be the relevant criterion for the place of supply). In *ARO* on the other hand the proposal of the Commission would require the Court to re-define the definition of a fixed establishment (as compared to *Berkholz*) based on the place of supply.

The effect of this difference is clearly illustrated by the fact that the assessment of the "reality" is centered on different "operational parts" of the schemes. In *DFDS* the assessment is made in order to evaluate where the effective centre of the taxpayers activity is situated. This is done by an assessment of objective factors regarding the establishment in relation to the criteria put out by the Court in its previous case law. I.e. the key questions in the case is whether the UK establishment fulfilled the requirements for being classified as a fixed establishment, and if so, whether the taxation could be made at the place of the fixed establishment. The criterion of economic reality is hereby relevant in relation to the second question and is there used as a tool of interpretation. In *ARO lease* the Commission proposes "an autonomous construction" of the notion "the place where the supplier has established his business".[292] Consequently the relevant question is if economic reality, applied independently could motivate an alternative for the basis for taxation. After having established that AROs' activity in the Netherlands was not sufficient to fulfill the requirements for a fixed establishment,[293] the assessment is therefore not made in relation to the place of taxation (as in DFDS) but in relation to the concept of a fixed establishment itself. According to the Court the legislator had already seen to the need of taxing in accordance with the destination principle, in

[290] *DFDS* para 23
[291] Ibid.
[292] de Broe 1997 p 221
[293] *ARO lease* para 18-19

considering the difficulty of deciding the place of supply for vehicles, by expressly addressing means of transportation in the directive.[294]

Consequently the application of the actual economic substance, or economic reality should be applied as a tool for interpretation of the concepts provided by the legislation, not as an independent ground for taxation. In a correct interpretation of the statement that "*consideration of the actual economic situation is a fundamental criterion for the application of the common VAT system*" should in my opinion be seen as an expression of the general objective that the VAT-system seek to cover actual, economic situation, not legal construction.

6.1.1.3 Planzer

This interpretation of the concept finds in my opinion support in the Courts' reasoning in the judgment in *Planzer*[295]. In *Planzer* a Swiss transport company incorporated a subsidiary in Luxembourg. The subsidiary was issued a VAT certificate under Annex b of the Eight Directive, stating that the company was established and liable to VAT in the country. In 1997 and 1998 the German authorities refused substantial refunds claimed by the Luxembourg company for fuel bought in Germany since the German authorities doubted that the company actually was genuinely established in Luxembourg. From the proceedings in the national court it was apparent that the company had neither permanent employees nor any property or equipment at the registered Luxembourg office and that the company was effectively administered from the parent companys' office in Switzerland.[296] The question referred by the national court regarded first, if the certificate issued by the Luxembourg authorities regarding the company's liability to taxation in the country created an "irrefutable assumption" that the undertaking is established in the issuing state. Secondly, if no such i presumption was created, whether the term "business" as stipulated in art. 1.1 of the 13th Directive should be interpreted as "registered office" or something else.

In relation to the first question the Court held that the purpose of the introduction of the certificate was to avoid double taxation by enabling the taxable person to deduct input VAT on invoices received form a business operator in a Member State where the taxable person has no taxable activity.[297] The Court then continued by stating that the prevention of tax avoidance is a general objective pursued by the VAT-directives.[298]Applying this dual purpose the Court on one side admitted that the issuing of the certificate create a presumption that the taxable person is established the issuing Member State. This presumption does however not prevent the tax

[294] Ibid. para 25-26
[295] Case C-73/06 *Planzer Luxembourg Sàrl v Bundeszentralamt für Steuern* [2007] ECR I-05655 (cit. *Planzer*)
[296] *Planze*r para 28
[297] Ibid. para 35
[298] Ibid. para 36

authorities of the Member States are allowed from seeking assurance regarding the economic substance of the establishment on which the issuing certificate is founded.[299]

In relation to the question regarding the understanding of the term "business" the AG (Trstenjak) correctly pointed out that the concept of "registered office" is not to be regarded as a concept defined by Union law, as the he concept in detail is regulated by national law.[300] The term "business" however, according to both the AG and the Court implies an actual economic establishment. This conclusion was drawn with consideration of the stated fact the actual economic situation is a fundamental criterion for the application of the VAT-system.[301] The Court concluded that the determination of the place of "business" should be made based on a range of factors, expressly stating that a mere registration in terms of a fictitious establishment such as a brass-plate or letter-box company cannot be regarded as falling within the definition of the concept.[302]

The application of the concept in *Planzer* reassembles the application of the concept in *DFDS*, where the concept is applied as a tool of interpretation. Stating that "*taking account of economic reality constitutes a fundamental criterion for applying the common system of VAT"* indicates that the concept should be regarded as imbuing the entire system. As such it is partly expressed through the provisions of the directive and partly providing guidance for the interpretation thereof. The concept cannot however in itself be used for independent review of circumstances. As shown in *ARO* the concept should not be interpreted as a self set purpose, the objective of the directive is not to tax activities in relation to the "economic reality". Instead the rules of the directives should be applied and interpreted in a manner that observes the factual, economic circumstances of the case.

6.1.2 Application of the concept in relation to contractual terms

Just as discrepancies between concepts of company law and tax law can lead legal uncertainties regarding consequences for taxation in relation to rules of establishment, the invocation of civil law concepts can result in similar confusion of concepts.

6.1.2.1 Auto lease Holland

In *Auto lease Holland*[303] the AG (Léger) and the Court adopted a similar reasoning to the one taken by the Court in *Planzer*. The case regarded a

[299] *Planzer* para 42
[300] Opinion of AG Trstenjak in *Planzer* para 61
[301] Opinion of AG Trstenjak in *Planzer* para 63, *Planzer* para 61-62
[302] *Planzer* para 62
[303] Case C-185/01 Auto Lease Holland BV v Bundesamt für Finanzen [2003] I-01317 (cit. *Auto lease Holland*)

Dutch company (ALH) that, providing leasing services, offered their customers to finance their fuel purchases through the leasing company. The scheme was plotted as follows: ALH issued, through an intermediary credit card company (DKV), a credit card in the name of ALH. This card could be used by the customer to purchase fuel and certain oil products at the liability of ALH. The payments for the transactions were settled between ALH and DKV and ALH and the customer on a scheduled basis.[304] Since ALH regarded the fuel and oil products to have been purchased by the customer in *the name of* ALH, within the frame of the leasing agreement the company perceived the VAT incurred on these purchases as deductable, emerging from an economic activity. The relevant question emerging from the case was consequently regarding how the transactions of the fuel should be treated. If the fuel was to be regarded to be supplied via ALH, within the frame of the economic activity of the company, or if was to be regarded as being supplied directly to the customers.

The AG started his assessment by recalling that it follows from the directive that concept of supply of goods is defined as "transfer of the right to dispose over tangible property as owner".[305] This definition should, according to the AG be regarded, as economic rather than legal and should be entirely separated from the civil law concepts of ownership stipulated by the legal traditions of the Member States. Consequently the AG resolves that since ALH primarily was acting as a creditor, without any actual right of disposition of the purchased products, the supply was to be regarded as being made directly to the customer.[306]

The Court concurred in the view taken by the AG, concluding that in order for a supply to take place it is necessary that there is an actual transfer of the right to dispose over the property, and that this transfer is the relevant criterion for the where and if the supply has taken place.[307]

6.1.2.2 Temco

The same pattern of reasoning can be recognized in AG Colomers reasoning in his opinion in *Temco*[308] where a company (Temco) had tried to dispose the exemption of VAT for the letting of immovable property enacted in Belgium. The scheme applied the definition of "letting of immovable property"[309] in a rather technical interpretation and in essence evolved around the idea that Temco, by applying alternative conditions for the concession of premises could dispose the exemption and consequently deduct VAT levied on certain reinstatement work made on the property. Assessing the contracts at hand the AG stated that "*The key is to be found, therefore, in the nature of the transactions and its economic reality,*

[304] Opinion of AG Léger in *Auto Lease Holland* para 10
[305] Ibid. para 26
[306] Ibid. para 30
[307] *Auto lease Holland* para 23
[308] Case C-284/03 *Belgian State v Temco Europe SA* [2004] ECR I-11237 (cit. *Temco*)
[309] Art 13 of the Sixth Directive, art 135, 137 RVD

regardless of the legal classification attributed to it by the parties"[310]. The Court, however, did not to the same extent center its assessment around economic factors. Instead the reasoning was based around the unitary notion of "letting of immovable property". In this analysis the Court derived that even if the concept had been defined from the observation of a number of factors, the application of these factors cannot lead to a situation where the purpose or intention behind these factors is dispatched.[311] Consequently the Court applies a purpose-orientated interpretation to the criteria laid down in earlier case law, coming to the conclusion that the relevant transactions should, regardless of how they where labeled, be classified as "letting of immovable property". Coming to this conclusion, it is my interpretation that the Court acknowledges the reasoning of the AG, indirectly basing their assessment on the economical factors of the transactions, or the economic reality, rather than the legal reality, illustrated by the contracts.[312]

In my opinion the functioning of the criterion of "economic reality" becomes even more apparent when applied in relation to contracts as the contracts in the cases referred above are inherently formulated around "legal realities". The conclusions of the Court clearly illustrate the difference of operation in a civil law context, and why civil law concepts to some extent are inadequate when it comes to illustrating situations that are intended to trigger taxation. It should however be observed that this conclusion is restricted to apply to concepts that are to perceived as unitary concepts, i.e. exclusively determined by EU-law.[313] In contexts where the provisions of the directives is formulated with reference to concepts defined by national law,[314] the interpretation of these concept must ultimately be made dependent on their definition in the national legal system.

6.2 The functioning of "economic reality" as a criterion for interpretation

Having established that "economic reality" is a fundamental criterion for VAT and that legal constructions cannot dispatch the applicability of this criterion could appear to require, in order to promote legal certainty and foreseeability, some kind of definition of this criterion in relation to the legal models of the legislation. It could be argued that if no such definition existed it would be impossible to distinguish what legal models that would be perceived as compliant with the scenarios stipulated by the legislation and which models that would be deemed to be reclassified under an arbitrary case-to-case assessment. In order to fully satisfy such a need for

[310] Opinion of AG Colomer in *Temco* para 25
[311] *Temco* para 17
[312] A similar reasoning is applied in joined cases C-53/09 and C-55/09 *Commissioners for Her Majesty's Revenue and Customs v Loyalty Management UK Ltd* (C-53/09) *and Baxi Group Ltd* (C-55/09) [2010] n.y.r (cit *Baxi Group*), see esp. para 60
[313] Such as the above relevant article 14.1 RVD (art. 5.1 sixth directive) which is formulated without reference to concepts defined by national law.
[314] Such as in art 13 and 132.1 (b) RVD

foreseeability would, in the extreme, require a whole different set of definitions for different parts of the legal system and would ultimately require a debate regarding what "reality-based" scenarios the legal models should cover.

This perception of the application of the concept is however, in my interpretation, incorrect. In my view is the application of economical factors as a basis for the interpretation a mandatory result of the supra-national character of the VAT-directive and the imperative prerogative of the ECJ given through art. 267 TFEU. As pointed out by the AG in *Temco* the application of economical factors is necessary in order to ensure the neutrality of taxation between similar transactions, regardless of how the parties has chosen to label them.[315] Further, as the AG points out in *Auto lease Holland*, if the legal definitions of unitary concepts where to be dependent on legal definitions of the Member States, rather than unitary concepts, this would render a unitary application of the directive virtually impossible.[316]

Consequently the rational of the Court is the reverse of the one presented above. The procedure is not disregarded or reclassified because it is not compliant with the legal concepts of the national law, it is, in relation to VAT-legislation, the legal concepts of national law and consequently the procedure invoking them that are assessed differently under EU law. The application of "economic reality" is thereby not to be regarded as a invocation of a measure in order to prevent tax avoidance. Instead it is to be regarded as a criterion for defining unitary concepts and application of Union legislation. Considering the objectives of the directive and the nature of the VAT-context, economical factors, as pointed out by the AGs, appears as a reasonable benchmark for the assessment.[317]

This idea is further supported by the fact that the Court does not mention neither tax avoidance, nor abuse, in any of the judgments referred above but *Planzer*.[318] In *Planzer* the prevention to prevent tax avoidance is observed as one of the objectives of the Eight Directive and the mutual assistance of

[315] AG Colomer in *Temco* para 25
[316] AG Léger in *Auto lease Holland* para 26 see further Case C-320/88 *Shipping and Forwarding Enterprise* for the significance of a definition of a unitary concept of supply of goods (para 7)
[317] This is further supported by the reasoning of AG Stix-Hackl in case C-33/03 *Commission v UK* and case C-338/98 *Commission v the Netherlands* . Both cases relate to national rules making it possible for employers to deduct VAT-costs emerging from employees use of private cars within the business activity of the employer possibly incompliant with the VAT-directives. Although the Court doesn't base its decision on an interpretation based on the concept of economic reality, the fact that the parties and the AG address and discuss the concept of economic reality as a method for interpretation shows that the criterion can be made relevant not only when assessing procedures put out by private operators, but possibly also in relation to the legislation of the Member s States when assessing the implementation of secondary legislation.
[318] The concepts of abuse and tax avoidance is however addressed by both the Commission and the AG in *Temco*

the tax authorities of the Member States.[319] Further the Court, in relation to the assessment of whether the issuing of the certificate forms an irrefutable assumption stresses the possibility for the tax authorities to examine the factual circumstances of a case in order to prevent abuse or tax avoidance.[320] Doing so the Court implies that and that the invocation of a certificate, not corresponding to economic reality, would amount to abuse or fraud.[321] The Court does however not address the two-part test of *Halifax* or make any further assessment of the factual circumstances of the case, but answer the questions posed in rather general terms.

A possible explanation to why the Court raises the issue of abuse but refrain itself of directly addressing if the procedure laid out is to be regarded as abusive is found in the nature of the rule and the questions themselves. The first question of the national court relates to the legal functioning of the issued certificate. Finding that the issuing of a certificate does form a presumption which can be penetrated by establishment that the issuing of the certificate does not correspond to an economic reality there is no need to examine whether the procedure could be dispatched by an application of the doctrine of abuse. Even if the doctrine was applied, the procedure would not be regarded as abusive as the first criterion of abuse is that the procedure, in order to be regarded as abusive, must be formally compliant with the provisions of the directive.[322] In this case the procedure was not formally compliant, since the Court prescribed a certain amount of economic substance for the fulfillment of the relevant prerequisite “established”. Since the Luxembourg establishment did not illustrate such a substance the procedure was consequently not formally compliant with the provisions of the Eight Directive. In this aspect *Planzer* reassembles *Fini H*, as presented above in section 5.1

[319] *Planzer* para 36, 48
[320] Ibid. para 48
[321] Ibid. para 45
[322] See above, 3.3.3

7 Conclusions

7.1 The relation between the concepts

As illustrated above I perceive tax avoidance, economic reality and abuse as three separate, though connected concept. All three concepts are expressions for the objective of applying and interpreting the VAT-legislation in line with its purpose. Distinctions can however be made both regarding the concepts functioning and legal character. The objective to prevent tax avoidance is primarily a general, legal and political objective. The Member States are under the VAT-system on one hand obliged and encouraged to counter avoidance and on the other severely restricted to independently do so. As an objective for the common system, this interest must be balanced against other interests and principles laid out by the Directives. Economic reality is to be regarded as a benchmark for the assessment of the legislation, and a criterion for interpretation. As such the concept is intended to ensure a uniform and correct application of the legislation, considering the economic nature of the VAT-system. The prohibition of abuse can be described as a legal functioning of the system laid out by the legislation, limiting the scope there of to exclude certain procedures. All the three concepts however strive to obtain the same objective, to ensure that the legislation is applied in compliance with its' purpose.

It is however important to observe that the concept of economic reality is however more disconnected from the objective to prevent tax avoidance. Even though the application of the concept could have the effect that avoidant behavior is thwarted this is not the primary function of the application of the concept. As a general criterion for VAT I can further see other possible applications of the concept than in relation to tax-saving schemes. Since the concept shall be applied as a criterion for interpretation of the provisions of the directives I am convinced that the concept could be applied in e. g. a review of a Member States implementation of the directive.

There is a fundamental distinction between the on one hand tax avoidance and on the other economic reality and the prohibition of abuse regarding the applicability of the concepts. As illustrated in *Holin Groep*, the objective to prevent tax avoidance cannot be applied in order to dispatch the literal letter of the law. Abuse and economic reality however derives from the literal letter of the law and examines the applicability of this literal interpretation. Abuse does this in the sense the formal application of the stipulated provisions are assessed in relation to the purpose of the legislation, in a review of the economic reality the tax law concepts are examined in relation to the corresponding concepts from other fields of law.

7.2 The relation between Economic reality and Abuse

Although abuse and economic reality are, in my opinion, two distinctly different concepts there are areas where the two concepts overlap each other. Both concepts strive to attain the objective that the VAT-system is applied in compliance with its' purpose, and so observe the economic character of the system.

It can be established from the *DFDS*-line that the concepts of VAT-system should be defined from an economic perspective. Further it has been held in *Tanoarch* and *Ampliscientifica* that "*the effect of the principle is therefore to prohibit wholly artificial arrangements not illustrating economic reality*". This could lead to the conclusion that the two concepts can be said to form two sides of the same coin. This in the sense and that the same objective, to prevent artificial arrangements, is obtained by alternative routes. The application of economic reality obtains the objective by interpretation of the provision and the prohibition of abuse by assessing the procedure. This perception is however far to simplified to be considered as correct. In its' decisions the Court has systematically advocated a rather strict application of the two-part test. Since the two-part test is inherently based on the interpretation of the legislation in order to assess the procedure, artificial arrangements cannot be regarded as sufficient in order to classify a procedure as abusive.

This lead in my view to two alternative conclusions regarding the role of artificial arrangements, or lack of economic reality, in the assessment of a possible abusive procedure.

a) That "artificiality", or lack of economic reality is supposed to act as a third, implied criterion, or "indicator" for the application of abuse. This would match the "effect of the principle" as described in *Tanoarch* and *Ampliscientifica* in the sense that it seems like a sensible prerequisite to prescribe the existence of "artificial arrangements" in order to prohibit said arrangements. This is further supported by the fact that "artificial arrangements has been held as a relevant factor for the assessment of both parts of the two part test.

   If "artificial arrangements" was to be regarded as a third, implied criterion this would also create a rational relationship to the concept of economic reality, applied as a criterion for interpretation. The concepts would overlap each other where the criterion of economic reality is applied in relation to specific concepts of the legislation and the prohibition of abuse prohibits artificial arrangements in a more general sense

b) That the prohibited “artificial arrangements” are detected by the application of the two part-test. This would establish the implied notion that artificiality is not a prerequisite for abuse, but in fact its’ essence.

This perception of the notion would create an autonomous concept of what is to be regarded as “artificial”, or “lacking economic reality” in relation to the assessment of the two part test. This concept would be inherently separated from the type of economic reality that is applied as a criterion for interpretation. This is since the application of economic reality is solely concerned with the motives for the legislation, and as opposed to when assessing the application of the prohibition of abuse, the purposes or objectives of the procedure are irrelevant.

This does however not totally exclude that the concepts occasionally overlap each other in the sense that the application of either concept would lead to the same outcome in the specific case. Any such overlap is however to be perceived as a result of the two concepts being parallel with each other rather than convergent.

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