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General Anti-Avoidance Rules and Legal Certainty in Sweden, USA and China

– A taxation determined by legal culture?

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[…] in this world nothing can be said to be certain, except death and taxes.
— Benjamin Franklin, 1789.[1]

[1] — Benjamin Franklin, in a letter to Jean-Baptiste Leroy, 1789. "Our new Constitution is now established, and has an appearance that promises permanency; but in this world nothing can be said to be certain, except death and taxes."

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Summary

The occurrence of taxpayers implementing arrangements without commercial purpose to avoid tax laws and reduce their taxation, *id est tax avoidance*, is counteracted in most legal systems with different methods. Most jurisdictions have implemented not only Specific Anti-Avoidance Rules ("SAARs"), but also General Anti Avoidance Rules ("GAARs") to counteract tax avoidance. The topic of this thesis is GAARs and the conflict between their application and taxpayers' legal certainty. In the light of this conflict, the thesis examines GAARs in three different legal systems on three continents. Sweden, United States and China all apply a common method to counteract tax avoidance: statutory or judicially developed GAARs. This thesis investigates these three GAARs and examines their purpose, design, legal frameworks and application in the light of *legal culture* and *legal certainty* by examining each country's government, political governance, legal system and tax law interpretation. The thesis further analyzes how each GAAR in the light of *legal culture* affects taxpayers' legal certainty. To achieve this purpose the thesis explores the significance of legal certainty in the countries, what impact GAARs have for taxpayers' legal certainty, and how legal culture impacts on legal certainty in the application of GAARs. The study shows that the GAARs applied in Sweden, United States and China are very similar in terms of design, purpose and the criteria for application, as well as with regard to the fact that their effectiveness is conflicting with taxpayers' legal certainty. Despite the fact that the three countries' GAARs are similar, there are however significant differences between their consequences for taxpayers' legal certainty. The conclusions are that the importance given to taxpayers' legal certainty vary between the countries, and in the context of GAAR application, there are conflicting interests that may limit taxpayers' legal certainty. The differences are largely attributable to the legal cultures of Sweden, the United States and China, and the political ideologies dominating each country respectively have proven to have a major impact on the significance given to taxpayers' legal certainty.

Sammanfattning

Förekomsten av att skattskyldiga genomför arrangemang utan affärsmässigt syfte för att kringgå skattelagstiftningen och sänka sin beskattning, *id est skatteflykt*, motverkas i de flesta rättssystem med olika metoder. De flesta jurisdiktioner har implementerat inte endast specifika skatteflyktsregler (”SAARs”), utan även generella så kallade General Anti-Avoidance Rules (”GAARs”) för att motverka skatteflykt. Ämnet för detta examensarbete är konflikten mellan GAARs och skattskyldigas rättssäkerhet. I ljuset av denna konflikt undersöker examensarbetet GAARs i tre olika rättssystem på tre kontinenter. Sverige, USA och Kina tillämpar en gemensam metod för att motverka skatteflykt: lagstiftade eller rättspraxisutvecklade GAARs. Detta arbete undersöker dessa tre GAARs och granskar deras syfte, utformning, rättsliga ramverk och tillämpning i ljuset av *rättskultur* och *rättssäkerhet* genom att undersöka respektive lands regering, politiska styre, rättssystem och skatterättsliga lagtolkning. Examensarbetet analyserar vidare hur respektive GAAR i ljuset av *rättskultur* inverkar på skattskyldigas rättssäkerhet. För att uppnå detta syfte utröner uppsatsen vilken betydelse rättssäkerhet har inom länderna, vilken inverkan GAARs har för skattskyldigas rättssäkerhet, samt hur rättskulturen inverkar på rättssäkerhet vid tillämpningen av GAARs. Undersökningen visar att de GAARs som tillämpas i Sverige, USA och Kina är mycket likartade vad avser utformning, syfte och kriterier för tillämpning, samt i avseendet att deras effektivitet står i konflikt med skattskyldigas rättssäkerhet. Trots att de tre ländernas GAARs är likartade finns emellertid väsentliga skillnader mellan deras konsekvenser för skattskyldigas rättssäkerhet. Slutsatserna är att betydelsen som ges till skattskyldigas rättssäkerhet varierar mellan länderna, och i kontexten av GAAR tillämpning finns motstående intressen som kan begränsa skattskyldigas rättssäkerhet. Skillnaderna är till stor del hänförbara till rättskulturerna i Sverige, USA och Kina, och de politiska ideologier som dominerar respektive land har visat sig ha stor inverkan på den betydelse som ges till skattskyldigas rättssäkerhet.

Preface

Thanks to all the teachers and fellow students at Lund University, Uppsala University and Peking University, which I have had the great pleasure to get to know and gain knowledge from – I am always grateful.

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This thesis is dedicated to my sons, Alfred and Henry.

Ad utrumque paratus.

Uppsala, May 2018
Markus Nyberg-Andersson

Abbreviations

ATAD	Council Directive (EU) 2016/1164 of 12 July 2016 laying down rules against tax avoidance practices that directly affect the functioning of the internal market.
BEPS Project	OECD/G20 Base Erosion and Profit Shifting Project
Chinese GAAR	Art. 47 of the Chinese Enterprise Income Tax Law
DIR	Detailed Implementation Regulations for the implementation of the Enterprise Income Tax Law of the People's Republic of China [中华人民共和国企业所得税法实施条例]
EITL	Enterprise Income Tax Law of the People's Republic of China [中华人民共和国企业所得税法]
EU	European Union
G20	The Group of Twenty
GAAR	General Anti-Avoidance Rule
HFD	Swedish Supreme Administrative Court [Högsta förvaltningsdomstolen]
IL	Swedish Income Tax Act [Inkomstskattelag (1999:1229)]
IMSTA	Implementation Measures of Special Tax Adjustments [2009] No. 2 [关于印发《特别纳税调整

	实施办法（试行）》的通知〔2009]2号]
IRC	United States Internal Revenue Code of 1986
IRS	United States Internal Revenue Service
JV	Joint Venture
MNEs	Multinational Enterprises
MoF	Ministry of Finance of the People's Republic of China [中华人民共和国财政部]
NPC	National People's Congress of the People's Republic of China [中华人民共和国全国人民代表大会]
OECD	Organisation for Economic Co-operation and Development
Prop.	Swedish Government bill [Regeringsproposition]
RÅ	Yearbook of the Swedish Supreme Administrative Court [Regeringsrättens årsbok]
RF	Swedish Instrument of Government [Kungörelse (1974:152) om beslutad ny regeringsform]
SAAR	Specific Anti-Avoidance Rule
SAT	State Administration of Taxation of The People's Republic of China [国税发]
SCNPC	Standing Committee of the National People's Congress of the People's Republic of China [中华

	人民共和国全国人民代表大会 常务委员会]
SFS	Swedish Code of Statutes [Svensk författningssamling]
SKV	Swedish Tax Agency [Skatteverket]
SOU	Swedish Government Official Reports [Statens offentliga utredningar]
SPV	Special Purpose Vehicle
SRN	Swedish Revenue Law Commission [Skatterättsnämnden]
State Council	State Council of the People's Republic of China [中华人民共和国国务院]
Swedish GAAR	Swedish Tax Avoidance Act [Lag (1995:575) mot skatteflykt]
TEU	Treaty on European Union
TFEU	Treaty on the functioning of the European Union
U.S. GAAR	Section 7701(o) of the Internal Revenue Code and the judicial Anti-Avoidance doctrines

1 Introduction

1.1 Background

The Organisation for Economic Co-operation and Development ("OECD") has emphasized that globalisation and the integration between national economies have increased significantly in recent years.[2] As the economy becomes more globally integrated, cooperation between companies in different countries increase, multinational corporate groups form and international business trading today represents a large part of all trade. Globalization has shifted from country-specific to global structures.[3] Studies prior to the initiation of the OECD/G20 Base Erosion and Profit Shifting Project ("BEPS Project") have shown an increase in segregation of where businesses conduct activities and income arises as compared to where taxes are paid.[4] To overcome these problems, the OECD on behalf of the G20 initiated the BEPS Project in 2013, with its final reports presented in 2015.[5] They are based on three pillars: Firstly, to increase coherence between different countries' legislations to prevent regulatory abuse. Secondly, to clarify the relationship between the country where the tax is paid and the country where the value arises, and ensure taxation where economic activities are performed and value created. Thirdly, to increase transparency and predictability in international tax matters.[6] In total, the BEPS project comprises 15 actions containing measures and methods to prevent erosion of national tax bases and to counteract tax avoidance.[7]

[2] OECD (2013), *Addressing Base Erosion and Profit Shifting*, p. 25.
[3] OECD (2013), *Action Plan on Base Erosion and Profit Shifting*, p. 7.
[4] OECD (2013), *Addressing Base Erosion and Profit Shifting*, p. 19.
[5] OECD (2015), *Explanatory Statement*, OECD/G20 Base Erosion and Profit Shifting Project, pp. 4–11.
[6] OECD (2013), *Action Plan on Base Erosion and Profit Shifting*, pp. 13 f.; OECD (2013), *Addressing Base Erosion and Profit Shifting*, pp. 5–11; Berglund & Cejie (2014), pp. 37 f.
[7] OECD (2015), *Explanatory Statement*, OECD/G20 Base Erosion and Profit Shifting Project, pp. 13–18.

The phenomena of *tax avoidance* dates back as early as the concept of taxation,[8] and generally refers to arrangements that are *prima facie* legal, but results in "unacceptable" tax benefits.[9] In line with a raising number of international transactions in recent decades, the occurrence of tax avoidance has increased and changed form.[10] Taxation is fundamental for states' income and policies, and tax avoidance undermines tax systems' equality, integrity, and legitimacy, unfairly shift the tax burden, distort economic behaviour, and adds complexity to tax systems.[11] Accordingly, tax avoidance is an issue necessary for all countries to address.[12] Most legal systems have thus implemented different measures on different levels to counteract tax avoidance,[13] and methods for dealing with the phenomena are discussed among legal scholars, practitioners and politicians worldwide.[14] Not only preventive measures, but also methods for identifying and counteracting completed tax avoidance arrangements have been implemented within most jurisdictions.[15] While specific anti-avoidance rules ("SAARs") have tried to address the problem, they have proved insufficient since the variety of tax avoidance arrangements continuously grow in number and complexity.[16] Consequently, an increasing number of states have implemented general anti-avoidance rules ("GAARs"), applying to arrangements that formally complies with a tax provision but are contrary to the legislator's intention since its purpose is to avoid taxation.[17]

[8] Krishna (1990), p. 8; Atkinson (2012), pp. 1 f.
[9] Xiong & Evans (2014), p. 686; Prebble & Prebble (2010), pp. 22 f.; Atkinson (2012), pp. 1 f.; Ogazón & Hamzaoui (2015), p. 4.
[10] Hilling (2016), p. 69; Li (2010), pp. 78, 85; van Brederode & Krever (2017), p. 11; Atkinson (2012), p. 1; Sulami (2012), p. 4; Krever (2016), pp. 1–2.
[11] Atkinson (2012), p. 1; Evans (2008), p. 1; Bankman (2000), p. 5; Ogazón & Hamzaoui (2015), pp. 7, 17; Li (2010), p. 84; Hilling (2016), pp. 69–70.
[12] Sulami (2012), p. 8; Ogazón & Hamzaoui (2015), p. 8; Prebble & Prebble (2010), p. 22; Atkinson (2012), pp. 1 f.; Hilling (2016), p. 69.
[13] Rosander (2007), p. 31; Prebble & Prebble (2010), p. 26; Shi (2017), p. 29; Hilling (2016), p. 72; Krever (2016), p. 13.
[14] Cui (2011), p. 42; Ogazón & Hamzaoui (2015), p. 9; Shi (2017), p. 29.
[15] Rosander (2007), p. 31; Krever (2016), p. 13; Hilling (2016), p. 75; Menuchin & Brauner (2016), p. 779; Sulami (2012), p. 9; Li (2010), p. 85; Ogazón & Hamzaoui (2015), p. 5.
[16] Morse & Deutsch (2015), p. 112; Xiong & Evans (2014), p. 686; Prebble & Prebble (2010), p. 38; Li (2010), pp. 78, 85; Krever (2016), p. 17.
[17] Cf. the GAARs of Sweden, the U.S. and China in section 4.2–4.4; Li (2010), pp. 78, 85; van Brederode & Krever (2017), p. 11; Krever (2016), pp. 5 f.; Ogazón & Hamzaoui (2015), p. 17; Sulami (2012), p. 12; Prebble & Prebble (2010), p. 25; Hilling (2016), p. 76.

In the context of creating, interpreting and applying GAARs, the principle *no taxation without legislation* or *nullum tributum sine lege*, is one of the most important legal principles in tax law.[18] Referred to as the principle of legality, it guarantees an explicit legal basis for taxation.[19] An application in accordance with the principle of legality takes concern to the protection of taxpayers, but not to its economic or social consequences.[20] Consequently, many countries accept that taxpayers arrange their affairs to minimize their tax liability.[21] GAARs are adopted since legislators cannot in advance define all situations in which a rule shall apply.[22] Although it is possible to argue that all legislation are vague, GAARs have a much wider part of their application within the "grey area".[23] A degree of uncertainty is *ergo* unavoidable for GAARs to function.[24] GAARs provide a possibility to recharacterize arrangements and restore the tax liability that would have resulted from the ordinary circumvented tax rules.[25] Accordingly, GAARs differ from ordinary tax provisions by operating generally without targeting any particular activity, and by targeting avoidance of liability to taxation.[26] Consequently, it is difficult to design GAARs that are efficient but still pays sufficient attention to taxpayers' legal certainty.[27] In the light of this background, the thesis examines the conflict between legal certainty and fiscal efficiency in a global context, by analysing GAARs within three different legal systems.

1.2 Purpose and Research Questions

In light of the widespread use of GAARs and their conflict with legal certainty, the overall purpose of this thesis is to examine and analyse *the*

[18] Cooper (1997), p. 13; Tjernberg (2016A), p. 170; Vanistendael (1996), p. 35.
[19] Cf. section 3.3; Tjernberg (2018), p. 21; Rosander (2007), p. 77; Påhlsson (2013), p. 89.
[20] Vanistendael (2010), p. 213; Xiong & Evans (2014), p. 690; Vanistendael (1996), p. 35.
[21] Vanistendael (2010), p. 213; Ogazón & Hamzaoui (2015), p. 8; Prebble & Prebble (2010), p. 23.
[22] Krever (2016), p. 17; Sulami (2012), p. 12; Xiong & Evans (2014), p. 689.
[23] Cooper (1997), p. 25; Prebble & Prebble (2010), pp. 28 f.; Vanistendael (1996), p. 35.
[24] Prebble & Prebble (2010), p. 41; Freedman (2004), p. 346; Hilling (2016), pp. 73 f.
[25] Orow (2000), pp. 58 f.; Hilling (2016), p. 76.
[26] Prebble & Prebble (2010), p. 30.
[27] Atkinson (2012), p. 3; Prebble & Prebble (2010), pp. 28, 30; Freedman (2004), p. 346; Xiong & Evans (2014), pp. 687 f.; Cooper (1997), p. 13.

application of general anti-avoidance rules in Sweden, the U.S. and China[28] *in the light of legal culture and legal certainty.* Such a comparison further requires an initial analysis of the significance of legal certainty within the three countries, based on an established universal definition of the concept.

To achieve this purpose the thesis intends to answer the following questions:

- What significance does the legal certainty concept have within the countries?
- What are the GAAR applications' consequences for taxpayers' legal certainty?
- How does legal culture affect legal certainty in the application of GAARs?

1.3 Theory, Method and Perspective

The *legal dogmatic* method with a comparative perspective is the starting point for this thesis. Thereby, to establish a comprehensive foundation for the analysis, the current law is analysed, systematised and determined through an examination of the recognized sources of law and guided by the research questions. Accordingly, the study is conducted by examining and analysing relevant legal frameworks, case law, *travaux préparatoires* and legal doctrine taking regard to the hierarchy of legal sources in each country.[29] The thesis focuses on the legal frameworks for understanding the functioning of the GAARs, the legal doctrine for a complete comprehension of the views among legal scholars, and case law to assess the GAARs applications. From a methodological point of view, this thesis consists of a critical examination and systematization of current and existing law, and an analysis and evaluation of the content of the law. Since the law is described and systematized *de lege lata*, it is most natural to regard the method as legal dogmatic, in the sence that existing law is reconstructed and rebuilding the view of reality.[30] A comparative perspective is used since an understanding

[28] In this thesis, "China" refers to the mainland part of the People's Republic of China.
[29] Kleineman (2013), pp. 21, 24; Tjernberg (2018), p. 15; Sandgren (2015), pp. 43 f.
[30] Jareborg (2004), pp. 2–4.

of our own jurisdiction's GAAR requires a reflection from other jurisdictions' perspective.[31] A precondition for all comparisons is a common denominator; a *tertium comparationis*,[32] which in this case consists of the GAAR. Furthermore, an understanding of a legal rule's *non-legal* environment and social purpose is necessary for understanding its functioning.[33]

The choice to analyse the GAARs in the light of legal certainty is motivated by the fact that the concept may be seen as the ultimate protection and very essence of taxpayers' rights, and since the GAAR application clearly illustrates the conflict between taxpayers' rights and the law's efficiency. The thesis thus has *legal certainty* as its main perspective, and *legal culture* as its secondary perspective, since it aims to examine the legal culture's impact and consequences for taxpayers' legal certainty in the context of GAAR application.[34] The choice to analyse the GAARs in the light of legal culture is motivated by its considerable impact on the significance of legal certainty within a country. The thesis further examines whether the GAARs limit legal certainty and, if so, whether there are any arguments justifying a limitation. The approach to examine the GAARs from a perspective of legal culture is carried out by examining factors significant for and distinctive of legal culture such as government and governance, legislative competence and tax law interpretation. This to establish a comprehensive view of the legal cultures in which the GAARs are operating.[35] The examination of GAARs in the light of legal certainty is conducted by analysing the concept itself both universally and within the chosen jurisdictions. To examine GAARs in the light of legal certainty, the concept itself is analysed and a universal definition determined in relation to closely related concepts and with particular emphasis on the considerations and legal frameworks within the three countries respectively.

[31] Cf. van Brederode & Krever (2017), p. 13; Zweigert & Kötz (1998), p. 16.
[32] Bogdan (2013), pp. 46 f.
[33] Bogdan (2013), p. 39; Zweigert & Kötz (1998), p. 10.
[34] Cf. Kellgren & Holm (2007), pp. 47 f.; Sandgren (2015), p. 68.
[35] Van Hoecke & Warrington (1998), pp. 5 f.

1.4 Material and Previous Research

Since direct guidance regarding the application of the GAARs as well as the meaning and status of the legal certainty concept within the chosen countries cannot be derived directly from legislation and *travaux préparatoires*, the thesis examines case law and legal doctrine. Legal doctrine generally lacks independent authority but may be considered to increase the democratic legitimacy of other legal sources.[36] The case law is selected to illustrate the GAAR applications' impact on taxpayers' legal certainty. An additional legal source that *could* be used is *travaux préparatoires,* which, for this thesis are used to interpret the Swedish GAAR's intended application.[37]

The thesis highlights a debated issue, and the international research on GAARs compatibility with different aspects of the principle of legality and the rule of law are quite extensive. The Swedish GAAR is dealt with extensively in legal doctrine;[38] in particular, by Ulrika Rosander who in her dissertation, *Generalklausul mot skatteflykt* from 2007 conducts a thorough examination of the GAARs of Sweden, Germany and Canada from a perspective of legal certainty and effectiveness. Furthermore, Christian Carneborn and Carl-Magnus Uggla conducts a comprehensive research on the application of the Swedish GAAR in *Tolkning och tillämpning av skatteflyktslagen* from 2015. Several scholars write about the U.S. GAAR and the judicial doctrines.[39] Particularly valuable for the purpose of this thesis is the chapter about the United States by Shay Menuchin and Yariv Brauner, in the anthology *GAARs - A Key Element of Tax Systems in the Post-BEPS World* from 2016, as well as the article *Tax Anti-Avoidance Law in Australia and the United States* by Susan C. Morse and Robert Deutsch from 2015. These works provide a great insight on the GAAR's functioning as well as

[36] Kleineman (2013), p. 27.
[37] Peczenik (1980), pp. 48 f.
[38] Cf. e.g. Påhlsson, Robert, *Kringgående av inkomstskattelag – en resa utan slut*, 2016, and Hultqvist, Anders, *Skatteundvikande förfaranden och skatteflykt*, 2005.
[39] Cf. e.g. Lampreave, Patricia, *An Assessment of the Anti-Tax Avoidance Doctrines in the United States and the European Union*, 2012, and Tiley, John and Jensen, Erik M., *The Control of Avoidance: The United States Alternative*, 2006.

problems from a legal certainty perspective. Regarding the Chinese GAAR, the most important works – in addition to the later mentioned work by Jinyan Li – are *Towards an Improved Design of the Chinese General Anti-Avoidance Rule: A Comparative Analysis* from 2014 by Wei Xiong and Chris Evans, as well as *Legal Interpretation of Tax Law: China* from 2017 by Dongmei Qiu. These works deal extensively with the Chinese GAAR's functioning as well as with the legal environment in which it operates.

The question of how legal culture relates to GAAR application is uncommon in the legal doctrine. However, Maria Hilling partly deals with this aspect in *Skatteavtal och generalklausuler* from 2016, when comparing the GAARs of Sweden and Canada, and so does Jinyan Li in *Tax Transplants and Local Culture: A Comparative Study of the Chinese and Canadian GAAR* from 2010. The concepts of the rule of law and the principle of legality have not received as much attention in the area of taxation. Although literature about GAARs may include aspects on their compatibility with the rule of law, few works examine GAARs direct consequences for legal certainty. Important works dealing with GAARs in relation to requirements of the rule of law in taxation are *Taxation, Tax Avoidance and the Rule of Law* from 2010, by Frans Vanistendael, and *Does the Use of General Anti-Avoidance Rules to Combat Tax Avoidance Breach Principles of the Rule of Law – A Comparative Study* from 2010, by Rebecca Prebble and John Prebble. These works provide insight into the most problematic aspects of GAARs from a rule of law perspective. Furthermore, Lon Fuller's *The Morality of Law* constitutes the starting point for determining the universal legal certainty concept. The mentioned works provide a rather good view of the rule of law and the principle of legality in taxation; however, none of them deals explicitly with taxpayers' legal certainty. The thesis attempts to examine the three GAARs in the light of legal culture and legal certainty to determine which factors that most significantly affect taxpayers' legal certainty. The thesis differentiates from what is previously authored as it elucidates a comprehensive view of GAARs in the light of legal certainty within three different legal cultures.

1.5 Terminology

1.5.1 Planning, avoidance and evasion in taxation

The following terms reflect the definitions internationally, and not within any specific legal system. To begin with, *tax planning* is not always easily distinguishable from *tax avoidance*,[40] which is a major reason why GAAR application is problematic.[41] Arrangements resulting in reduced tax liability are considered either acceptable or unacceptable.[42] While *acceptable tax avoidance*, *id est tax planning* follow both the wording and the purpose of the law, *unacceptable tax avoidance* follows the law's wording but violates its purpose.[43] Furthermore, the term *aggressive tax planning* must be distinguished since it is a political expression used by the OECD/G20 and the EU. It differs from the legal terms as it refers to arrangements with unwanted tax benefits but that are *de lege lata* not necessarily covered by GAARs.[44] In this thesis, "tax avoidance" refers to the aforementioned legal definition of *unacceptable tax avoidance*. Tax avoidance exists when a taxpayer obtains tax benefits from an arrangement complying with the statute's literal text but circumventing its intended purpose.[45] Such arrangements usually offer no pre-tax gain, with tax benefits as their only aim.[46] Tax avoidance arrangements take varying forms and abuse inconsistencies, gaps, tax incentives and tax reliefs within national tax systems and across international borders, using tax-efficient structures, offshore schemes, tax arbitrage arrangements, tax shelters etc.[47] Although modern democracies accept taxpayers' right to engage in acceptable tax planning, it is crucial that they draw a line as to what constitutes *unacceptable tax avoidance*.[48] However,

[40] Ogazón & Hamzaoui (2015), p. 6; Lampreave (2013), p. 49; Hilling (2016), pp. 71 f.
[41] Evans (2008), pp. 4 f.; Prebble & Prebble (2010), pp. 28 f.; Hilling (2016), p. 72.
[42] Ogazón & Hamzaoui (2015), p. 5; Prebble & Prebble (2010), p. 23; Hilling (2016), p. 69.
[43] Krever (2016), pp. 5–7;; Whait, Whittenburg & Horowitz (2012), p. 775; Ogazón & Hamzaoui (2015), p. 5.
[44] European Commission (2017), *Aggressive Tax Planning Indicators - final report*, pp. 23 f.; Hilling (2016), p. 27.
[45] Sulami (2012), p. 3; Evans (2008), p. 7; Ogazón & Hamzaoui (2015), p. 5; Hilling (2016), pp. 69, 71.
[46] Sulami (2012), pp. 10 f.; Hilling (2016), p. 69; Prebble & Prebble (2010), p. 22.
[47] Li (2010), p. 83; Hilling (2016), p. 71; Ogazón & Hamzaoui (2015), pp. 6 f., 17; Sulami (2012), p. 9; Evans (2008), p. 3.
[48] Sulami (2012), pp. 3, 9; *Gregory v. Helvering*, 69 F.2d 809, 810 (2nd Cir. 1934).

since the latter due to its nature as situational, fact-specific and dynamic is very challenging to define precisely, this causes the line delineating unacceptable tax avoidance from tax planning to be rather uncertain.[49] There is in the Western world a consensus that *tax avoidance* shall be distinguished from *tax evasion*. While tax avoidance respects the law's letter and violates its purpose, *tax evasion violates the letter of the law*. Accordingly, while tax benefits arising from the former are achieved legally, those arising from the latter, on the other hand, involves a deliberate and illegal violation of tax law.[50] The definition of tax avoidance differ between jurisdictions,[51] and some countries, like China, even lacks a distinction between planning, avoidance and evasion in taxation.[52]

1.5.2 General and specific anti-avoidance rules

An increasing trend internationally for dealing with the more sophisticated tax avoidance arrangements is the use of GAARs.[53] GAARs protect the tax liability following from other tax provisions by prohibiting tax benefits arising from tax avoidance arrangements.[54] As GAARs extend the scope of tax laws to arrangements that are otherwise not covered, they constitute something more than ordinary rules.[55] Although their form, design, and sets of rules vary, GAARs can be divided into four main types:[56]

- Rules identifying one or several related transactions with the purpose or effect to provide a tax benefit, and re-examining the taxpayer's tax liability based on a hypothetical transaction that presumably would have been used instead of the most tax-efficient alternative.[57]
- Rules that imply a tax law interpretation and application based on one or several transactions economic substance, and which enable a

[49] Evans (2008), p. 5; Ogazón & Hamzaoui (2015), p. 6; Sulami (2012), pp. 8–10.
[50] Whait, Whittenburg & Horowitz (2012), p. 775; Prebble & Prebble (2010), p. 22; Sulami (2012), p. 9; Evans (2008), p. 3; Ogazón & Hamzaoui (2015), pp. 5 f.
[51] Hilling (2016), p. 71.
[52] Li (2010), p. 83.
[53] Rosander (2007), p. 14; Ogazón & Hamzaoui (2015), p. 17; Yang (2010), pp. 211 f.
[54] Sulami (2012), pp. 12 f.; Atkinson (2012), p. 3; Orow (2000), pp. 47, 59 f.; Hilling (2016), p. 74.
[55] Orow (2000), p. 61; Prebble & Prebble (2010), pp. 25, 29.
[56] Prebble & Prebble (2010), p. 27; Krever (2016), p. 3.
[57] Cf. e.g. the Chinese GAAR (section 4.4).

reassessment of the tax liability based on a hypothetical legal transaction reflecting the underlying economic substance.[58]

- Judicially developed GAARs, based on a broad abuse of law doctrine.[59]
- GAARs targeting statutory abuse of law, applicable when fictitious or valid arrangements are used to defeat the tax law's intention.[60]

Another common feature are SAARs regulating, regardless of the taxpayer's purposes, the precise tax result of specific arrangements.[61] While SAARs define and target already identified avoidance arrangements, such as Controlled Foreign Corporations, thin capitalization and transfer pricing, GAARs target tax avoidance arrangements not covered by SAARs.[62] SAARs clear formulations, precision, and automatic effect increase predictability, but limit their scope of application to the arrangements specified.[63] Since SAARs cannot define a continuously changing number of tax avoidance arrangements, they can never alone effectively counteract tax avoidance.[64]

1.6 Delimitations

This thesis addresses the questions of what consequences GAAR application in Sweden, USA and China have for taxpayers' legal certainty, and the role of legal culture in this context. Accordingly, it is only GAAR application in the domestic tax systems of these three countries that are dealt with. Furthermore, the thesis deals neither with GAARs in tax treaties or within other jurisdictions, nor with general rules other than such that may derive from the concepts of legal certainty, the principle of legality and the rule of law in tax law. The thesis, to a certain degree, simplifies reality, aiming to make it more comprehensible and to facilitate a clear analysis. This

[58] Cf. e.g. the Swedish true import alternative, which is not seen as a GAAR; Prebble & Prebble (2010), pp. 25.
[59] Cf. e.g. the U.S. GAAR (section 4.3).
[60] Cf. e.g. the Swedish GAAR (section 4.2); Krever (2016), p. 3.
[61] Vanistendael (2010), pp. 213; Mingxing Cao & Li (2016), pp. 197 f.; Krever (2016), p. 13; Li (2010), p. 85; Sulami (2012), p. 11; Evans (2008), p. 15; Hilling (2016), p. 73.
[62] Hilling (2016), pp. 73; Menuchin & Brauner (2016), pp. 779 f.; Li (2010), p. 76; Krever (2016), p. 13; Ogazón & Hamzaoui (2015), p. 8; Holmes (2012), pp. 213–216.
[63] Vanistendael (2010), pp. 214; Mingxing Cao & Li (2016), p. 196; Krever (2016), p. 13.
[64] Li (2010), p. 85; Sulami (2012), pp. 11 f.; Evans (2008), p. 15; Hilling (2016), p. 75.

simplification consists primarily of the focus on GAARs, with no focus on other measures against tax avoidance. Although the thesis touches upon some of the legal bases on which legal certainty rely, the thesis instead of focusing on specific instruments ensuring taxpayers' legal protection adopts a to some extent broader focus on legal certainty. This is because legal certainty may be considered to constitute the very basis that essentially all legal rights instruments have as a purpose to facilitate. Consequently, the thesis does not go into depth regarding the legal rights instruments and specific substantive procedures that protect legal certainty within the chosen countries, the EU or in international treaties.

1.7 Disposition

The thesis is organised as follows. *Chapter 2* provides legal culture characteristics and highlights similarities and differences between Sweden, the U.S. and China, as regards government and governance, legislative competence and tax law interpretation. *Chapter 3* examines the background and requirements of the legal certainty concept in taxation. It examines the rule of law, the principle of legality, and establishes a universal definition of the legal certainty concept and analyses its significance and legal bases within the three countries. *Chapter 4* examines and analyses the GAARs purposes, designs and frameworks as well as applications in the three countries' respectively. Furthermore, it highlights the problematic aspects of the GAARs applications in the light of legal certainty. *Chapter 5* concludes the thesis by answering the research questions, and ends with some concluding remarks regarding the conflict between the government's fiscal interest and the taxpayers' interest of legal certainty, with special emphasis on the key question: *does GAARs provide for a taxation determined by legal culture?*

2 Legal culture characteristics

2.1 Introduction

The application of GAARs as well as the meaning and significande given to legal certainty is greatly affected by how GAARs are created, interpreted and applied. The operation of GAARs is largely influenced by *legal culture*; factors such as government and governance, legal system and political ideology, which influence the attitude towards tax avoidance and legal certainty.[65] This implies that the GAAR application is affected by the differences in the legal cultures of Sweden, the U.S. and China. Accordingly, it is necessary to examine these differences and how they could affect the application. In addition, since civil and common law legal systems involve different ways of adopting tax law, a distinction is necessary. In civil law countries like Sweden, and theoretically China, legislation constitute the primary source of law, while case law has a secondary role principally limited to interpreting the legislation. In common law jurisdictions like the U.S. however, case law constitute a much more important source of law, because the courts through their precedent rulings in individual cases can create new legal norms that become binding on other similar cases.[66] This chapter therefore examines government and governance, legislative competence and interpretation of tax law within the countries.

2.2 Government and governance

2.2.1 Sweden

Sweden is a stable parliamentary democracy with a strong municipal autonomy.[67] The Swedish Instrument of Government (”RF”)[68] contains fundamental principles for democracy and expresses in several ways that

[65] Van Hoecke & Warrington (1998), pp. 5 f.; Bogdan (2013), p. 46; van Brederode & Krever (2017), p. 6; Silvani (2013), pp. 5 f.; Gribnau (2013), p. 52.
[66] Alvarrenga (2013), p. 350; Lampreave (2013), p. 50; Dunbar (2010), pp. 20 f.
[67] Hilling (2016), p. 110; Sterzel (2015), p. 72; Strömberg & Lundell (2016), p. 22.
[68] Kungörelse (1974:152) om beslutad ny regeringsform, a part of the Constitution.

Sweden is a state governed by law.[69] RF is based on the principles of public sovereignty and legality since Chapter 1, Section 1 RF stipulates that "All public power derives from the people", and that the "public power is exercised under the law".[70] The courts' independence follows from Chapter 11, Section 3 RF. Swedish courts are not subject to political interference, and political judicial appointments have rarely existed.[71] The fact that Sweden is an EU Member State adds a further dimension to the Swedish legal system.[72] To create its internal market, the EU has according to Art. 114 of the Treaty on the functioning of the European Union ("TFEU") legislative competence.[73] As a starting point, the EU has left the area of tax law autonomous, which means that Member States' in principle are free to form their tax laws without regard to the EU regulations.[74] However, applying the GAAR on cross-border transactions must take concern to the EU's rules on free movement of goods, services, businesses, capital and workers within the internal market, as protected in Arts. 28, 45, 49, 56 and 63 TFEU.[75] The primacy of EU law is established by the Court of Justice of the European Union and provides that EU law has direct effect in the Member States.[76] The EU legal order requires a uniform application of EU law and Member States' must facilitate its effective application.[77] Sweden as an EU Member State is obliged to implement EU directives.[78] Directives are in accordance with Art. 288 TFEU binding on the result to be achieved, and must be transposed into national law within a specified deadline. The form and methods of implementation however lays within the Member States' discretion.[79] As explained later in

[69] Sterzel (2015), p. 74; Strömberg & Lundell (2016), p. 22; Melz (2010), p. 130.
[70] Sterzel (2015), pp. 73 f.; Strömberg & Lundell (2016), p. 23; Hilling (2016), p. 110.
[71] Sterzel (2015), p. 85
[72] Strömberg & Lundell (2016), p. 22; Berglund & Cejie (2014), p. 73; Cf. Arts. 1–7 TEU.
[73] Berglund & Cejie (2014), p. 73; Snell (2017), pp. 329 f.
[74] Cf. Art. 110 TFEU; Krever (2016), p. 16; Snell (2017), p. 334.
[75] Krever (2016), p. 16; Berglund & Cejie (2014), pp. 73 f.; Oliver (2017), p. 339.
[76] Chalmers, Davies & Monti (2014), p. 293; Cf. Case C-26/62 *Van Gend en Loos v Administratie der Belastingen* EU:C:1963:1; Berglund & Cejie (2014), p. 80; Bobek (2017), pp. 146, 161.
[77] Cf. Art. 4(3) TEU; Case 33/76 *Rewe/Landwirtschaftskammer für das Saarland* EU:C:1976:188; Hofmann (2017), p. 200.
[78] Chalmers, Davies & Monti (2014), p. 100; Mitroyanni (2016), p. 32; Berglund & Cejie (2014), p. 73; Bradley (2017), pp. 101 f.; Hofmann (2017), p. 201.
[79] Chalmers, Davies & Monti (2014), p. 112; Mitroyanni (2016), p. 32; Berglund & Cejie (2014), p. 73; Bradley (2017), p. 100.

section 4.2.2, the Council of the European Union may harmonize the Member States tax law based on Art. 115 TFEU,[80] and adopted in 2016 a Directive regarding an EU GAAR.

2.2.2 USA

The U.S. is a country with a democratic system of government and a long stable constitutional framework.[81] The U.S. legal system consists of a federal system with a national government and fifty states, which are independent sovereigns and have separate revenue systems. Additionally, the doctrine of intergovernmental fiscal immunity means that the federal government may not tax the state governments, and the state governments may not tax the federal government. The federal government and the state governments do not share tax revenues although the federal government makes substantial grants to the states.[82] Under the states, there are a multitude of local governmental units, such as counties, cities, towns, and other special use districts. These units only have the power to issue regulations and raise taxes conferred upon them according to the law of that state.[83] When the states ratified the U.S. Constitution, they partly surrendered their sovereignty to the federal government. The Constitution's Art. VI highlights this, as it states that in the event of conflict of norms, federal laws supersede the laws of the state. Federal statutes however protect the states under several circumstances, as e.g. the Tax Injunction Act, which prohibits federal courts from interfering with the states collection of state taxes, if the taxpayer has access to an efficient remedy in state court.[84]

2.2.3 China

The state philosophy of China for almost all dynasties, *Confucianism*, emphasize the importance of harmony and contempt the idea of litigation.[85]

[80] Cf. Art. 114(2) TFEU; Berglund & Cejie (2014), p. 83.
[81] van Brederode & Krever (2017), p. 14; Tiley & Jensen (2006), p. 185.
[82] Johnson (2017), p. 319; Bogdan (2013), p. 121.
[83] Bogdan (2013), pp. 122 f.; Johnson (2017), p. 319.
[84] Johnson (2017), p. 320.
[85] Sevastik (2015), pp. 289 f.; Xiong & Evans (2014), p. 691; Qiu (2017), pp. 81 f.

The Chinese society as well as its politics have traditionally been deeply influenced by the Confucian values, which meant that society was governed by ritualism (*li*), rather than legalism (*fa*), and that individuals' were guided by observing their place by virtue instead of by law.[86] Ancient China's legal system was used as a means of control, and both civil and criminal matters were decided in non-legalistic ways, giving law-enforcers wide discretion. Still today the legal system is characterized by great uncertainty, and due to the tradition of mediation with the local authorities, legal issues are often solved outside of the court system.[87]

As apparent from Art. 85 of the Constitution, the State Council of China ("State Council") is China's civil government and supreme executive and administrative body.[88] As the State Council and the People's Courts according to the Constitution are subordinate to the NPC, China lacks a separation of governmental powers.[89] Art. 2 of the Chinese Constitution stipulates that all public power proceeds from the people, which are represented by the National People's Congress ("NPC") and the local People's Congresses. According to the Constitution's Art. 5, "The People's Republic of China governs the country according to law and makes it a socialist country under rule of law."[90] Although the Constitution's introductory paragraph clarifies that the people's *democratic dictatorship* constitutes the framework of the Constitution, it is the Communist Party and not the people that has the dominant role.[91] The political and judicial systems are closely intertwined, which greatly influence the ways in which legal interpretation and application are conducted.[92] Due to China being a one-party state without free elections, and the Communist Party's dominant role, China is neither a democracy nor a rule of law-state with Western standards.[93]

[86] Qiu (2017), pp. 81 f.; Sevastik (2015), pp. 289 f.; Vanistendael (2010), pp. 209, 211.
[87] Li (2010), p. 91; Vanistendael (2010), pp. 212; Cui (2011), p. 46; Silvani (2013), p. 69.
[88] Cf. Sevastik (2015), p. 300; Qiu (2017), p. 74.
[89] Li (2010), p. 91; Xiong & Evans (2014), p. 691; Qiu (2017), p. 74; Silvani (2013), p. 69.
[90] Cf. Bogdan (2013), p. 164; Sevastik (2015), p. 298; Zweigert & Kötz (1998), p. 287.
[91] Sevastik (2015), p. 298; Zweigert & Kötz (1998), p. 287; Grimheden (2009), p. 164.
[92] Qiu (2017), p. 74; Holmes (2012), p. 105; Tamanaha (2004), p. 3.
[93] Sevastik (2015), pp. 288, 322; Bogdan (2013), p. 165; Grimheden (2009), pp. 168, 169.

2.3 Legislative competence

2.3.1 Sweden

In Sweden, the state power is divided between the parliament and the government. According to Chapter 1, Sections 4 and 6 RF, the democratically elected parliament enacts legislation, decides on state taxes and on how government expenditure are used, while the government governs the state, executes the laws and enacts regulations.[94] Tax regulations are decided by the Parliament, and Chapter 8, Section 3 RF prevents delegation of taxation rights to the government. Because state agencies only exercise functions entrusted to them by the people, government power is indivisible.[95] The enactment of laws thus requires a parliamentary decision, and no adjustments can be made in the legislative text adopted by Parliament.[96] Chapter 8, Section 2 RF specifies that regulations concerning the relationship between individuals and the public in matters of individuals' obligations, or intervention in personal or economic conditions, *id est taxation*, must be regulated by law.[97]

2.3.2 USA

The separation of powers is a strong feature of the U.S. Constitution. The Constitution restricts the state's legislative competence, and Art. 1, Section 8 explicitly states that the Congress, through its decisions, "has the power to lay and collect taxes […]". The Constitution was designed to prevent power concentration and built on the idea of three powers that can be identified, institutionalised and separated.[98] The Constitution allocates the public power: Congress has the legislative power, the President the executive power, and the Supreme Court the judicial power. As none of these have exclusive legislative competence, regulations are affected by legislative changes, regulatory guidelines and court decisions, and in terms of tax avoidance, all

[94] Sterzel (2015), p. 73; Hilling (2016), p. 110.
[95] Hilling (2016), p. 110.
[96] Sterzel (2015), p. 78
[97] Sterzel (2015), p. 78
[98] Bull (2015), pp. 229 f.

three have played a role.[99] Congress consists of the House of Representatives representing the people, and the Senate, which represent the other U.S. states.[100] The fact that the constitutional law plays a tremendously important role in the U.S. legal system has to do with the development of a rights-based law, which is based on the constitutional rules and their status as superordinate other legal rules.[101] The Internal Revenue Code ("IRC") is the primary source of U.S. tax law, and for its interpretation and application, common law doctrines have developed in case law. The doctrines and legal principles developed by the Supreme Court entails a creation of substantive legal rules that complement the written legislation.[102] Furthermore, the U.S. tax system provides for a simplified enactment of interpretative regulations under Section 7805(a) IRC by the Treasury Secretary. These regulations are usually sustained unless deemed incompatible with the statutes, and are in such a case invalidated.[103]

2.3.3 China

According to Arts. 58 and 62 of the Chinese Constitution, the National People's Congress ("NPC") is China's highest governing body, which decides on changes to the Constitution, adopts and amends laws, and together with the Standing Committee of the National People's Congress ("SCNPC"), constitutes its legislative assembly.[104] The most significant regulations are enacted by the NPC or the SCNPC as primary law, while the State Council through deligated legislative power enacts administrative regulations.[105] Since tax legislation is formulated generally, and further interpretation usually is required, administrative regulations are enacted by the State Council to explain and complement primary law.[106] The State Council has according to the Constitution's Art. 89, the power to "enact administrative

[99] Tiley & Jensen (2006), p. 163; Kaye (2012), p. 337; Bogdan (2013), p. 122.
[100] Bull (2015), p. 231.
[101] Bull (2015), p. 230; Edling (2009), p. 34.
[102] Dunbar (2010), pp. 20 f.; Repetti (2010), p. 192; Kaye (2012), p. 334 f.
[103] Tiley & Jensen (2006), pp. 163–165; Repetti (2010), pp. 191 f.
[104] Cf. e.g. Sevastik (2015), p. 298; Holmes (2012), p. 107.
[105] Bogdan (2013), p. 164; Sevastik (2015), p. 308; Li (2010), p. 93; Qiu (2017), p. 77.
[106] Qiu (2017), p. 92; Holmes (2012), p. 107.

measures, […] rules, regulations, decisions and orders […]" even on issues that have never been legislated by the NPC or the SCNPC.[107] The tax administration's role highlights a significant difference between Sweden, the U.S. and China. The main task of the tax authorities in Sweden and the U.S., is to administer tax legislation, and they have a status equivalent to the taxpayer in the courts.[108] In China, on the other hand, the State Administration of Taxation ("SAT") has a significant influence on tax law and has enacted several regulations regarding the GAAR's application.[109] Furthermore, all Chinese tax authorities conduct GAAR investigations, apply the GAAR, and adjust taxes when identifying avoidance arrangements.[110] According to the Constitution's Arts. 89–90, administrative regulations are issued by the State Council and its ministries: the Ministry of Finance ("MoF") and the SAT, and due to the power delegation have the same legal effect as primary law. Hence, the Chinese concept of *tax law* is considerably wider than in Sweden and the U.S.[111] The process of creating tax law does not include the judiciary, and sometimes not even the legislature.[112]

2.4 Tax law interpretation

2.4.1 Introduction

The following chapter describes tax law interpretation and interpretation powers in general in the countries, in order to provide for a background to the need and function of GAARs as well as to illustrate the differences between the countries. The interpretation method used has a significant impact on the legal application and its results, and the interpretation of the meaning derived by the legal text constitute the most vital step of the application.[113] It shall be noted that these methods primarily describe how and by who the legal text is interpreted in tax law, and not how the actual circumstances are to be

[107] Qiu (2017), pp. 74, 77; Sevastik (2015), p. 300; Holmes (2012), pp. 107 f.
[108] Cf. sections 2.3.1 and 2.3.2.
[109] Mingxing Cao & Li (2016), p. 179; Li (2010), pp. 94 f.; Xiong & Evans (2014), p. 691.
[110] Mingxing Cao & Li (2016), p. 179; Xiong & Evans (2014), p. 691.
[111] Vanistendael (2010), p. 212; Li (2010), p. 94; Qiu (2017), p. 75; Holmes (2012), p. 107.
[112] Li (2010), p. 93; Holmes (2012), pp. 107 f.; Xiong & Evans (2014), p. 691.
[113] van Brederode & Krever (2017), p. 1.

determined. Furthermore, in today's Western world, laws reflect and realise the society's economic, political, moral and social goals, and there is no abstract, external ideal law in the legal application. Thus, applied rights are created by legislation and court decisions.[114] To avoid repeating the commonly used interpretation methods, which remain essentially alike in the Western world,[115] they are described briefly within a Swedish context in the following.

The *objective interpretation* interprets the law based on its wording, regardless of the legislature's intention, and without regard to the law's *travaux préparatoires*.[116] The *literal* or *textual interpretation* method means that a rule is strictly interpreted based on the written words of the legal text. Solely the linguistic meaning of the rule describes its content.[117] This interpretation is favourable for legal certainty, but may give opportunity for tax avoidance.[118] However, since tax laws commonly have vague criteria, this method is often supplemented.[119] The legal system's organization and structure constitute the basis for the *systematic interpretation*, which interprets the text based on the provision's legal function, and allows for a freer interpretation.[120] The *subjective interpretation* interprets a rule according to the legislature's intention, as it may appear from a study of the *travaux préparatoires*.[121] The *teleological* or *purposive interpretation* interprets the rule by means of the legal text, concrete statements in the *travaux préparatoire*, and the purpose of the rule or the entire area of law, through *inter alia* consideration of the values behind the law as well as

[114] Tjernberg (2016A), p. 167; van Brederode & Krever (2017), p. 6; Krever & Mellor (2014), p. 28; Gribnau (2013), p. 52.
[115] van Brederode & Krever (2017), pp. 6–8; Repetti (2010), p. 185; Vanistendael (1996), pp. 34 f., Maxeiner (2007), pp. 571 f.
[116] Lodin, Lindencrona et al. (2017), p. 711; Strömholm (1996), p. 453 f.
[117] Tjernberg (2018), pp. 19–20, 23; Peczenik (2005), p. 330 f.; Påhlsson (2014), p. 557.
[118] Tjernberg (2018), p. 100; Hilling (2016), p. 118; Lodin, Lindencrona et al. (2017), p. 704; Xiong & Evans (2014), p. 690; Vanistendael (1996), pp. 34 f.
[119] Tjernberg (2018), p. 20; Peczenik (1980), p. 68 f.
[120] Lodin, Lindencrona et al. (2017), pp. 706 f.; Strömholm (1996), p. 453; Hilling (2016), p. 118.
[121] Tjernberg (2018), p. 20; Strömholm (1996), p. 452; Lodin, Lindencrona et al. (2017), pp. 706 f., 711.

judicial, political or ideological values.[122] Not rarely however, various methods lead to the same result for a legal issue.[123] Different interpretation methods, legal principles, doctrine etc., are used to justify legal applications.[124] In the application of GAARs however, the *textual* interpretation is generally abandoned in favour of a more *purposive* interpretation.[125]

Finally, and of particular relevance for this thesis since the GAAR application may result in that circumvented legal texts are applied analogously, is so-called *analogous application*. This application means that a provision is applied beyond its wording and linguistic meaning, but within its purpose. Analogous application is arguably not a method of *interpretation*, but extends the applicability of a law beyond its *de facto* meaning. This enables an application to situations that are substantially similar to the situations for which the provision is intended, even though they are not actually covered.[126] Analogous application has been considered to require that the linguistic meaning of the legal provision in question is clear, that no other provision is applicable, and that the existing circumstances "without violating the language can be fitted under the rule."[127] If these conditions are met and there are predominant similarities between regulated and unregulated situations, the provision may be applied by analogy.[128] As the application extends the provision's scope, the result is more far-reaching than ordinary legal interpretation.[129] Analogous application is however primarily used to handle regulatory gaps, and is controversial, since concerns of legal certainty and predictability speaks against its use in disadvantage of the taxpayer.[130] In light of the importance of the legal text in tax law interpretation and the problems

[122] Tjernberg (2018), p. 20; Strömholm (1996), p. 455; Peczenik (2005), pp. 367 f.
[123] Tjernberg (2018), p. 20.
[124] van Brederode & Krever (2017), p. 4; Repetti (2010), pp. 185 f.
[125] Xiong & Evans (2014), p. 690; Atkinson (2012), p. 47; Krever & Mellor (2014), p. 40.
[126] Lodin, Lindencrona et al. (2017), p. 718; Påhlsson (2013), p. 90; Vanistendael (2010), p. 213.
[127] Strömholm (1996), p. 437.
[128] Lodin, Lindencrona et al. (2017), p. 718; Strömholm (1996), p. 436 f.
[129] Peczenik (1980), p. 78 f.; Lodin, Lindencrona et al. (2017), p. 718.
[130] Tjernberg (2018), p. 21; Påhlsson (2014), p. 554; Rosander (2007), p. 76.

of analogous application from a legal certainty perspective, the next section examines characteristics of tax law interpretation within the countries.

2.4.2 Sweden

Swedish tax law interpretation is characterized by strong boundaries to the legal text's wording, which constitutes the interpretation's starting point.[131] Legal certainty has significant importance and clear legal texts are followed.[132] Only if the wording does not clarify the meaning of a rule can the law's general purpose and objective be taken into account, which means that the *travaux préparatoires* are important. In addition, consideration is given to motives and principles that are consistent with the wording, and thereafter case law, legal doctrine and the Swedish Tax Agency's recommendations.[133] The Swedish Supreme Administrative Court ("HFD") has traditionally complied with the *travaux préparatoires* and followed concrete normative statements consistent with the legal text. However, as HFD appears to have taken greater regard to legal certainty, this has resulted in an increasingly stricter textual legal interpretation.[134] Giving *travaux préparatoires* the same weight as legislation is not permitted and HFD disregards statements in *travaux préparatoires* that are incompatible with the wording or general purpose of the legal text.[135] The legal interpretation is conducted through a convergence of different factors, considerations and principles along with several interpretation methods aiming to achieve, with respect to different values, a reasonable result.[136]

2.4.3 USA

As regards the U.S., its constitutional background plays a role for its tax law interpretation, since federal courts normally construct ambiguous federal laws to minimize interference with the areas of operation traditionally ascribed to the states. This factor of courts statutory interpretation is known

[131] Lodin, Lindencrona et al. (2017), p. 711; Hilling (2016), pp. 118 f. Cf. RÅ 2005 ref. 3.
[132] Cf. e.g. HFD 2012 not. 48; Tjernberg (2018), pp. 23, 100; Melz (2010), p. 138.
[133] Bergström (2003), pp. 8 f.; Melz (2010), p. 138; Strömholm (1996), p. 402 f.
[134] Hilling (2016), p. 119; Tjernberg (2003), p. 14; Melz (2010), p. 138.
[135] Tjernberg (2003), p. 18; Melz (2010), p. 130; Bergström (2003), p. 3.
[136] Lodin, Lindencrona et al. (2017), p. 716; Rosander (2007), p. 73 f.

as *federalism*.[137] Furthermore, U.S. courts generally interpret the meaning of a statue in two seps. Firstly, by finding *the ordinary meaning of the language* in its textual context. Secondly, by applying established guiding principles of construction for the legal area as well as determine whether there is any clear indication that a meaning other than the ordinary is permissible and should apply.[138] However, if one seeks to find a clearer definition of the interpretation method applied in the U.S. courts, there is significant disagreement among scholars and it could be argued that there is no generally accepted and consistently applied method of interpreting statutes.[139] This could imply that the U.S. courts are quite pragmatic in their interpretational approach. However, rather than calling it unpredictable it may be more accurate to argue that the approach of interpretation is very contextualised, dependant *inter alia* on which body is interpreting the statute (*id est* the tax agency, the tax courts or general courts).[140] When looking at tax law interpretation, the most uncontroversial approach is that the text applies in its current wording provided it is clear. When the text is unclear, any Treasury regulation aiming directly at the situation may be applied as a guideline. Only if such regulations are lacking, will the courts proceed to assess the legislative purpose, sub-regulation tax agency guidelines or other applicable indicators. The U.S. courts however generally interpret tax law virtually the same way as they interpret other laws.[141] One could thus argue, and most convincingly so, that there is no particular method of tax law interpretation as separated from ordinary legal interpretation. Conclusively, the judicial doctrines mentioned later in section 4.3.1 are – due to the common law tradition – closely connected to and have a significant impact on the tax law interpretation.[142]

[137] Johnson (2017), p. 320; Maxeiner (2007), pp. 595, 605.
[138] Johnson (2017), p. 341; Repetti (2010), pp. 185 f.
[139] Johnson (2017), p. 341; Maxeiner (2007), pp. 571 f.
[140] Johnson (2017), pp. 341 f.
[141] Johnson (2017), p. 343; Vanistendael (1996), pp. 34, 43 f.; Johnson (2017), p. 345.
[142] Vanistendael (1996), pp. 42–44; Repetti (2010), pp. 186 f.

2.4.4 China

Although the legal text constitutes the basis for the Chinese tax law interpretation, it differs significantly from that of Sweden and the U.S.[143] As a highly distinctive feature, legal interpretation in China are closely intertwined with legislative activities, and unlike in Sweden and the U.S. China has provided its legislature, judiciary and tax administrations with the power of interpreting tax law.[144] The Chinese Constitution's Art. 67(1) and (4) stipulates that legislated statutes are interpreted by the SCNPC. According to Art. 77(1) and (4) the NPC not only enacts laws, but can interpret the laws and the Constitution.[145] However, since interpretative power according to the Constitution's Arts. 89–90 comes with legislative power, the SAT interprets regulations enacted by itself and by the State Council, and can significantly affect the GAAR's application.[146] Binding interpretations of the Constitution and of statutes are thus made by the NPC, the SCNPC and in practice the SAT; however, the two former have never issued interpretations.[147] Through the implementation of directly applicable regulations, the SAT's interpretations have the same legal effect as law.[148] Thus, interpretations are used to develop regulations, and the initial rules general formulations provide tax authorities with a wide discretion.[149] Any interpretation that no longer serves its purpose, because taxpayers' behaviours have changed, can be replaced.[150] As the law shall manage changing political policies, the legal interpretation must be flexible so the legislation can be adapted quickly.[151] The SAT and the MoF, and not the courts, primarily conduct the Chinese tax law interpretation, and the judiciary as well as the legislature play limited

[143] Mingxing Cao & Li (2016), pp. 186 f.; Qiu (2017), p. 92.
[144] Qiu (2017), p. 73; Li (2010), p. 40; Vanistendael (2010), p. 212; Xiong & Evans (2014), p. 691; van Brederode & Krever (2017), pp. 10 f.
[145] Cf. Qiu (2017), p. 74; Li (2010), p. 40; Sevastik (2015), p. 308.
[146] Li (2010), pp. 94 f.; Qiu (2017), p. 78; Holmes (2012), p. 114; Xiong & Evans (2014), p. 691.
[147] Li (2010), pp. 94 f.; Xiong & Evans (2014), p. 691; van Brederode & Krever (2017), pp. 10 f.; Qiu (2017), p. 75.
[148] Qiu (2017), p. 78; Holmes (2012), p. 107; Vanistendael (2010), p. 212.
[149] Vanistendael (2010), p. 212; Xiong & Evans (2014), p. 691.
[150] Vanistendael (2010), p. 212; van Brederode & Krever (2017), pp. 10 f.
[151] Qiu (2017), p. 74.

roles.[152] Within the area of tax law, Chinese courts are limited to regulate procedural matters, and cannot deal with interpretation of tax laws.[153] Normally, court decisions are only binding between the parties. However, although it has never happened, the Supreme People's Court and the Supreme People's Procuratorate have power to make binding legal interpretations.[154] Furthermore, culture and tradition makes it common for local tax officials to provide informal interpretations of particular issues.[155] Accordingly, the Chinese tax law interpretation is not fully compatible with the Western expectation of an independent judiciary.[156] Conclusively, in great contrast to Sweden and the U.S., the Chinese judiciary's power of legal interpretation is greatly limited while the political power remains with a great deal of power in the interpretation and application of tax law.

[152] van Brederode & Krever (2017), p. 4; Li (2010), p. 97; Holmes (2012), pp. 107, 110.
[153] Xiong & Evans (2014), p. 691; Qiu (2017), p. 75; Silvani (2013), p. 69.
[154] Li (2010), pp. 40, 97; Vanistendael (2010), p. 213; Qiu (2017), p. 74.
[155] Vanistendael (2010), pp. 212 f.; Xiong & Evans (2014), p. 691.
[156] van Brederode & Krever (2017), p. 4; Xiong & Evans (2014), p. 691,

3 Legal certainty in taxation

3.1 Introduction

In order to establish a common understanding of the term *legal certainty*, this chapter provides a conceptual background to the concept and an explanation of how legal certainty relates to GAARs and their applications, as well as to other closely related concepts. Additionally, the chapter ends with some observations regarding the significance of legal certainty within the three countries. Although broadly referred to as the rule of law, the formal requirements below focus on the requirements of the legality concept of particular importance for taxpayers' legal certainty in the context of GAAR application. The most common argument against using GAARs is legal certainty.[157] Although legal certainty is often considered a superior and even an absolute right, at least in the Western world, there are also opposing interests to an overly strong legal certainty in taxation. Primarily the interest of the law's effectiveness and the state's ability to tax its companies and citizens.[158] The thesis assumes the view that these are justified interests that conflicts with, and must be balanced to, taxpayers' interest of legal certanty.

3.2 The rule of law and the principle of legality

In most Western world jurisdictions, the legal system – as well as society – is based on a set of fundamental principles, which together form the so-called *rule of law* concept.[159] These principles are also referred to as the *principles of legality* and enshrined worldwide in international treaties, case law and constitutions.[160] The rule of law concept governs the constitutional order as well as the public administration, and is a cornerstone for democracy.[161] In the context of taxation, the rule of law increases predictability and legal

[157] Xiong & Evans (2014), p. 688; Cooper (1997), p. 13.
[158] Gribnau (2013), p. 53; Mutén (1997), p. 319.
[159] Vanistendael (2010), p. 210; Atkinson (2012), p. 12; Prebble & Prebble (2010), p. 22.
[160] Waldron (2008), p. 10; Vanistendael (2010), pp. 210 f.; Raz (1979), p. 210.
[161] Deak (2008), p. 187; Atkinson (2012), p. 12; Hilling (2016), p. 116.

certainty vertically, between goverments' and taxpayers'.[162] Legal professionals – especially judges – therefore has a unique position to reinforce or undermine the rule of law.[163] To define whether a country is governed by rule of law is easier said than done since definitions vary between countries, and the only general requirements are the existence of a regulatory requirement along with freedom from arbitrariness.[164] The main elements of the rule of law in taxation are the principles of legality and equality, as well as the doctrine of power separation and the right to a fair trial.[165] While the two latter components affect tax authorities' investigative powers and the handling of tax avoidance cases, the principles of legality and equality are, as will be apparent, of significant importance for the creation and interpretation of tax law.[166] Although the principle of equality through its requirement that taxation should be non-discriminatory and apply the same in similar cases is of immense importance for legal certainty,[167] the thesis focuses on that of legality, since it includes requirements of particular importance in the context of GAAR applications; *id est* the regulatory requirement and the analogy prohibition.[168]

Although not often mentioned in the area of taxation, the principle of legality in taxation dates back as early as year 1215 when *Magna Charta* was created.[169] The European feudal system was based on loyalties between lords and vassals. This, however, came to a change in 1215, when King John of England demanded aid from his vassals, which was only granted subject to the vassals' approval. This was the start of a principle, which continued to apply, and almost 600 years later became part of the Rights Declarations of both the United States and France. At this time, democratically elected

[162] Tamanaha (2004), p. 35; Prebble & Prebble (2010), p. 22; Hilling (2016), p. 116.
[163] Tamanaha (2004), p. 59; Morse & Deutsch (2015), p. 138.
[164] Sterzel (2015), p. 74; Prebble & Prebble (2010), pp. 28; Hilling (2016), p. 116.
[165] Vanistendael (2010), p. 210; Gribnau (2013), p. 53; Pfordten (2014), p. 25.
[166] Vanistendael (2010), p. 210; Atkinson (2012), p. 13; Tamanaha (2004), p. 67.
[167] Gribnau (2013), p. 53; Vanistendael (2010), pp. 210, 212; Atkinson (2012), p. 13.
[168] Rosander (2007), p. 75; Cooper (1997), pp. 15 f.; Prebble & Prebble (2010), pp. 22, 28; Sterzel (2015), p. 74; Rawls (1971), p. 235; Hayek (1960), p. 142; Raz (1979), pp. 210, 213. Vanistendael (1996), p. 35; Hilling (2016), p. 116.
[169] Pfordten (2014), p. 23; Vanistendael (2010), p. 210; Tamanaha (2004), pp. 25–27.

representatives of the people had to give their approval. In the 19th and 20th centuries, most Western societies incorporated the principle of legality in their constitutions. From this point, taxation could only be levied when based on clear and unambiguous parliament approved legal texts, and the principle became a fundamental protection against arbitrary taxation.[170]

Today, the principle of legality remains a fundamental principle, which guarantees taxpayers' legal certainty through its requirements of predictability, equal treatment and freedom from arbitrariness.[171] Although its requirements and significance vary between jurisdictions, it is in the Western world commonly considered to require predictability and prohibit analogous and retroactive application.[172] Its core, the regulatory requirement, prevents taxation that are not regulated by law, or are deviating from what the law states.[173] The prohibition of undetermined and vague rules is a further, more unexplored aspect of the principle of legality, which prevents that regulations are formulated indefinitely to enable a very extensive interpretation and application.[174] In this aspect, the principle of legality constitutes a guarantee for legal certainty by requiring that the law must be relatively certain, a concept which is treated in the following.[175] Nevertheless, for the principle to be more than a value based legal objective and to have any significance in practice, its requirements must be realised through formal national or international requirements set up statutorily, constitutionally or judicially with constitutional support. Therefore, the implementations of these requirements are dealt with below in section 3.4.

3.3 The legal certainty concept

Legal certainty *via* predictability is described as the core of the rule of law and its specific demonstration, and is of particular importance in the context

[170] Vanistendael (2010), p. 210; Pfordten (2014), pp. 23 f.; Tamanaha (2004), p. 116.
[171] Rosander (2007), p. 77; Vanistendael (1996), p. 35; Cooper (1997), p. 15.
[172] Hilling (2016), p. 116; Sterzel (2015), p. 74; Prebble & Prebble (2010), pp. 22; Rawls (1971), p. 235; Hayek (1960), p. 142; Raz (1979), pp. 210, 213.
[173] Tjernberg (2018), p. 23; Rosander (2007) , p. 89; Vanistendael (1996), p. 35.
[174] Hultqvist (2016), p. 738; Prebble & Prebble (2010), p. 30.
[175] Prebble & Prebble (2010), p. 28; Rawls (1971), p. 235; Cui (2011), p. 43.

of public power exercise.[176] Fuller has constructed one of the most recognized definitions of the legal certainty concept in his work "*The Morality of Law*",[177] where he establishes eight principles commonly considered to determine a rule's degree of *formal* legal certainty:[178]

1. It shall be *general* and applied sufficiently general, in the sence that there must be a rule, which cannot address too specific behaviours.[179]
2. It shall be *promulgated* and made public, so that those covered by the rule can be aware of its requirements. Fuller emphasises, however, that the principle does not require that *everyone* covered by the law also must have *complete* knowledge of the law.[180]
3. It shall be *prospective* and not applicable to past behaviour, but shall regulate future behaviour.[181]
4. It shall fulfil a minimum level of *clarity* and be comprehensible. The legislator shall ensure that what a rule prohibits, permits or requires is clear.[182]
5. It shall be *free from contradiction* and consistent, meaning that it cannot prohibit what another rule permits.[183]
6. It shall *not require the impossible*, implying that there must be an actual possibility to obey it.[184]
7. It shall have *constancy through time* and cannot change frequently.[185]
8. Finally, there shall be *congruence between the written rule and its execution*. It shall apply in accordance with its apparent meaning.[186]

The concept of *legal certainty* is often divided into *formal* legal certainty, which means that public power is predictable and exercised within a legal

[176] Deak (2008), p. 187; Prebble & Prebble (2010), p. 30; Raz (1979), p. 213; Rawls (1971), p. 235; Hayek (1960), p. 142; Gribnau (2013), p. 54; Hilling (2016), p. 116.
[177] Fuller (1969), pp. 32–39, 46–90.
[178] Gribnau (2013), p. 70; Waldron (1994), pp. 283 f.; Prebble & Prebble (2010), p. 33.
[179] Fuller (1969), pp. 45 f.
[180] Fuller (1969), pp. 50 f.
[181] Fuller (1969), pp. 52 f.
[182] Fuller (1969), pp. 63 f.
[183] Fuller (1969), pp. 66–68.
[184] Fuller (1969), pp. 72–74.
[185] Fuller (1969), pp. 80 f.
[186] Fuller (1969), pp. 82 f.

framework, and *substantive* legal certainty, which is the result of formal legal certainty intertwined with ethical values.[187] The Swedish scholar Peczenik constructed a definition of the concept, based on the principle of predictability, namely, that laws must be designed in a way that makes it possible for individuals to predict the consequences of acting both legally and illegally.[188] Peczenik distinguishes substantive legal certainty from formal legal certainty, and believes that the latter only involves a predictability requirement.[189] He argues, however, that the fact that a regulation meets the formal requirement of legal certainty, *id est* predictability, is insufficient to meet all requirements of legal certainty. Peczenik claims that one cannot construe the concept of legal certainty without considering ethical values.[190] He argues that if the predictability requirement is the only component of legal certainty, then regulations that we intuitively perceive as lacking legal certainty may fall within the concept.[191] Substantive legal certainty would thus include not only formal legal certainty but also ethical acceptability. Accordingly, in order to fulfil the requirement of legal certainty, the regulation must be both *predictable* and *ethically acceptable*.[192] Jareborg, another Swedish scholar, on the other hand, argues that the concept of legal certainty should only include one formal requirement.[193] In his opinion, a concept of legal certainty that includes moral statements is unclear and loses value. A conceptualization based on moral positions is further problematic because what is "ethically correct" does not necessarily promote predictability, and the two values that are to be aggregated can thus be contradictory. His conclusion is that one for the sake of clarity should refrain from dividing legal certainty into the categorisations of "formal" and "substantive".[194]

[187] Peczenik (1995), p. 11; Maxeiner (2007), p. 546; Tamanaha (2004), pp. 95, 111.
[188] Peczenik (1995) pp. 89 f.; Cf. Hayek (1960), p. 142; Rawls (1971), p. 235.
[189] Peczenik (1995) pp. 97 f.; Cf. Tamanaha (2004), p. 111.
[190] Peczenik (1995) pp. 94 f.; Cf. Maxeiner (2007), p. 547.
[191] Peczenik (1995) pp. 97 f.
[192] Peczenik (1995) p. 94; Cf. Maxeiner (2007), p. 546.
[193] Jareborg (1992), pp. 82–84.
[194] Jareborg (1992) pp. 89 f.

Although some argue that the concept of legal certainty shall be defined in each case, since a comprehensive definition is impossible,[195] it is a consensus that legal certainty refers to "*predictability in legal matters*".[196] Despite the absence of a clear definition, a universally recognised core of the legal certainty concept in taxation clearly seems to be the taxpayers' protection from unpredictable and arbitrary *ultra vires* exercise of public power.[197] The thesis therefore assumes that the concept of legal certainty primarily refers to *the protection from arbitrary and unpredictable public power exercise*. Even though the legal certainty concept in taxation is recognised in most countries, its meaning and significance differs.[198] In the following sections of this thesis, as the GAARs is discussed from a legal certainty perspective, the aforementioned definition however constitutes the basis of the formal concept of legal certainty together with Fuller's eight principles identified as determining a rule's degree of legal certainty.

3.4 The legal basis for legal certainty in Sweden, USA and China

3.4.1 Sweden

In Sweden, the principle of legality is a fundamental principle of public law.[199] In accordance with Chapter 1, Section 1, Paragraph 3 RF, all public power in Sweden derives from the people and must be exercised with support in law or other binding regulations based on delegated authority from the parliament.[200] The public power exercise requires legal support for actions against individuals', and state power must be pre-legislated and exercised *intra vires*, in accordance with the law.[201] This regulatory requirement protects taxpayers' from government intervention in their economic sphere

[195] Frändberg (2005), pp. 284;
[196] Frändberg (2005), pp. 283 f.; Raz (1979), pp. 213 f.; Rawls (1971), p. 235; Hayek (1960), p. 142; Gribnau (2013), p. 54; Maxeiner (2007), p. 546.
[197] Peczenik (2005), p. 43; Gribnau (2013), p. 53; Prebble & Prebble (2010), pp. 30.
[198] Deak (2008), p. 184; Hilling (2016), p. 116; Sterzel (2015), p. 74.
[199] Tjernberg (2016A), p. 168; Sterzel (2015), p. 74; Hilling (2016), p. 116.
[200] Hilling (2016), p. 116; Påhlsson (2013), p. 90; Melz (2010), p. 130.
[201] SOU 1993:62, p. 75; Mutén (1997), p. 319; Melz (2010), p. 130; Hilling (2016), p. 116.

that occurs without legal support.[202] The complexity of society however, requires legal texts to be formulated and interpreted more generally to determine whether taxation should apply, which may result in taxation in situations where it is not completely clear that taxes should be levied.[203] The principle of legality in taxation consists of several motives and principles and based on the idea that taxation shall apply equally to all.[204] The principle's core is to achieve legal certainty through predictability and protect against arbitrary power exercise.[205] In Swedish tax law, the principle is considered to consist of a regulatory requirement, an analogy prohibition, a retroactivity prohibition and a disputed determination requirement.[206]

The legal support for the legality principle's constituents in Swedish tax law has been debated for decades.[207] One scholar, Hultqvist, considers all aspects of the principle constitutionally anchored, through Section 10, Chapter 2 and Sections 2–3 and 7, Chapter 8 RF. According to him, the principle of legality is an absolute principle, which, through its constitutional basis, taking into account the separation of governmental powers, cannot be overridden.[208] Other scholars, on the other hand, consider this conclusion to be too far-reaching and lacking support. His opponents argue that the mentioned legal bases can merely be regarded as portal provisions, which give no support for the principle of legality being absolute. The principle's requirements cannot, due to their vagueness, be characterised as more than value-based guidelines.[209] Most scholars however acknowledges that legal support for the regulatory requirement can be found in the Constitution.[210] Despite the split opinions regarding whether some or all aspects of the legality principle are constitutionally anchored, there is consensus that the regulatory requirement, the analogy prohibition, and the retroactivity prohibition have a very strong

[202] Påhlsson (2014), p. 558; Melz (2010), p. 130; Hilling (2016), p. 116.
[203] Melz (2010), p. 130; Rabe & Hellenius (2011), pp. 490 f.
[204] Påhlsson (2013), p. 90; Mutén (1997), p. 319; Hilling (2016), p. 116.
[205] Rosander (2007), p. 77; Hilling (2016), p. 116; Alhager (1999), pp. 74 f.
[206] Hultqvist (2015), p. 9; Tjernberg (2018), pp. 23, 27.
[207] Cf. e.g. Hultqvist (1995), pp. 102; Rosander (2007), pp. 80–82; Hilling (2016), p. 117.
[208] Hultqvist (1995), pp. 112 f.; Hultqvist (2005), p. 308.
[209] Alhager (1999), pp. 94 f.; Tikka (1996), pp. 57; Påhlsson (2016), p. 121.
[210] Rosander (2007), p. 81 f.; Hilling (2016), p. 116; Tjernberg (2016A), p. 170 f.

position in the interpretation and application of tax law.[211] In addition, as Sweden is an EU member state, one must bear in mind that legal certainty is a fundamental EU principle and a prerequisite for EU membership according to *inter alia* Arts. 2 and 49 of the Treaty on European Union.[212]

3.4.2 USA

The rule of law is highly regarded in U.S. legislation and case law.[213] Although the concept "as a whole" lacks an explicit legal basis, a number of doctrines establish its components. The common law system means that the rule of law is realised by the judiciary.[214] The U.S. Constitution's Arts. I–III give effect to the rule of law *inter alia* through its "*checks and balances*"-system and separation of the governmental powers. As the judiciary is both independent from and equal to the legislature and the executive branch, the Constitution allows judges' use of federal constitutional norms to invalidate inconsistent laws deriving from a state or enacted by Congress.[215] The U.S. rule of law-notion covers legislative and administrative activities and gives rise to both the Constitution and the judicial review-system. It particularly focuses on the protection of individuals' liberties and rights in both substance and procedure, achieved through the Constitutional principle of governmental power being strictly bound by law.[216]

The Constitution provides for several fundamental principles developed by the Supreme Court and often involving the protection of rights.[217] The legislative power is affected by *inter alia* the *void for vagueness*- and *overbreadth*-doctrines. The former has its constitutional basis in the 14th amendment's stipulation of *due process*, and protects predictability and legal certainty, as rules must meet a certain minimum level of precision. If a rule is too vague to indicate clearly its legal consequences, it may be declared

[211] Tjernberg (2018), pp. 23, 27; Rosander (2007), p. 82; Hilling (2016), p. 117.
[212] Cf. e.g. European Commission (2014), *A new EU Framework to strengthen the Rule of Law*, pp. 2 f.; Maxeiner (2007), pp. 547–549.
[213] Scheiber (1984), p. 217; Maxeiner (2007), p 546; Urabe (1990), p. 61.
[214] Bull (2015), p. 238; Urabe (1990), p. 61; Rosenfeld (2001), p. 1336.
[215] Rosenfeld (2001), pp. 1336 f.; Cf. *Brown v. Board of Education*, 347 U.S. 483 (1954).
[216] Urabe (1990), pp. 61 f.
[217] Bull (2015), p. 238; Urabe (1990), p. 61.

unconstitutional.[218] The doctrine of *overbreadth* means that in cases where the state has a valid reason for introducing a regulation, this power cannot be used to regulate excessively. In the protection of individual rights, it has been applied even though a regulation in the individual case could be justified, for example, when the regulation collided with protected activities.[219] If a rule has a legitimate purpose and is designed in such a way that it either has too wide scope or too vague wording, it is still not immune to objections. The Supreme Court also apply the principle that the objective should not be possible to achieve with a less restrictive regulation. The Court thus requires the legislator to use *the least restrictive means* to achieve the objective, which implies a proportionality principle.[220] Finally, the *stare decisis* doctrine means that the ruling of a decision is indicative in other similar cases. Although there is no formal obstacle for courts to deviate from previous rulings, so-called *overruling*, this rarely occurs. This doctrine affects the entire legal system, and is the reason for the strong position of precedents.[221]

3.4.3 China

China's legal system is based on a different foundation than the rule of law in the Swedish and the U.S. judicial systems.[222] Instead, China has a so-called "rule by law" or "rule by man"-tradition, which emphasizes the law's primary function as a means of control.[223] While the rule of law concept as defined in Western democracies requires a separation between the legislative, executive and judicial powers, China has no separation of governmental powers.[224] The Western rule of law-values are absent in China, and the tax administration is highly influenced by traditional cultural values.[225] According to Art. 5 of its Constitution, China is a "socialist rule of law state", and the Constitution's preamble further provides that the ideologies of Marxism-Leninism, Mao

[218] Bull (2015), p. 238.
[219] Bull (2015), p. 238 f.
[220] Bull (2015), p. 239; Cf. e.g. *Shelton v. Tucker*, 364 U.S. 479 (1960).
[221] Bull (2015), p. 239; Urabe (1990), p. 62.
[222] Cf. Sections 3.4.1 and 3.4.2.
[223] Li (2010), pp. 90 f.; Holmes (2012), pp. 105 f.; Tamanaha (2004), p. 3.
[224] Holmes (2012), p. 105; Vanistendael (2010), pp. 211 f.; Silvani (2013), p. 69.
[225] Qiu (2017), p. 82; Silvani (2013), p. 69; Cui (2011), p. 44.

Zedong, and Deng Xiaoping shall guide China, and "the Chinese people […] adhere to the people's democratic dictatorship […]".[226] Furthermore, there are no safety mechanisms that could force the Chinese government to act in accordance with politically and democratically created legislation, or to respect individuals' or taxpayers' rights. Courts can further not invalidate "unlawful" statutes.[227] Court cases are historically assessed unequally, without any regard to the power imbalance between taxpayers' and the state.[228] Considering the Communist Party's constitutionally anchored power monopoly, it is evident that the significance of legal certainty largely depends on the extent to which it benefits the Party's interests.[229] In conclusion, the significance of legal certainty appears considerably weaker in China than in Sweden and the U.S. How this affects the Chinese GAAR application is dealt with below in section 4.4.3.

[226] Cf. e.g. Li (2010), pp. 90 f.; Grimheden (2009), pp. 161 f.
[227] Vanistendael (2010), p. 212; Qiu (2017), p. 83.
[228] Tamanaha (2004), p. 3; Holmes (2012), p. 105.
[229] Bogdan (2013), p. 165; Sevastik (2015), p. 322; Zweigert & Kötz (1998), p. 287.

4 Analysis of the GAARs

4.1 Introduction

Since the thesis aims to examine and analyse the GAAR applications' in the light of legal culture and taxpayers' legal certainty, the following chapter examines and analyses the GAARs purpose, design and framework, as well as application and problems from a legal certainty perspective.

4.2 The Swedish GAAR

4.2.1 The Swedish GAAR's purpose, design and framework

In Sweden, counteracting tax avoidance has always been an explicit objective of the legislature.[230] One of the methods developed in this endeavour is the Swedish GAAR, created to address the problems of a wide range of specific provisions and the fact that courts were unable to deny certain types of tax avoidance arrangements.[231] The GAAR was subject to an intensive debate with great legal and political divergence, and aimed to achieve a more uniform and fair domestic taxation.[232] It was design to achieve the tax result that would follow from the ordinary tax rules, if they were not circumvented.[233]

The Swedish GAAR is found in Section 2 of the Swedish Tax Avoidance Act[234] and consists of four cumulative criteria. When these criteria are met, the taxpayer shall according to the third section be taxed as if it had never conducted the legal action giving rise to its substantial tax benefit. For a legal act to be covered it must thus be part of an arrangement which entails a *substantial tax benefit* for the taxpayer, in which the taxpayer must *have*

[230] Rabe & Hellenius (2011), p. 498 f.
[231] Påhlsson (2016), p. 104; Rosander (2007), pp. 30 f.; Rabe & Hellenius (2011), p. 505.
[232] Hultqvist (2005), p. 306; Rabe & Hellenius (2011), p. 499; Påhlsson (2016), p. 118.
[233] Prop. 1982/83:84, pp. 7–9.
[234] The Swedish Tax Avoidance Act [Lag (1995:575) mot skatteflykt]

participated directly or indirectly. Furthermore, the tax benefit must be assumed to be the arrangement's *main reason*, and a taxation based on it would be *contrary to the purpose of the legislation*. The criterion that has proved to be the most important as well as the most problematic is the fourth,[235] which states that:

> *An assessment of the basis for taxation based on the arrangement would be contrary to the purpose of the legislation, as evidenced by the general structure of the tax rules and the provisions directly applicable or that have been circumvented through the arrangement.*[236]

In the GAAR's *travaux preparatoire*, the legislature emphasises, firstly, that this criterion is usually the decisive requisite for the GAAR's application, and secondly, that it is the most difficult criterion to apply.[237] This is confirmed by several cases decided by the HFD.[238] The assessment of whether an arrangement is contrary to "*the purpose of the legislation"* is made based on what is apparent from the general design of the provisions that are directly applicable or which have been circumvented.[239]

The interpretation method thus involves an objective teleological interpretation, and to derive the purpose, it is necessary to identify which cases that are typically covered. The *travaux preparatoire* of the Swedish GAAR clearly states that the design of the law circumvented intends to serve as a primary basis for the assessment of the criteria.[240] However, if the purpose cannot be derived with certainty from the wording of the circumvented tax provision, guidance may be sought in its *travaux préparatoires* in the same way as in ordinary legal interpretation.[241] In addition to ordinary legislation, fundamental principles and general rules

[235] Lodin, Lindencrona et al. (2017), p. 744; Cf. e.g. HFD 2012 ref. 6, RÅ 2001 ref. 66; Prop. 1996/97:170, pp. 38–40; Melz (2010), p. 130.
[236] Cf. Supplement A – The Swedish GAAR.
[237] SOU 1996:44, pp. 104 f., 127 f.; Lodin, Lindencrona et al. (2017), p. 744; Carneborn & Uggla (2015), p. 126.
[238] Lodin, Lindencrona et al. (2017), p. 744; Carneborn & Uggla (2015), p. 126; Cf. e.g. RÅ 2010 ref. 51 and RÅ 2009 ref. 31.
[239] Prop. 1996/97:170 pp. 38 f.; Prop. 1982/83:84, p. 20.
[240] Prop. 1996/97:170 pp. 38–40; Holstad (2010), p. 296; Holstad (2013), p. 550.
[241] Påhlsson (2016), p. 124; Prop. 1996/97:170, p. 39.

within the area of tax law, as well as rules for determining the tax liability may be taken into account when assessing the criterion. Furthermore, the assessment must clearly show that the legislature never intended to accept the actualised tax avoidance arrangement.[242] The GAAR functions by excluding taxation results based on arrangements contrary to the law's purpose, and enables taxation of arrangements not actually covered by the wording of the law. Accordingly, it covers arrangements not intended by the legislature, which aims at making tax provisions applicable in cases where they normally not apply.[243] As the application excludes certain legal consequences, arrangements are not taxed in accordance with the directly applicable substantive tax provisions. Instead, the circumvented tax provisions apply analogously.[244]

4.2.2 The impact of the EU GAAR

To provide a uniform minimum level of tax avoidance rules within the EU, and to ensure a more fair and stable business environment, the EU Council adopted in 2016 the Directive (EU) 2016/1164 laying down rules against tax avoidance practices that directly affect the functioning of the internal market ("ATAD").[245] ATAD is a core component for EU's implementation of the BEPS project and includes binding rules against tax avoidance arrangements, which Member States must transpose into national laws and regulations before January 1, 2019.[246] In addition to strengthening the EU's protection against tax avoidance, Art. 6 ATAD establishes EU's first GAAR.[247] It stipulates that non-genuine arrangements having as the main purpose of achieving a tax advantage contrary to the purpose of the otherwise applicable tax provisions shall not be included in the taxable base for corporate income tax.[248] Accordingly, the Swedish GAAR must fulfil these minimum requirements, and it is possible that the requirements imposed by the EU

[242] Prop. 1996/97:170, pp. 38–40; Prop. 1982/83:84, p. 19; SOU 1996:44, p. 92.
[243] Prop. 1982/83:84, pp. 8, 19; Prop. 1996/97:170 p. 18; SOU 1996:44, p. 130.
[244] Carneborn & Uggla (2015), p. 126; Påhlsson (2013), p. 94; Prop. 1996/97:170 p. 17.
[245] Cf. Tjernberg (2018), p. 100 and Mitroyanni (2016), p. 32; Cédelle (2016), p. 494.
[246] Hultqvist (2016), p. 853; Tjernberg (2018), p. 100; Ogazón & Hamzaoui (2015), p. 4.
[247] Mitroyanni (2016), p. 32; Hultqvist (2016), p. 856; Cédelle (2016), pp. 491, 494.
[248] Cf. Supplement D – The EU GAAR; Tjernberg (2018), p. 100; Hultqvist (2016), p. 858.

GAAR's criterion of *main purpose* are higher. If the Swedish GAAR goes further than the EU GAAR, then EU law may restrict its application to companies in cross-border transactions within the EU.[249] Although it is not certain whether the Swedish GAAR must be revised to meet the requirements of Art. 6 ATAD, it appears that the GAAR already fulfils this part of the requirements.[250] It is however too early to draw any firm conclusions.

4.2.3 The Swedish GAAR application

The following cases illustrates the application of the Swedish GAAR. In HFD 2012 ref. 58, an economic association owned all shares in both X AB and in Y AB. The shares in X AB represented inventory assets, while those in Y AB represented capital assets. The economic association planned to transfer the assets of X AB to Y AB through an under-price transfer, to achieve a situation where earnings attributable to the operations of X AB could be obtained as tax-free dividends from Y AB. The association requested an advance ruling on whether the arrangement would trigger a taxation, and whether the Swedish GAAR was applicable. HFD, in line with the Swedish Revenue Law Commission ("SRN"), concluded that the transfer of shares in the subsidiaries would in accordance with the directly applicable law not result in a taxation. HFD noted *inter alia* that the transfer of receivables and liabilities should be regarded as a transfer of the entire business, and that the criteria for a tax-neutral under-price transfer therefore were fulfilled. Finally, HFD noted that the arrangement's tax effects were a direct result of the under-price transfer rules design. Condequently, HFD decided that the GAAR was not applicable. Although the outcome may appear quite unproblematic, it is however not as predictable in the context of three prior cases, RÅ 2009 not. 86, RÅ 2009 not. 99 and HFD 2012 not. 30, which all dealt with similar under-price transfers and where the GAAR was applied. The difference of HFD 2012 ref. 58 compared to the prior cases appears to be that the under-price transfer was

[249] Tjernberg (2018), p. 100; Hultqvist (2016), pp. 858 f., 863.
[250] Hultqvist (2016), p. 853; Tjernberg (2018), p. 100.

considered more of a typical character that the rules intended to cover and did not lead to a definitive tax relief.[251]

In HFD 2015 ref. 17 A and B conducted an under-price transfer of the business of their limited company Old Y to their new company New Y. Afterwards, the shares of Old Y were sold to their company X. No business activity that could qualify their shares were conducted in Old Y or X. Since the earnings of Old Y originated from the company's previously operated business, it was considered to conduct the same or a similar activity, and their shares in X were therefore qualified.[252] A and B intended to sell their shares in X after a five-year period when they were no longer qualified, taxed as capital income. SRN noted that the sale would result in capital income taxation under Chapter 48 of the Swedish Income Tax Act ("IL"). Regarding the GAAR's applicability, it was decisive whether the procedure was contrary to *the purpose of the legislation*. SRN found, and later confirmed by HFD, that the profits in Old Y through the procedure were taxed exclusively as capital income and that taxation of employment income was avoided. SRN referred to RÅ 2009 ref. 31 in which the GAAR was applied to a similar procedure. The difference was that the shares would now cease to be qualified after the five-year period, whereas they were in the previous case immediately unqualified through internal share transfers and an external business transfer. As the business would continue, all profits, by repeating the procedure, could be taxed as capital income. Accordingly, the GAAR was considered applicable, and A and B were taxed as if their shares were qualified when selling the shares in X. The case was criticised since the ruling in RÅ 2009 ref. 31 did not give support for the GAAR application and the assessment of the legislation's purpose was subjective and unpredictable.[253] As regards the assessment of the legislator's passivity and its significance for the fourth criterion, it is argued that neither HFD 2015 ref. 17 nor RÅ 2009 ref. 31

[251] Cf. Carneborn & Uggla (2015), p. 75.
[252] If a shareholder's shares are qualified in accorance with Section 4, Chapter 57 IL, his or her income is taxed partly as employment income and parly as capital income.
[253] Tjernberg (2016B), p. 372.

provided any guidance or established any uniformity regarding the application. This is particularly clear in comparison to prior case law.[254]

In HFD 2016 ref. 61, L.J. owned 45 percent of the company Z AB, in which he was active to a significant extent. His shares were therefore qualified until the end of 2015. L.J's son was also active to a significant extent in Z AB. In 2010, L.J. acquired all shares in X AB with the wholly owned subsidiary Y AB, and sold his shares in Z AB to Y AB, which made L.J.'s shares in X AB qualified. Thereafter L.J.'s son, through his wholly owned company Å AB, acquired the shares in Z AB from Y AB. Å AB also acquired the remaining shares in Z AB from, among others, L.J.'s partner whose shares were qualified until the end of 2015. L.J. requested an advance ruling on whether his shares in X AB after the arrangement were qualified at the beginning of 2016 or if the GAAR was applicable. SRN found that L.J's shares ceased to be qualified by the end of 2015, and stated with reference to HFD 2015 ref. 17 that the GAAR's first three criteria were fulfilled. When assessing the fourth criterion, SRN highlighted that L.J. following the procedure would not hold shares in Z AB or Å AB, as opposed to HFD 2015 ref. 17, in which the taxpayer owned shares in the company where the business continued. In further difference, L.J. would not continue to work in the company. The decisive question was whether the arrangement was contrary to *the purpose of the legislation* despite that L.J.'s son indirectly owned Z AB, and would continue to be active to a significant extent. The fact that the procedure could not be repeated, in contrast to the referenced 2015-case, became important. These differences and particularly that L.J.'s son would continue the business suggested that the procedure had a "change of generation-character". SRN therefore deemed the GAAR's fourth criterion unfulfilled. HFD however disagreed. Like SRN, HFD emphasized the similarities of the procedure with those in the prior cases,[255] but determined that work conducted by a relative to a shareholder in a closely held company should be treated as if the shareholder performed the work himself, as this was a basic objective of the

[254] Cf. e.g. RÅ 2009 ref. 47 I and RÅ 1995 ref. 84. Carneborn & Uggla (2015), p. 84; Carneborn & Uggla (2016), pp. 505 f., 511 f.
[255] Cf. RÅ 2009 ref. 31, HFD 2015 ref. 17 I and II.

tax rule.[256] Consequently, HFD applied the GAAR. The case was criticised for resulting in an unfair taxation since L.J.'s partner, who also sold his shares to Å AB, but did not use another company and was not related to its owner, avoided taxation. It may be questioned whether the purpose of the legislation is that selling shares in a closely held company through another closely held company to a related person for commercial reasons, motivates higher taxes than if the sale had been performed directly by a shareholder to a third party.[257]

The essence of the referenced cases is that it is quite unpredictable whether an arrangement will be covered. Besides the GAARs vague design and criteria providing subjectivity in the assessments, this is largely due to the lack of guidance regarding the application, since the first three criteria are accepted by the court without any reasoning, and since no explanation is provided regarding what is actually necessary for the fourth criterion to be applied. Accordingly, this subjectivity and lack of guidance creates uncertainty.

4.2.4 The Swedish GAAR in the light of legal certainty

The GAAR's several vague formulations are criticized for making its application unpredictable and conducted *in casu*.[258] At the same time, the phrase "*the purpose of the legislation*" is particularly problematic by enabling an interpretation going beyond the wording of the law.[259] Additionally, the forth criterion involves several assessments of subjective character and lacks guidance on what should actually be taken into consideration in the assessment.[260] The Swedish GAAR's compatibility with the principle of legality has therefore been questioned, and it is debated whether its application is consistent with the legality principle's regulatory requirement

[256] Cf. Chapter 57, Section 4 IL.
[257] Tjernberg (2017), pp. 335–337; Richter (2016), pp. 312–314; Carneborn & Uggla (2016), pp. 511–513.
[258] Hultqvist (2015), p. 16; Tjernberg (2018), p. 100; Carneborn & Uggla (2015), p. 126.
[259] Holstad (2013), pp. 551 f.; Påhlsson (2016), pp. 120 f.; Hultqvist (1995), p. 425.
[260] Påhlsson (2016), p. 121; Påhlsson (2013), p. 95.

and inherent analogy prohibition.[261] The GAAR's analogous effect enables courts to tax arrangements that are not actually covered by the legal text, and is recurrently considered problematic from a legal certainty perspective.[262] Hultqvist has argued that since the Swedish GAAR application through its two-step assessment always requires the finding that the procedure is not covered by ordinary legal application, it constitutes an unlawful analogous tax law application.[263] Rosander, on the other hand, admits that the application requires a problematic analogous effect from a legal certainty perspective, but rejects that it provides a *pure* analogous application.[264] Along with other scholars, she claims that the GAAR is a part of Swedish tax law, whose application in the context of ordinary legal application results in legally supported taxation, and thus meets the legality principle's regulatory requirement.[265] However, most scholars acknowledge that the GAAR's wider scope of application as well as its vague criteria risk implying a discretionary and unpredictable legal application, and thus to deteriorate legal certainty.[266]

Sweden is however one of few countries with a unique and long-standing system where taxpayers' have the opportunity to obtain advance rulings, issued by the independent SRN, with binding effect on taxation concerning various tax matters.[267] The procedure involves a trial in court-like forms with the tax authorities and the taxpayer as counterparties. The requirement is that the matter is of importance to the taxpayer or to a uniform interpretation or legal application.[268] Advance rulings appealed to HFD constitute an immensely important part of the case law.[269] The advance ruling system was created to increase taxpayers' predictability regarding the interpretation and

[261] Påhlsson (2013), p. 89; Hultqvist (1995), p. 126; Rosander (2007), p. 75.
[262] Hultqvist (1995), p. 13, 127; Hultqvist (2005), p. 308; Lodin, Lindencrona et al. (2017), p. 734.
[263] Hultqvist (1995), p. 283.
[264] Rosander (2007), p. 82.
[265] Påhlsson (2013), p. 93; Tikka (1996), pp. 56 f.; Rosander (2007), pp. 82 f.
[266] Påhlsson (2016), p. 121; Tjernberg (2018), pp. 102 f.; Rosander (2007), p. 82; Hultqvist (1995), p. 126.
[267] Cf. Sections 5 and 16 Lagen (1998:189) om förhandsbesked i skattefrågor; Lodin, Lindencrona et al. (2017), p. 798 f.; Silfverberg (1999), p. 565; Vanistendael (1996), p. 62.
[268] Lodin, Lindencrona et al. (2017), p. 799; Rosander (2007), p. 99.
[269] Silfverberg (1999), p. 565; Lodin, Lindencrona et al. (2017), p. 800; Vanistendael (1996), p. 62; Rosander (2007), p. 99.

application of tax law to arrangements with uncertain tax consequences.[270] It has been very important for the Swedish GAAR, and the possibility of obtaining knowledge in advance on whether a situation is covered by the GAAR is considered crucial in order to satisfy legal certainty.[271]

4.3 The U.S. GAAR

4.3.1 The U.S. GAAR's purpose, design and framework

The U.S. has a history of avoiding statutory GAARs and generally applicable rules due to its legal culture's strong tradition of limiting government and ,in particular, federal fiscal powers.[272] The political climate has however not meant that the U.S. courts and the Internal Revenue Service ("IRS") were lacking tools to counteract tax avoidance.[273] In contrast to the statutory GAARs of Sweden and China, the U.S. common law system satisfies the need for anti-avoidance rules with judicial doctrines developed in case law along with specific legislations and regulations.[274] This method means that the courts counteract tax avoidance without any specific legal basis, and the U.S. was early to adopt a restrictive approach towards tax avoidance.[275] In this endeavour, the Supreme Court developed several judicial anti-avoidance doctrines, by interpreting tax laws in relation to individual cases.[276] Accordingly, the U.S. "GAAR" constists of judicial doctrines established in case law, and only partly codified in statutory law.[277] The judicial doctrines are not a GAAR in a traditional sense, but fulfil the same function and purpose.[278]

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[270] Rosander (2007), p. 99; Silfverberg (1999), p. 565; Lodin, Lindencrona et al. (2017), p. 798.
[271] Rosander (2007), p. 99.
[272] Menuchin & Brauner (2016), p. 765; Prebble & Prebble (2010), p. 27.
[273] Dunbar (2010), p. 21; Varma & West (2010), pp. 826 f.; Bogdan (2013), p. 117; Lampreave (2013), p. 50.
[274] Menuchin & Brauner (2016), p. 765; Brauner & Herzfeld (2013), p. 785; Morse & Deutsch (2015), p. 119; Prebble & Prebble (2010), p. 27.
[275] Rosander (2007), p. 168; Varma & West (2010), p. 826 f.; Dunbar (2010), pp. 20 f.
[276] Alvarrenga (2013), p. 349; Vanistendael (1996), p. 28; Prebble & Prebble (2010), p. 27.
[277] Lampreave (2013), p. 50; Menuchin & Brauner (2016), p. 778.
[278] Prebble & Prebble (2010), p. 27; Brauner & Herzfeld (2013), p. 785; Menuchin & Brauner (2016), p. 765; Morse & Deutsch (2015), p. 119.

Although described separately below, the judicial doctrines overlap and are applied in conjunction,[279] and are widely applied to various unacceptable arrangements aiming to reduce taxpayers' tax liability.[280] Since their applications' are subject to a statutory interpretation of the rules circumvented, they could arguable be viewed as rules of construction.[281] A common feature is that they prevent taxpayers from circumventing the tax rule's purpose, while formally following its wording.[282] The five judicial doctrines that comprise the U.S. GAAR are the doctrines of:

(1) *business purpose*,
(2) *substance over form*,
(3) *step transaction*,
(4) *sham transaction*, and
(5) *economic substance*.[283]

The *business purpose* doctrine distinguishes between transactions with valid business purpose, and artificial transactions designed only to avoid taxation. Transactions must be justified by commercial reasons, rather than fiscal, as they otherwise can be excluded or re-characterized.[284] The doctrine thus requires that taxpayers have a genuine business purpose other than to avoid taxation.[285] It has together with the other tax avoidance doctrines its initial origin in the U.S. Supreme Court ruling of *Gregory v. Helvering*[286] from 1935.[287] In the case, a reorganization was investigated in which a company was created and liquidated for the sole purpose of avoiding the two tax levels provided for by the corporate tax legislation. The Supreme Court ruled that

[279] Bankman (2000), p. 29; Tiley & Jensen (2006), p. 168; Rosander (2007), p. 163; Varma & West (2010), p. 827.
[280] Alvarrenga (2013), p. 349; Gardner (2007), p. 523; Menuchin & Brauner (2016), p. 768.
[281] Tiley & Jensen (2006), p. 169.
[282] Rosander (2007), p. 162; Varma & West (2010), p. 826; Kaye (2012), pp. 342.
[283] Cf. e.g. Kaye (2012), p. 344; Dunbar (2010), p. 39; Glickman & Calhount (2008), p. 1183; Morse & Deutsch (2015), p. 118; Tiley & Jensen (2006), p. 168; Gardner (2007), p. 523; Menuchin & Brauner (2016), p. 767.
[284] Lampreave (2012), p. 155; Varma & West (2010), p. 827; Vanistendael (1996), p. 28.
[285] Glickman & Calhount (2008), pp. 1182 f.; Varma & West (2010), pp. 827–829.
[286] *Gregory v. Helvering*, 293 U.S. 465 (1935).
[287] Glickman & Calhount (2008), pp. 1182; Alvarrenga (2013), pp. 348–349; Prebble & Prebble (2010), p. 27.

the measure lacked "business or business-related purpose", and was merely conducted for concealing the arrangement's real nature. Except for situations where statutory provisions explicitly require business purpose, the doctrine is generally used in combination with other doctrines.[288]

The doctrine of *substance over form* means that the actual circumstances of a procedure are assessed in accordance with its commercial meaning, instead of its formal content. Its basic premise is that a transaction's tax consequences should be assessed based on its results rather than the measures taken formally.[289] In assessing the transaction's validity, its business substance and meaning is taken into account. The key is whether the particular arrangement is economically justified, which is not the case in, for example, an under-price transfer. The doctrine generally applies when a transaction's legal form differs from its consequences, and results in a determination of its true economic substance.[290]

The *step transaction* doctrine can be viewed as a variation of the *substance over form* doctrine, meaning that several related transactions are treated as a compound transaction.[291] It aims to prevent transactions' from achieving the same economic results but being taxed differently only because of the form in which the legal measures are taken. It applies when taxation of each step of a transaction leads to tax consequences other than those of a taxation of the transaction in its entirety, meaning that formally separate steps are viewed as a single transaction.[292]

[288] Dunbar (2010), p. 38 f.; Varma & West (2010), p. 827; Brauner & Herzfeld (2013), p. 786.
[289] Lampreave (2012), p. 153; Glickman & Calhount (2008), p. 1186; Brauner & Herzfeld (2013), p. 788.
[290] Glickman & Calhount (2008), p. 1184; Lampreave (2012), p. 155.
[291] Glickman & Calhount (2008), p. 1185; Menuchin & Brauner (2016), p. 777; Lampreave (2012), p. 153.
[292] Lampreave (2012), p. 155; Menuchin & Brauner (2016), pp. 777 f.; Glickman & Calhount (2008), p. 1185; Cf. *Del Commercial Properties Inc. v. Commissioner of Internal Revenue* T.C. Memo 411 (1999).

The *sham transaction* doctrine is applied when a taxpayer claims tax benefits based on taking certain measures that were not actually taken. The assessment involves an analysis of the evidence that, for example, a company's alleged ownership change has actually meant that the previous owner has lost corporate control.[293]

The aforementioned doctrines' are commonly used in conjunction with the most central one, that of *economic substance*.[294] Like the other judicial doctrines, it constitutes a legal basis for re-classifying transactions carried out with a tax avoidance purpose.[295] A starting point for the economic substance doctrine was the aforementioned ruling of *Gregory v. Helvering*[296] in 1935.[297] However, it further developed in 1960, through the ruling of *Knetsch v. United States*[298], in which the taxpayer made interest deductions for debt incurred through the purchase of life insurance without any regressment right. Since the yield of the annuity was below the debts interest expense, the taxpayer's purpose was to make interest deductions for tax purposes. The Supreme Court ruled that the transaction in economic terms was "false" since it lacked "economic substance".[299] The doctrine prevents taxpayers' from being granted tax benefits due to transactions, which although may be covered by the wording of the law do not constitute transactions that the Congress intended to be covered.[300] It is a fact-finding method and its basic premise is that courts may deny tax benefits arising from business transactions that has no commercial or economic advantage other than the tax benefit.[301] The doctrine progressed considerably in *Frank Lyon Co. v. Commissioner*[302]

[293] Glickman & Calhount (2008), pp. 1186; Menuchin & Brauner (2016), p. 768; Lampreave (2012), p. 156.
[294] Gardner (2007), p. 524; Prebble & Prebble (2010), p. 27.
[295] Bankman (2000), p. 5; Morse & Deutsch (2015), p. 118; Cf. e.g. *Black & Decker Corp. v. United States*, 436 F.3d 431,440 (4th Cir. 2006).
[296] *Gregory v. Helvering*, 293 U.S. 465 (1935).
[297] Varma & West (2010), p. 828; Morse & Deutsch (2015), p. 119; Prebble & Prebble (2010), p. 27; Glickman & Calhount (2008), p. 1183; Cf. *Frank Lyon Co. v. United States*, 435 U.S. 561 (1978); *Goldstein v. Comm'r*, 364 F.2d 734 (2d Cir. 1966).
[298] *Knetsch v. United States*, 364 U.S. 361 (1960).
[299] Cf. Alvarrenga (2013), p. 350; Cf. e.g. *Boca Investerings P'ship v. United States*, 314 F.3d 625,631 (D.C. Cir. 2003).
[300] Lampreave (2012), p. 153; Johnson (2017), p. 351; Varma & West (2010), p. 828.
[301] Lampreave (2012), pp. 152 f.; Alvarrenga (2013), pp. 349 f.
[302] *Frank Lyon Co. v. United States*, 435 U.S. 561 (1978).

where the Court established that the decisive factors for avoiding an application were whether the transaction:

1. was a genuine multiparty transaction;
2. possessed economic substance;
3. was compelled by external business and regulatory requirements;
4. was imbued with tax-independent considerations; and
5. was not undertaken solely for tax avoidance.[303]

The doctrine's main problem is the multiple approaches used for its application. While some courts require taxpayers to prove the existence of both economic substance and business purpose to allow the arrangement, other considers through a disjunctive test that one of the two is sufficient.[304] The doctrine is applied through assessing and concluding whether an arrangement fulfils one or – in some cases – two prongs; First, whether the arrangement is profitable other than in respect to the tax benefits (*the objective prong*), second, whether there is a business purpose for entering the arrangement other than tax avoidance (*the subjective prong*). This demonstrates the difficulties of a consistent and uniform interpretation of *economic substance*.[305] Additionally, case law has clarified that the doctrine partially subsumes the other doctrines.[306]

Despite the general scepticism in the U.S. towards GAARs, the *economic substance* doctrine was in 2010 codified in Section 7701(o) IRC[307] to clarify and prevent continued inconsistent application.[308] Its first paragraph provides that the application's scope covers transactions to which the *economic substance doctrine* is *relevant,* and that a transaction only has *economic substance* if the taxpayer aside from benefiting from a lower taxation:

i) has its *economic position changed* [emphasis added] in a meaningful way, and

[303] Id. at 583 f.; Cf. Gardner (2007), p. 525.
[304] Alvarrenga (2013), p. 350; Giordano (2017), p. 470; Lampreave (2012), p. 153.
[305] Giordano (2017), pp. 470, 474; Brown (2012), p. 4; Alvarrenga (2013), p. 350; Cf. *Gilman v. Comm'r*, 933 F.2d 143, 149 (2d Cir. 1991) at 147–148; Cf. e.g., Altria Grp., v. United States, 694 F. Supp. 2d 259, 282 (S.D.N.Y. 2010).
[306] Bankman (2000), p. 12; Morse & Deutsch (2015), p. 119.
[307] Internal Revenue Code Section 7701(o) Clarification of economic substance doctrine.
[308] Sulami (2012), p. 8; Kaye (2012), pp. 344 f.; Menuchin & Brauner (2016), p. 766.

ii) enters into the transaction due to a *substantial business purpose* [emphasis added].[309]

Noteworthy is that the codification lacks influence on the other doctrines, and codifies only the framework and legal instruments for the application, and not *when* it shall apply.[310] Consequently, there are some difficulties comparing the "ordinary" statutory GAARs of Sweden and China with the U.S. codification. Following the codification, the main debate concerned its new sanction systems' strict liability components, as well as its lack of clarification.[311] Despite the doctrine's statutory codification, courts still have the same interpretive authority, since a precondition for its application, as mentioned above, is that the common law doctrine must be *relevant*.[312] The U.S. Court of Appeals has further confirmed the validity of precedent rulings made before the codification, and concluded that the Congress has specified that "[…] the 2010 codification [shall apply] as courts have previously and consistently applied the economic substance doctrine".[313] The case law examined below therefore includes earlier rulings.

4.3.2 The U.S. GAAR application

As mentioned in the previous section, the economic substance doctrine's codification aimed to resolve the problems of its unpredictable and inconsistent application. The following cases illustrate its application both before and after the codification.

In *ACM Partnership v. Commissioner*[314], the Colgate Company joined a non-U.S. taxpayer into a partnership and acquired and sold corporate debt for contingent payments, taxed in accordance with the instalment sale rules. The

[309] Cf. Supplement B – The U.S. GAAR.
[310] McMahon, McGovern & Shepard (2015), p. 261; Menuchin & Brauner (2016), p. 767; Cf. e.g. *Wells Fargo & Co. v. United States of America*, Case No. 09-CV-2764 (PJS/TNL) (2017).
[311] Menuchin & Brauner (2016), p. 767; McMahon, McGovern & Shepard (2015), pp. 264.
[312] Cf. e.g. Morse & Deutsch (2015), pp. 119 f.; McMahon, McGovern & Shepard (2015), p. 262; Sulami (2012), p. 8.
[313] *Santander Holdings USA, Inc. v. United States* 844 F.3d 15 (1st Cir. 2016).
[314] *ACM P'ship v. Comm'r*, 157 F.3d 231 (3d Cir. 1998).

arrangement created capital losses of USD 84 million, for which Colgate claimed tax deductions. The arrangement produced profit distributed to another taxpayer in accordance with the partnership rules. After a majority of the gains were recognised and Colgate had benefitted from the losses, the taxpayer was redeemed. The purpose was to achieve tax benefits by creating capital losses, which Colgate used to compensate capital gains.[315] The Eleventh Circuit examined the arrangement's separate steps as a series of transactions, starting with the partnership creation. This method enabled the court to conclude that the arrangement did not change the taxpayer's economic position. The court held that the partnership's way of selling assets and debts made its principal value constant, so its interest payments remain fixed. After concluding that the partnership had not satisfied the objective prong of the economic substance inquiry, id est to change its economic position, the court rejected the subjective prong arguments.[316][317] It thus did not examine the arrangement's purpose, but instead whether it aimed to develop any actual activity. The case may appear rather uncontroversial today, but at the time it progressively took the doctrine's application a great leap forward by establishing that benefits could be disallowed solely based on the arrangement's failure to fulfil the objective prong.[318]

In *Coltec Industries v. United States*[319] the Coltec-company created the Garrison-company, which issued stocks to Coltec and to another Coltec-subsidiary, Garlock, which had asbestos liabilities. Garrison assumed Garlock's litigation responsibilities for asbestos related claims, and indemnified it against future claims, which in return transferred a USD 375 million note and agreed to cover Garrison's future capital needs. Thereafter,

[315] Id. at 233, 238–243; Giordano (2017), p. 480; McMahon, McGovern & Shepard (2015), p. 261; Lampreave (2012), p. 155; Bankman (2000), pp. 8 f.
[316] Id. at 251 f.; Giordano (2017), p. 480; Silverman & Varma (2011), pp. 15 f.; Bankman (2000), pp. 9 f.; Prebble & Prebble (2008), p. 165; Keinan (2005), pp. 383, 401.
[317] Id. at 252–254. Giordano (2017), pp. 480 f.; Silverman & Varma (2011), pp. 15 f.; Lampreave (2012), p. 155; Bankman (2000), pp. 9 f.; Prebble & Prebble (2008), p. 165; Keinan (2005), pp. 401 f.
[318] Giordano (2017), p. 480; Silverman & Varma (2011), pp. 15 f., 31.; Lampreave (2012), p. 155; Bankman (2000), pp. 9 f.; Prebble & Prebble (2008), p. 165; Cummings (2010), p. 222; Keinan (2005), pp. 413, 417.
[319] *Coltec Industries v. United States*, 454 F.3d 1340 (Fed. Cir. 2006).

two banks purchased Garlock and were indemnified by Coltec against asbestos-related claims. Following the transaction, Coltec retained a 93 percent ownership share of Garrison. Coltec later claimed a USD 379 million loss on the Garrison's stock sale. Interestingly, the Trial Court deemed the economic substance doctrine unconstitutional and accepted the arrangement. After appeal however, the Federal Circuit rejected this finding and applied the doctrine.[320] It further stated that prior case law did not give proper effect to the doctrine as established in *Frank Lyon Co. v. United States*[321]. The Court therefore applied a disjunctive, instead of a conjunctive approach, holding that "[…] a lack of economic substance is sufficient to disqualify the transaction without proof that the taxpayer's sole motive is tax avoidance."[322] The Court also concluded that, firstly, it is the taxpayer's burden to prove a transaction's economic substance. Secondly, an objective consideration of whether the transaction causes a *change in the flow of economic benefits*, whether the transaction has a *reasonable possibility of profit*, or whether the transaction *affects a taxpayer's financial position in any way*, shall be used to determine its economic substance. Thirdly, transactions without independent third parties shall be particularly closely scrutinised.[323] The application lowered the threshold of the doctrine since it was applied despite that the taxpayer's aim could not be proven to be tax avoidance and since the objective prong was deemed sufficient *per se* for establishing tax avoidance.[324] The application only considered the specific transaction from which the deduction arose and was very strict in comparison to other courts broader considerations of transactions' context.[325] The case suggests that taxpayers' may have to demonstrate that each part of a transaction has both economic substance and a non-tax avoidance motive. This sharp transition to an application in the taxpayer's disadvantage was considered to highlight the need for clarification.[326]

[320] Id. at 1343–1346, 1353; Cf. e.g. Gardner (2007), pp. 519 f., 522.
[321] *Frank Lyon Co. v. United States*, 435 U.S. 561 (1978).
[322] Id. at 1355; Gardner (2007), p. 522.
[323] Id. at 1355–1357; Cf. Gardner (2007), pp. 522 f.
[324] Id. at 1360; Gardner (2007), p. 523.
[325] Gardner (2007), p. 528; Cf. e.g. Cottage Savings Ass'n v. Commissioner, 499 U.S. 554 (1991).
[326] Gardner (2007), pp. 528, 532.

In the case *Bank of N.Y. Mellon Corp. v. Comm'r*[327], BNY joined into a Structured Trust Advantaged Repackaged Securities transaction with Barclays U.K. and obtained USD 200 million of foreign tax credits. BNY transferred USD 6.5 billion to BNY REIT, and formed InvestCo, which BNY REIT capitalized with USD 10.4 billion. Thereafter, it formed DelCo, which InvestCo capitalized with USD 9.2 billion, and in return received two classes of stocks giving it all voting rights and nearly all DelCo's future asset distributions. BNY then created a Trust, to which InvestCo transferred its remaining assets. BNY formed NewCo, and provided InvestCo with a complete ownership interest. Barclays then lent BNY USD 1.5 billion and a BNY subsidiary subject to U.K. taxes replaced the U.S. trustee. The Trust created tax obligations through lump-sum payments, resulting in U.K. taxable income of USD 402 million. As a result, Barclays received a tax credit for 22 percent of its 30 percent tax rate. BNY payed Barclays tax liability and received a tax credit and a reimbursement for half the tax amount.[328] The Tax Court concluded that the analysis should involve a bifurcation of the arrangement to determine its objective profitability. It dismissed BNY's claim that the arrangement was a precondition for the cheap loan and to consider income arising from the loan. The Court deemed that BNY's arrangement did not have any non-tax business purpose why it lacked subjective economic substance.[329] The Second Circuit partially agreed but held that the loan transaction viewed separately did have economic substance and thus allowed a deduction for the loan costs.[330] The Second Circuit however separated the part of the transaction having economic substance from that giving rise to tax benefits. Consequently, although a non-tax business purpose is concluded, i.e. the affordable loan, which from the taxpayers' perspective may be essential for the arrangement as a whole, the subjective prong may still be unfulfilled due to the courts bifurcation of the transaction and decision to treat parts of

[327] *Bank of N.Y. Mellon Corp. v. Comm'r*, 801 F.3d 104, 124 f. (2d Cir. 2015).
[328] Id. at 16–20, 23–30; Cf. Giordano (2017), pp. 473 f.
[329] Id. at 33 f., 39, 44–46; Cf. Giordano (2017), p. 475.
[330] Id. at 122 f., 125; Cf. Giordano (2017), p. 475.

the transaction as separate from others.[331] It was argued that to extend the prior application beyond closely analogous scenarios by separating the transaction went against the doctrine's separate subjective and objective prongs, which both before and after its codification is inherent in its application. Such a far-reaching application could make the subjective prong impossible to satisfy and the objective prong highly subjective within the courts' discretion, thus very unpredictable.[332]

4.3.3 The U.S. GAAR in the light of legal certainty

Although the decision to examine an arrangement is subject to strong rule of law requirements, a significant consequence of the doctrines' applications' is the extensive discretionary powers provided to tax authorities' and the judiciary when reviewing a transaction.[333] The main problem of the U.S. GAAR, namely the economic substance doctrine, appear to be the different and inconsistent approaches that since its initial creation have characterized its application.[334] It has repeatedly been criticized for not offering a desirable degree of predictability to taxpayers.[335] Accordingly, tax professionals, scholars and taxpayers alike strongly stressed the need of a codification to solve the problem.[336] The rulings examined in sections 4.3.1–4.3.2 highlight not only the inconsistencies of earlier applications of the doctrine, but also the codification's failure to provide clarity. As apparent from the case law, several approaches are used for the GAAR's application, resulting in an inconsistent and unpredictable application.[337] This is primarily attributable to the fact that the codification essentially requires an application in line with the already established judicial doctrine, and since it lacks clarification regarding the assessment of the application's objective and subjective prongs,

[331] Id. at 120–125; Cf. Giordano (2017), pp. 471 f., 476, 482.
[332] Cf. Giordano (2017), p. 484.
[333] Menuchin & Brauner (2016), p. 778.
[334] Giordano (2017), p. 474; Lampreave (2012), pp. 153 f.; Alvarrenga (2013), p. 350.
[335] Brown (2012), p. 4; Cf. e.g. *Gilman v. Comm'r*, 933 F.2d 143, 149 (2d Cir. 1991) at 147 f.; Cf. e.g., *Altria Grp., v. United States*, 694 F. Supp. 2d 259, 282 (S.D.N.Y. 2010);
[336] Kaye (2012), pp. 345, 354; Menuchin & Brauner (2016), p. 766; Brauner & Herzfeld (2013), p. 786.
[337] Menuchin & Brauner (2016), pp. 767, 778; Morse & Deutsch (2015), p. 124.

which causes the inconsistent application.[338] Despite the GAAR application's considerable consequences for taxpayers, its decisive feature, when it should apply, remains unregulated and unclarified, and thus stays within the tax authorities and courts' discretion.[339] Since this discretion remains, the codification does not improve the application's predictability or prevent its inconsistencies, which essentially are the same.[340] Even though it may be too early to determine its exact consequences, some even argue that the codification could further impair taxpayers' legal certainty, as it increases the IRS's discretion and thus provides additional unpredictability regarding the application.[341]

In the U.S., there is a long history of the IRS issuing advance rulings with binding applications of the tax law.[342] A so-called *letter ruling* is a written statement requested by a taxpayer interpreting the tax law to the specific circumstances. These rulings establish an authoritative interpretation of the tax law in advance, with the main benefit of providing taxpayers' with predictability regarding the application in a particular case.[343] However, what may discourage taxpayers' from using this option is that the procedure is costly and may take several months. Furthermore, the IRS does not issue rulings within all areas and may refrain from delivering rulings within areas that could change in the near future.[344]

4.4 The Chinese GAAR

4.4.1 The Chinese GAAR's purpose, design and

[338] Morse & Deutsch (2015), p. 124; Cf. *Wells Fargo & Co. v. United States of America*, Case No. 09-CV-2764 (PJS/TNL) (2017); McMahon, McGovern & Shepard (2015), p. 262.
[339] Menuchin & Brauner (2016), p. 778; McMahon, McGovern & Shepard (2015), p. 262.
[340] Morse & Deutsch (2015), p. 124; Lampreave (2012), p. 160; McMahon, McGovern & Shepard (2015), p. 262.
[341] Menuchin & Brauner (2016), p. 766.
[342] Culbertson & Halphen (1999), p. 627; Vanistendael (1996), p. 61; Deak (2008), p. 187.
[343] Culbertson & Halphen (1999), p. 629; Tiley & Jensen (2006), pp. 183 f.; Deak (2008), p. 187.
[344] Tiley & Jensen (2006), pp. 183 f.; Vanistendael (1996), p. 61.

framework

As regards China, it should be pointed out that several features of its tax system for decades facilitated tax avoidance. In the beginning of the late 1970s reformation, a way to attract foreign investments was to offer beneficial tax incentives.[345] However, after China's huge economic expansion and accession to the World Trade Organization in 2001, it shifted its focus from solely trying to attract foreign investment to actively counteract tax avoidance.[346] In 2008, China undertook a major tax reform, and enacted the new Enterprise Income Tax Law[347] ("EITL"). As EITL applied a uniform income tax to domestic and foreign taxpayers; it was anticipated to give foreign taxpayers – primarily Multinational enterprises ("MNEs") – tax avoidance incentives.[348] Consequently, as there were no efficient anti-avoidance rules in place, China in accordance with the global trend adopted its own internationally applicable GAAR.[349] Since the GAAR is based on the idea that tax avoidance is closely associated with MNEs, it appears to – in contrast to the GAARs of Sweden and the U.S. – primarily target cross-border transactions.[350] Capital gains arising from the transfer of shares of companies with Chinese domicile are subject to a withholding tax of 10 percent. Foreign investors for many years avoided such such taxation by incorporating holding companies in low-tax jurisdictions, in large thanks to tax treaties concluded by China. The adoption of a GAAR emphasized the desire of China to eradicate abusive practices by entities without business purpose or sufficient substance, and controlled, directly or indirectly, by Chinese entities.[351]

[345] Shi (2017), pp. 29 f.; Lampreave (2013), p. 51.
[346] Ng (2015), p. 40; Shi (2017), p. 28; Mingxing Cao & Li (2016), p. 180; Li (2010), p. 91.
[347] The Chinese Enterprise Income Tax Law [中华人民共和国企业所得税法].
[348] Li (2010), p. 85; Holmes (2012), p. 111.
[349] Lampreave (2013), p. 51; Yang (2010), p. 211; Finnerty & Lai (2012), p. 377; Cui (2011), p. 42; Xiong & Evans (2014), p. 686; Holmes (2012), pp. 12, 112; Mingxing Cao & Li (2016), p. 180.
[350] Holmes (2012), p. 111; Li (2010), p. 85.
[351] Mingxing Cao & Li (2016), p. 185; Li (2010), p. 85; Lampreave (2013), p. 52; Finnerty & Lai (2012), p. 377; Cui (2011), p. 42; Xiong & Evans (2014), p. 686; Holmes (2012), pp. 13, 112; Yang (2010), p. 211.

The GAAR covers national as well as international arrangements, and is regarded a tax transplant since it was imported into the Chinese tax system after inspiration from the form and design of numerous countries' GAARs.[352] The GAAR is found in Art. 47 EITL and provides that:

> *In case an enterprise makes any other arrangement not for any reasonable business purpose, which causes the decrease of its taxable revenue or income, the tax organ may, through a reasonable method, make an adjustment.*[353]

In other words, if a taxpayer conducts or engages in arrangements lacking *reasonable business purpose* and which are created with the intention of reducing its taxable revenue or income,the arrangement qualifies as "tax avoidance", and the Chinese tax authorities may apply *reasonable methods* to adjust the taxpayer's tax liability.[354] Tax avoidance arrangements are thus identified based on the GAAR application's key criterion: the lack of a *reasonable business purpose*, meaning that the underpinning purpose of the activities of an arrangement is examined.[355] As the definition of "reasonable business purpose" was not specified by the NPC, it was thus to be interpreted and decided by state authorities and the SAT through administrative regulations. Accordingly, the SAT determines which arrangements constitute tax avoidance.[356] According to Art. 120 of the Detailed Implementation Regulations for the implementation of the EITL ("DIR"), the formulation not for any *reasonable business purpose* in Art. 47 EITL shall be understood as targeting arrangements with a primary purpose to reduce, avoid or defer taxation.[357] Furthermore, the Implementation Measures of Special Tax Adjustments ("IMSTA") clarifies SAT's interpretation of the GAAR's application. Art. 92 IMSTA stipulates that the assessment of tax avoidance should focus on, and be initiated when:

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[352] Mingxing Cao & Li (2016), p. 191; Li (2010), pp. 78, 85; Yang (2010), p. 212.
[353] Cf. Supplement C – The Chinese GAAR.
[354] Wong (2014), p. 36; Cui (2011), p. 42; Xiong & Evans (2014), p. 686; Lampreave (2013), p. 52; Holmes (2012), pp. 111 f.; Finnerty & Lai (2012), p. 377; Yang (2010), pp. 211 f.
[355] Yang (2010), p. 212; Wong (2014), p. 38; Xiong & Evans (2014), p. 686.
[356] Holmes (2012), pp. 111, 113; Yang (2010), p. 212.
[357] Wong (2014), p. 36; Holmes (2012), p. 113; Yang (2010), p. 212; Xiong & Evans (2014), p. 686.

(1) arrangements abuse tax treaties and entail treaty shopping;
(2) tax incentive claims about investment in certain sectors are abused;
(3) investments are made in a special economic zone;
(4) the legal form or organisational corporate structure are abused;
(5) offshore structures or tax havens are used; and
(6) arrangements are lacking a reasonable business purpose.[358]

However, since this method of identifying *reasonable business purpose* is subjective, it provides the tax authorities with a wide discretion. To reduce the risk of power abuse, the objective "substance over form-principle" was incorporated into the GAAR to be used in conjunction with the assessment of reasonable business purpose.[359] According to Arts. 138–139 IMSTA, the tax authorities should, when determining a taxpayer's participation in a tax avoidance arrangement, review several objective factors extensively.[360] The provisions enable an assessment of not only the arrangement's legal form but also its economic essence, through testing activities by reference to inconsistencies between its form and economic essence.[361] Art. 93 IMSTA addresses these activities and provides the use of the "substance over form-principle" when identifying tax avoidance arrangements and determining the GAAR's applicability, by comprehensively taking into account the arrangements:

(1) form and substance;
(2) time of conclusion and duration;
(3) form of implementation;
(4) relationship between its components and steps;
(5) financial effects for the parties participating; and
(6) tax consequences.

Art. 94 IMSTA provides that an identified tax avoidance arrangement shall be re-characterized in accordance with its economic essence, consequently disallowing tax benefits which otherwise would have resulted from the

[358] Cf. Arts. 92–97 IMSTA; Xiong & Evans (2014), p. 686; Yang (2010), p. 212; Lampreave (2013), pp. 52 f.
[359] Xiong & Evans (2014), pp. 686 f.; Yang (2010), p. 212.
[360] Xiong & Evans (2014), p. 686; Yang (2010), p. 212; Holmes (2012), p. 13.
[361] Xiong & Evans (2014), pp. 686 f.

arrangement. Accordingly, arrangements and enterprises without economic substance are disregarded in the assessment.[362] The principles of business purpose and substance over form thus apply in conjunction as the GAAR's core criteria, and form the framework and limitations of its application.[363] Conclusively, it must be noted that in 2017, a new Public Notice on "Administrative Measures of Special Tax Investigation and Adjustment and Mutual Agreement Procedure" was issued by the SAT. It supersedes the previous IMSTA and strengthens the monitoring of enterprises. However, it is not explained further as it became effective from May 1, 2017 and it remains unclear how it affects the GAAR application.[364]

4.4.2 The Chinese GAAR application

The primary source of guidance on the Chinese GAAR application consist of brief case reports occasionally published by the tax authorities.[365] Despite referred to as "cases",[366] they are merely investigations of arrangements to which the tax administrations have applied the GAAR without any judicial review.[367] While containing short descriptions of the circumstances, they barely, or not at all, show neither any legal reasoning nor the taxpayers' position in the negotiation process.[368] Discussed in the following are a few such investigations demonstrating the GAAR's development and application.

The case of *Chongqing*[369] established a "precedent" concerning the Chinese GAAR application.[370] The shares of a wholly controlled Singaporean special purpose vehicle ("SPV"), whose Singaporean parent company participated in a Chinese joint venture ("JV"), was sold to a Chinese company. The company argued that since the shares were transferred to a Singaporean entity by its Singaporean parent company, the Chongqing tax authorities did not have

[362] Wong (2014), p. 36; Holmes (2012), pp. 13, 113 f.; Yang (2010), p. 212.
[363] Xiong & Evans (2014), pp. 686 f.; Yang (2010), p. 212.
[364] SAT Public Notice [2017] No. 6 on "Administrative Measures of Special Tax Investigation and Adjustment and Mutual Agreement Procedure".
[365] Mingxing Cao & Li (2016), p. 191; Yang (2010), p. 222.
[366] 案例 (cases).
[367] Li (2010), p. 97; Mingxing Cao & Li (2016), p. 191.
[368] Qiu (2017), p. 92.
[369] *Chongqing* (2008), issued by the Chongqing Tax authorities on November 27, 2008.
[370] Mingxing Cao & Li (2016), p. 192; Yang (2010), p. 222; Lampreave (2013), p. 53.

authority to tax the capital gains, despite the fact that the purchaser was a Chinese entity that indirectly transferred the shares of a Chinese JV. The SAT held that the SPV – lacking any substantial capital or business activity – had no economic substance, and had been incorporated with the sole purpose of holding a participation in the JV and avoiding taxation by abusing the 1986 tax treaty between China and Singapore. Consequently, the SAT treated the transaction as if it was conducted between a Singaporean seller and a Chinese buyer, concerning a Chinese JV. Accordingly, the SPV was disregarded and the Singaporean parent company was subject to Chinese income tax of 10 percent on its capital gain as if it made the transfer directly.[371] From the case, it appears that if the tax authorities consider a procedure to lack proper capital or business activity, this is sufficient to establish that the arrangement lacks economic substance and has as its sole purpose to avoid taxation. There seems to be no assessment of whether the taxpayer's purpose indeed was to avoid taxation and neither of what capital or business activity is required for an arrangement to have economic substance. Although the arrangement's purpose of avoiding taxation may appear obvious in this case, the absence of legal reasoning and a comprehensive description of all facts and circumstances relevant for the application creates unpredictability.

In the case of *Xinjiang*[372], a U.S. company group established an SPV in Barbados, with three U.S. resident managers. The SPV bought 33 percent of the shares in a JV from an oil and gas extraction company in the autonomous region of Xinjiang. Thereafter, the Xinjiang Company injected an amount corresponding to the purchase price into the JV, which increased its registered capital accordingly. After that, the SPV sold the JV shares back to the initial shareholder for a higher price, which resulted in a capital gain. In 2008, the tax authorities determined that the arrangement was conducted with the sole purpose of avoiding taxation. As there was insufficient evidence for residency, the SPV was – for tax purposes – not considered to be resident in

[371] Mingxing Cao & Li (2016), p. 192 f.; Silvani (2013), pp. 25 f.; Lampreave (2013), p. 53; Yang (2010), p. 222.
[372] *Xinjiang* (2008), published in Circular 1076.

China. Consequently, article 13 of the Barbados-China Income Tax Treaty from 2000 – which grants exclusive taxing rights in respect of capital gains to the state in which the seller was resident, in this case, Barbados – was disregarded. Instead, article 4 was applied, under which an entity is considered to be resident in the state where the entity is managed. The tax authorities disallowed the exemption from capital gains and the SPV to benefit from the tax treaty. Following the two cases of *Chongqing* and *Xinjiang* was a considerable controversy concerning their legality, primarily since they were the first two cases in which the GAAR applied.[373] It must further be highlighted that the arrangements in the two rulings were conducted before the GAAR formally came into force, and that prior legislation lacked a GAAR. Despite this, the SAT did in fact apply the GAAR retroactively in the two cases, although not explicitely stating so. This causes great concern from a legal certainty perspective and, naturally, imply profound limitations of taxpayers' predictability.[374]

In the case of *Jiangdu*[375], China's determination to tax capital gains arising from indirect transfers of shares of Chinese companies was highlighted.[376] In the case, a U.S. company with a Chinese JV sold the shares of a Hong Kong SPV. Both the seller and the purchaser were established in the U.S., while the SPV whose shares were transferred was located in Hong Kong, owned by the seller since 2007. The JV was owned by a Chinese entity with a 51 percent stake and by the U.S. company with a 49 percent stake. The tax authorities notified the JV that its shareholders had not fulfilled the obligation to provide information regarding the transaction as required by the GAAR. The JV was further informed that there was sufficient evidence to assume that the transaction's potential capital gains should be subject to Chinese taxation. This was *inter alia* because the holding company established in Hong Kong was an SPV incorporated with the only purpose of excluding capital gains from taxation. The SPV lacked any real substance in respect of employees,

[373] Lampreave (2013), pp. 54 f.; Mingxing Cao & Li (2016), pp. 192 f., 200 f.; Holmes (2012), pp. 111 f.; Silvani (2013), p. 25; Yang (2010), pp. 222 f., 225–228.
[374] Yang (2010), pp. 227 f.; Silvani (2013), p. 26; Finnerty & Lai (2012), p. 383.
[375] *Jiangdu* (2010), issued by the Jiangdu Tax authorities on June 8, 2010.
[376] Cheung (2012), p. 41; Lampreave (2013), pp. 55 f.; Ng (2015), p. 41.

operating assets, liabilities or business purpose. The local tax authorities therefore deemed that it incorporated with the only purpose of avoiding Chinese taxation. The tax authorities investigated the transaction by reviewing the equity transfer agreements and information from the purchaser's website. There it had published details about its Chinese investments, but had omitted to mention that the shares transferred were those of the SPV in Hong Kong and not those of the Chinese JV. The seller argued, despite the fact that its entity indirectly participated in a JV in China, that the purpose of the transaction was not to transfer the JV shares, but instead to transfer the SPV shares. This argument was however weak, since the purchaser stated on its website that the shares of the Chinese JV had been acquired directly. Consequently, the seller finally agreed to a "tax ruling" and paid USD 25 million.[377] The case highlights the GAAR's broad criteria and accompanying discretion. That the GAAR does not define when or how a re-characterization is done is problematic. However, the most concerning issue is that there are insufficient guidance and clarification of the application, and courts never elaborate on how to interpret the GAAR's key criteria: *id est reasonable business purpose*. This makes the GAAR application very subjective.[378]

4.4.3 The Chinese GAAR in the light of legal certainty

When adopted, the GAAR was criticised for being impossible to interpret. Clear guidance on its application was found neither in the government's official publications, nor in the work of scholars.[379] It was mainly criticised due to its use of broad formulations such as "reasonable", "purpose" and subsequently, "economic substance", which gave rise to a high degree of uncertainty.[380] The criteria of a "*reasonable business purpose*" does not clarify whether the arrangement's business purpose should be "decisive" or "one of several main purposes". The vague formulations give rise to a legal

[377] Wong (2014), p. 36; Cheung (2012), p. 41; Lampreave (2013), p. 55; Ng (2015), p. 41.
[378] Cheung (2012), pp. 41, 43; Ng (2015), p. 41; Lampreave (2013), pp. 55 f.
[379] Cui (2011), p. 42; Holmes (2012), p. 114 f.; Vanistendael (2010), p. 215.
[380] Holmes (2012), p. 114; Prebble & Prebble (2010), p. 28; Cui (2011), p. 43.

interpretation and application going beyond the legal text's wording, which is criticised for making the interpretation very subjective, risking wrongful and arbitrary applications.[381] Because of the GAAR's general formulations and the absence of clarifications or restraints on the tax authorities' competence, the application provides the authorities with a wide discretion in its assessment of whether an arrangement constitutes tax avoidance.[382] The GAAR was designed as generally as possible, to provide tax authorities' with the possibility to counteract all types of avoidance arrangements through their professional judgment.[383] A problem is that the GAAR's application due to its nature requires a subjective test. This combined with the absence of independent judicial review, and the fact that any legal interpretation that no longer serves its purpose can be replaced, creates unpredictability regarding the application.[384] Problematic issues raised prior to the GAAR's enactment, which have remained unresolved, is how to distinguish between tax evasion, tax avoidance and tax planning, and whether the GAAR violates the rule of law requirements, since its application cannot be derived from its legal text.[385] With the Western rule of law notion, the assessment of whether the business purpose is reasonable should be made by the court, and not the tax administration, thus putting it under court review. In China however, it is quite uncertain how the assessment is done, and a common way of solving legal issues is through mediation with the local authorities.[386] Additionally, due to the Communist Party's influence on the tax authorities, the interpretation and application risks political influence.[387] Furthermore, since tax authorities "make adjustments using appropriate methods", and clarifying guidelines are absent, practically any method could be justified.[388] In conclusion, due to the GAAR's broad and general design, its application heavily rely on the highly subjective judgments of the authorities.[389]

[381] Vanistendael (2010), p. 215; Xiong & Evans (2014), p. 694; Holmes (2012), p. 114 f.
[382] Xiong & Evans (2014), pp. 686 f.
[383] Mingxing Cao & Li (2016), p. 187; Xiong & Evans (2014), pp. 694 f.
[384] Li (2010), p. 94; Qiu (2017), p. 90; Vanistendael (2010), p. 212.
[385] Mingxing Cao & Li (2016), p. 185.
[386] Cf. section 2.2.3.
[387] Li (2010), p. 34; Qiu (2017), p. 74; Holmes (2012), p. 105.
[388] Vanistendael (2010), p. 215; Xiong & Evans (2014), p. 695.
[389] Mingxing Cao & Li (2016), p. 187; Xiong & Evans (2014), pp. 694 f.

Furthermore, while advance rulings are since long used in Sweden and the U.S., a formal advance ruling system does not exist in China, implying a huge disadvantage for taxpayers' legal certainty.[390] However, despite the lack of such a system, a few companies selected by the SAT may get access to a somewhat similar preliminary assessment.[391] According to Art. 9 of the SAT's Large Enterprise Tax Services and Administrative Procedures[392], tax authorities shall accept tax related requests from the selected companies and provide replies similar to the "advance rulings" in the developed countries. Since these "rulings" are unavailable for most companies and their significance is unclear, they can however not currently be considered to increase taxpayers' legal certainty.[393] They could however, indicate a development in the direction towards a more certain tax system.

[390] Liu (2014), pp. 123 f.; Vanistendael (2010), p. 215.
[391] Liu (2014), pp. 123 f.
[392] On 13 July 2011, the SAT issued State Administration of Taxation Large Enterprise Tax Services and Administrative Procedures (Trial), Guo Shui Fa [2011] No. 71 ("Notice 71").
[393] In 2008, the SAT selected four private-owned enterprises and ten foreign-owned enterprises, cf. Liu (2014), pp. 124.

5 Ending and Conclusions

5.1 Answers to Research Questions

5.1.1 What significance does the legal certainty concept have within the countries?

As shown in this study, the concept of legal certainty primarily aims to protect predictability in legal matters by preventing arbitrary power exercise. It is however difficult, and perhaps impossible, to establish a complete universal definition of its requirements. The significance given to legal certainty within the countries is closely connected with, and dependant on, the meaning and status given to the rule of law-components within each country.

The legal certainty concept constitutes a central value within Swedish law and its main basis are the requirements derived from the principle of legality, and primarily the constitutionally anchored regulatory requirement. The regulatory requirement protects taxpayers from arbitrary taxation without legal support, and prevents arbitrary power exercise since the public administration must act in accordance with the law. As seen in Section 3.4.1, the principle of legality is a fundamental principle in Sweden. It is unclear whether all proposed components of the principle have legal support, but it is clear that the regulatory requirement along with the analogy prohibition have a strong position in the interpretation and application of tax law.

The wider concept of the rule of law is the basis for legal certainty in the U.S. and is highly regarded. Although the rule of law concept as a whole lacks an explicit legal basis, the concept is realised *via* constitutional doctrines developed by the judiciary in its interpretation of the Constitution. The focus on protecting individuals' rights and liberties is further achieved by the constitutional principle that all government powers are strictly bound by law. These doctrines largely reflect the same aspects that are considered to comprise the Swedish principle of legality, namely that laws cannot be too

vague and must meet a minimum level of precision to fulfil the requirement of a legal basis. Taxpayers' must be able to predict the consequences of their actions, and proportional measures must be used to achieve an objective. The *stare decisis*-doctrine means that rulings are indicative in other similar cases and therefore increases predictability. Courts can however overrule previous case law and invalidate legislation that are inconsistent with the Constitution.

China does not have a rule of law-notion as in Sweden and the U.S. The Chinese authorities can, and do, use the law as a means of control. Other values of the Chinese Constitution, such as its support for the dominating political ideologies, seem to have more influence than the Western rule of law concept. Additionally, China lacks the separation of governmental powers that is normally inherent in the rule of law concept. The lack of a separation of powers are detrimental to taxpayers' legal certainty. Several governmental organs and public authorities may create, interpret and apply legislation. Taxpayers' legal certainty largely depends on the significance currently given to the concept by the Chinese Communist Party. Legal certainty may be given significance if it increases the possibilities of achieving the Party's goals and policies. An example that has likely played a role for and increased taxpayers' legal certainty is the demands of MNEs and foreign investors to participate in the Chinese economic market, and the fact that a complete lack of legal certainty would prevent their participation. In conclusion, however, there are in contrast to Sweden and the U.S. no statutory, constitutionally or judicially anchored safety mechanisms protecting taxpayers' legal certainty.

5.1.2 What are the GAAR applications' consequences for taxpayers' legal certainty?

From a Swedish perspective, the GAAR application is problematic primarily due to its analogous effect. Mainly the fourth criterion is criticized since it provides that a transaction that results in taxation contrary to *the purpose of the legislation* should instead be taxed in accordance with the rule circumvented. Accordingly, the criterion provides for a legal interpretation going beyond an ordinary literal interpretation of the legal text, thus resulting

in an analogous tax law application. The assessment of the fourth criterion entails subjective elements and provides the courts' with discretion since there is no clear guidance on what should actually be taken into account.

A literal interpretation is, for legal certainty reasons, the starting point for Swedish tax law interpretation, and the GAARs departure implies an increased uncertainty. This could indicate that the legislature have left it to the courts to clarify and perhaps decide its application. Although it is clear that the application results in an analogous effect, most scholars seem to agree that it meets the regulatory requirement but still, due to its wide scope and vague criteria, risks a discretionary and unpredictable application that deteriorates taxpayers' legal certainty.

As shown in section 4.2.3, the courts do not elaborate on the assessment of the GAAR's first three criteria, and do not clarify under what circumstances an arrangement is contrary to the legislation. The uncertainty arising from the fourth criteria's vague and general formulation increases since courts, perhaps intentionally to let the GAAR remain general, avoid clarifying their reasoning when applying the GAAR, and since unclear differences in the circumstances of the cases appear to result in different outcomes. Although the courts exercise their discretion within the framework of the legality principle, the applications vary considerably in seemingly similar cases. Cases further appear conducted *in casu,* significantly decreasing taxpayers' predictability. Nevertheless, the judiciary is clearly bound by the legal text, which might imply a *formal* legal certainty. The GAAR application is solely based on the GAAR's and the circumvented rules' statutory basis. The Swedish judiciary apply the GAAR in a way that can be derived from the legal text of the rules circumvented. Hence, this provides for greater *formal* legal certainty, but at the same time, the *substantive* legal certainty may still be considered low.

In addition, as shown in section 4.2.4, the Swedish advance ruling system has a special significance for the GAAR's application. The advance rulings enable taxpayers to receive decisions in advance by the independent SRN, with an assessment of whether the GAAR will apply to an arrangement, and significantly increases taxpayers' legal certainty.

The U.S. GAAR comprises several judicial doctrines with the common purpose of counteracting tax avoidance. Their designs and framework are court developed, and may to the extent they have not been codified rather be understood as principles for interpretation. The doctrines' criteria and assessments are undetermined, and if it had not been for the Constitutional principle of Supreme Court rulings precedency, they would likely provide for a highly unpredictable and uncertain GAAR application. Since the Supreme Court interpret and develop legal rules that in principle are binding also for other courts, there are plenty of guidance on the judicial doctrines' applications in the form of court rulings.

The U.S. GAAR is problematic since its core, namely the economic substance doctrine and its codification, is applied in conjunction with other quite undetermined doctrines, and since the court's interpretation approaches are inconsistent and change frequently. There are plenty of case law stipulating and clarifying its application. However, the case law does not clarify its application precisely. Consequently, its design and framework, statutorily and in precedents, leaves discretion to the courts and results in different interpretations and unpredictable applications. This unpredictability prompted the mentioned codification of the doctrine, predicted to increase taxpayers' predictability and legal certainty. The case law in Section 4.3.2 however shows that the codification does not appear to have changed the GAAR application. Different approaches are still used for its application, with varying interpretations of how strictly it should be applied. The subjective and the objective prongs used for its application are the main reason; the objective prong which determines whether an arrangement is profitable other

than in respect to the tax benefits, and the subjective prong which assesses whether there was a business purpose for conducting the arrangement other than tax avoidance. In some cases both of the two prongs have been necessary for an application, and in others only one. Additionally, the assessment of these prongs are based on different factors in different rulings. The case law seems to indicate that the courts' in some cases realize that the application must be stricter in order to effectively counteract tax avoidance, and the court in its rather free interpretation acts accordingly.

Courts does not only deviate from previous case law, which may be a result of their interpretative discretion, but additionally establish new approaches and criteria for the GAAR application. This could be seen both as attempts of clarifying the application, but perhaps also as extensions of its scope. The case law imply that the application may change and vary between courts'. It appears unpredictable what approach will be used to determine whether the objective or the subjective prongs are fulfilled. Further, it should be noted that it is the courts and not the legislature that determines when the GAAR's effectiveness should prevail over taxpayers' legal certainty. This is largely due to the courts' purposive interpretation, since the GAAR application's main basis is to prevent arrangements *contrary to the purpose of the legislature*. The lack of complete codifications of the judicial doctrines may suggest that the GAAR application provides for less *formal* legal certainty, but at the same time provides the judiciary with the possibility of taking regard to ethical values, which in theory could increase taxpayers' *substantive* legal certainty. As apparent from the study however, this have led to an inconsistent application. The unpredictability arising from the application can however be remedied through taxpayers' ability to obtain advance rulings. Although the IRS issues these rulings, and not an independent party, they sufficiently increase taxpayers' legal certainty.

When it comes to the Chinese GAAR, its design, function and purpose are very similar to the GAARs of Sweden and the U.S., but it has developed within a different contextual background and legal environment. When

created, the GAAR was impossible to interpret since there were no guidance on its intended application. Like the GAARs of Sweden and the U.S., it is generally formulated with vague criteria, providing the tax authorities with a wide discretion in their application. The GAAR's criteria of *reasonable business purpose* is especially problematic since the assessment, due to the lack of guidance, leaves wide discretion to the authorities and risk being subjective. Additionally, court rulings do not constitute precedents, something which further decreases taxpayers' predictability. The lack of any independent judicial interpretation and the fact that tax authorities can provide new interpretations to change the GAAR and its application provides additional uncertainty. The GAAR application is not put under court review but remains created, interpreted and applied by the tax authorities. It is further unclear who actually determines whether the business purpose is reasonable, since legal issues are often resolved through mediation with the tax authorities. As regards the application's outcome, it is left entirely within the tax authorities' discretion to make adjustments "using appropriate methods". The Communist Party's prominent role makes the application in great risk of being politically influenced. As seen in Section 4.4.1, the GAAR's general and vague design implies a delegation, or perhaps even abdication of the legislature, to the tax authorities to decide what constitutes tax avoidance. This is especially true since it is the tax authorities and not the courts' that provide interpretations of the application with the same legal effect as law. A way to decrease the business purpose assessments subjectivity and increase legal certainty was to combine it with the assessment of economic substance, probably caused by foreign investors' demands. Although these factors to take into account somewhat limit the GAAR application, it largely remains within the tax authorities' discretion. This is also a result of a rapidly changing attitude of the Chinese government towards tax avoidance and strong influences from Western GAARs, which are operating in completely different legal cultures. The cases presented in Section 4.4.2 show the lack of transparency and insight into how the GAAR application is conducted. The Chinese tax authorities apply the GAAR without clarifying their assessment. It is impossible from these cases to interpret what business activity is required

for an arrangement to have economic substance, and there does not appear to be any assessment of the taxpayers' purpose for conducting the arrangement. It is also apparent that the influence of mediation directly affects the application since a scrutinized taxpayer can agree to a tax ruling without any judicial review, which may not be completely legitimate. Lastly, the perhaps not surprising fact that China lacks a formal advance ruling system is especially unfortunate in the context of the GAAR's application. A functional advance ruling system would greatly benefit taxpayers' legal certainty.

5.1.3 How does legal culture affect legal certainty in the application of GAARs?

The legal culture has proved significant for taxpayers' legal certainty. Factors such as respect for the rule of law, the governmental structure and control, the distribution of power and legislative as well as interpretative competence are decisive for the functioning of GAARs. Despite the similarities in design and purpose, the GAARs applications' and consequences for legal certainty in each country is, due to their legal environment, quite different. The conflict between the taxpayer's interest in, and right to, predictability and legal certainty, and the fiscal interests of the state is to some extent rooted in a political conflict. As commonly known, the U.S. is a rather individualistic country, Sweden is a country strongly based on a social democratic fundament, and China is a country based on the Marxist and Communist ideology, although taking steps towards a Western style capitalism. Interestingly enough, one can easily perceive a connection between the previous findings of this thesis and the dominant political ideology of each country respectively.

The Swedish legal culture is based on respect for individuals' legal certainty. Sweden is a parliamentary democracy with a high regard for the principle of legality and the public power emanates from the people and must be exercise in accordance with the law. The courts' are independent and protected from the government's political interests. Sweden is thus a nomocratic country, ruled by law, and the tax law interpretation is largely characterized by

concerns to legal certainty and is textual to its nature. Although Sweden has a strong rule of law basis where taxes are levied according to written law, reflecting the modern and stable democracy Sweden is, statutes are sometimes rather beneficial for the state, reflecting the social democratic ideology that permeates the Swedish society. Inherent in the Swedish GAAR application is therefore a balance between enforcing the state's fiscal interest and protecting taxpayers' legal certainty.

The U.S. legal culture rests upon a democratic government and a strong constitutional framework. The U.S. notion of the rule of law shares the fundamental and universally acknowledged aspects of the principle in the Western world, namely the necessity of power separation and the requirement of a legal basis for taxation. The separation of powers is a strong feature of the U.S. legal system, separating the legislative, executive and judicial powers. None of these have exclusive legislative competence and all three have played a role for and influenced the GAAR. The constitutional rights-based law means that constitutional law is superordinate to other laws, reflecting the individualism's protection of individuals' rights above state power. However, the U.S. approach sometimes result in different outcomes depending on the assessment in the individual case. The courts' powers are vast, which may be attributed to the power separation ideology of keeping the politically ruled government from being too powerful. The U.S. system thus evidently risks an inconsistent and unpredictable GAAR application. On the other hand, a lower conformity to the legal text in the GAAR application provides the court with a discretion that may, as seen in Section 3.3, sometimes improve taxpayers' *substantive* legal certainty. Taxpayers' legal certainty thus appear largely dependent on the significance given to it by the judiciary, whose decisions in turn are affected by the U.S. legal system and legal culture in general, and the Constitutional rights in particular. This suggests that the crucial factor for taxpayers' legal certainty in the context of GAAR application is not primarily the design and framework of the GAAR itself, but rather the U.S. legal culture and its consideration to legal certainty.

Several distinct factors affect the Chinese legal culture. The Confucian philosophy deeply influence the legal culture and emphasizes ritualism above legalism and mediation before court proceedings. Taxpayers' commonly use mediation to resolve legal issues with the tax authorities. The legal system is used as a means of control, with arbitrary applications and a wide discretion for law enforcers, thus characterized by uncertainty. The Chinese government are subordinate to the Chinese Parliament, and China lacks a separation of governmental powers. The people are represented by the Parliament, but it is the Communist Party that has the governing role. The governmental system is not democratic and the political and judicial systems closely intertwined, naturally affecting the creation, interpretation and application of the GAAR.

Furthermore, court rulings do not constitute precedents and are not binding to other courts. The role of the Chinese tax administration is therefore distinctive since it not only administers tax law, but also has an indirect legislative power and has enacted regulations with significant effect on the GAAR's application. Tax authorities may conduct GAAR investigations, apply the GAAR and adjust taxes based on a GAAR application without any involvement of the judiciary or the government. The tax authority's interpretations have the same legal effect as law, why it in practice is the tax authority that determines the GAAR's application. If a particular GAAR interpretation does not longer serve its purpose of making the application effective in counteracting tax avoidance, the tax authorities may easily replace it with a new effective interpretation. Both the government and the tax authority can accordingly create and amend the GAAR without involving the judiciary or the legislature. The significant difference to Sweden and the U.S. is therefore that although the Parliament and its standing committee shall interpret the tax law, the legislature, the courts and the tax administrations all have interpretative powers.

China is a declared dictatorship with a legal system deeply rooted in the socialistic ideal of the state's prosperity. A key aspect in this context is the impact of the political system on the legal culture as well as the whole society.

China has even before its GAAR implementation due to the allocation of interpretive authority and the, to some extent, absent rule of law, been able to apply its regulations more freely. This may suggest that specific regulations, such as SAARs, can be given new interpretations and applications without any legislative changes. Hence, the legal interpretation can change the law without the legislature's involvement. This means that a SAAR covering a particular situation may be extended to cover additional situations. This implies that a SAAR could function similar to a GAAR, however still from the starting point of a constructed typical case. This may raise the question of why China would need a GAAR. Authorities apply the law in the same way as in the U.S., and the courts apply the law in the same way as in Sweden, but the legal interpretation can be made by most state agencies. Accordingly, a large "invisible area" of regulations governs the GAAR application. This may be due to a reluctance to act with transparency, which obviously comes with the price of less predictability and legal certainty.

As further apparent from the study, China for decades accepted tax avoidance and even provided tax incentives to attract foreign investments. However, after its reformation and lesser dependency of MNEs, its policy changed to aggressively counteract tax avoidance and recover tax revenue. The application of the Chinese GAAR appear to focus on making it functional and effective, especially in an international context, rather than taking regard to taxpayers' legal certainty. This may reflect the Chinese legal culture, pursuing pragmatic solutions beneficial for the state rather than for the taxpayer, *id est* collectivism before individualism.

5.2 Concluding Remarks

This thesis have examined three GAARs in three jurisdictions with different legal systems and legal cultures. The GAARs similar but still different design and framework show close ties to the legal culture in which they developed. The applications further show that the rather similar GAARs on paper operate in different legal environments and apply quite differently. However, they all suffer from the same flaws, namely their generality and lack of legal certainty.

Moreover, the most interesting aspect of this study has proved to be the different approaches to deal with the issue of counteracting tax avoidance as well as related issues, such as generally applicable rules consequences' for legal certainty.

Common to the three GAARs is perhaps unsurprisingly that none of them has successfully managed to solve the issue of completely protecting taxpayers' legal certainty in their application. Although all three countries appear to have acknowledged the issue, they all have their separate ways of dealing – or not dealing – with the issue. The manoeuvring of taxpayers conducting business within the regimes could be characterized as a balancing act on the edge of three rather uncertain grey zones. The application of GAARs is *per se* problematic from a legal certainty perspective due to the nature of GAARs as well as of tax avoidance. Replacing the generality of a GAAR with the precision of a SAAR clearly increases predictability and taxpayers' legal certainty. However, resulting in a rather toothless regulation, since the complexity of avoidance arrangements makes SAARs incapable of effectively counteracting tax avoidance. Conclusively, it appears like generality and uncertainty goes hand in hand as a rather unavoidable combination.

The thesis shows that the main problems arising from a legal certainty perspective in the context of GAAR application remains the same in Sweden, the U.S. and China, but also that these problems may increase or decrease depending on the legal culture in which they are created, interpreted and applied. Accordingly, the opening statement of Benjamin Franklin in 1789, "*[...] in this world nothing can be said to be certain, except death and taxes*", can be considered correct in the sense that states' will *always* find ways to collect taxes, even at the expense of taxpayers' legal certainty. At the same time, from a taxpayer perspective, taxation are never completely *certain*. The author of this thesis thus remains with one question in particular; can any GAAR ever resolve the conflict between the efficiency of the state's fiscal interest and taxpayers' legal certainty?

Supplement A – The Swedish GAAR

Lag (1995:575) mot skatteflykt

1 § Denna lag gäller vid fastställande av underlag för att ta ut kommunal och statlig inkomstskatt. Lag (2011:1372).

2 § Vid fastställandet av underlag ska hänsyn inte tas till en rättshandling, om
1. rättshandlingen, ensam eller tillsammans med annan rättshandling, ingår i ett förfarande som medför en väsentlig skatteförmån för den skattskyldige,
2. den skattskyldige direkt eller indirekt medverkat i rättshandlingen eller rättshandlingarna,
3. skatteförmånen med hänsyn till omständigheterna kan antas ha utgjort det övervägande skälet för förfarandet, och
4. ett fastställande av underlag på grundval av förfarandet skulle strida mot lagstiftningens syfte som det framgår av skattebestämmelsernas allmänna utformning och de bestämmelser som är direkt tillämpliga eller har kringgåtts genom förfarandet. Lag (2011:1372).

3 § Om 2 § tillämpas ska beslut om fastställande av underlag fattas som om rättshandlingen inte hade företagits. Framstår förfarandet med hänsyn till det ekonomiska resultatet - bortsett från skatteförmånen - som en omväg i förhållande till det närmast till hands liggande förfarandet, ska beslutet i stället fattas som om den skattskyldige hade valt det förfarandet. Om de nu angivna grunderna för beslutet om fastställande av underlag inte kan tillämpas eller skulle leda till oskäligt resultat, ska underlaget för att ta ut skatt uppskattas till skäligt belopp. Lag (2011:1372).

4 § Fråga om tillämpning av denna lag prövas av förvaltningsrätten efter framställning av Skatteverket. I fråga om handläggning av framställning om tillämpning av lagen och i fråga om överklagande av beslut med anledning av sådan framställning gäller i tillämpliga delar bestämmelserna i 67 kap. skatteförfarandelagen (2011:1244).

Framställning enligt första stycket får göras före utgången av de frister som enligt 66 kap. 27, 29-34 §§ skatteförfarandelagen gäller för beslut om efterbeskattning. Lag (2011:1372).

Supplement B – The U.S. GAAR

U.S. Code: Title 26 - I.R.C. Section 7701(o) Clarification of economic substance doctrine

(1) Application of doctrine
In the case of any transaction to which the economic substance doctrine is relevant, such transaction shall be treated as having economic substance only if—
(A) the transaction changes in a meaningful way (apart from Federal income tax effects) the taxpayer's economic position, and
(B) the taxpayer has a substantial purpose (apart from Federal income tax effects) for entering into such transaction.

(2) Special rule where taxpayer relies on profit potential
(A) In general
The potential for profit of a transaction shall be taken into account in determining whether the requirements of subparagraphs (A) and (B) of paragraph (1) are met with respect to the transaction only if the present value of the reasonably expected pre-tax profit from the transaction is substantial in relation to the present value of the expected net tax benefits that would be allowed if the transaction were respected.
(B) Treatment of fees and foreign taxes
Fees and other transaction expenses shall be taken into account as expenses in determining pre-tax profit under subparagraph (A). The Secretary shall issue regulations requiring foreign taxes to be treated as expenses in determining pre-tax profit in appropriate cases.

(3) State and local tax benefits
For purposes of paragraph (1), any State or local income tax effect which is related to a Federal income tax effect shall be treated in the same manner as a Federal income tax effect.

(4) Financial accounting benefits
For purposes of paragraph (1)(B), achieving a financial accounting benefit shall not be taken into account as a purpose for entering into a transaction if the origin of such financial accounting benefit is a reduction of Federal income tax.

(5) Definitions and special rules
For purposes of this subsection—
(A) Economic substance doctrine
The term "economic substance doctrine" means the common law doctrine under which tax benefits under subtitle A with

respect to a transaction are not allowable if the transaction does not have economic substance or lacks a business purpose.

(B) Exception for personal transactions of individuals
In the case of an individual, paragraph (1) shall apply only to transactions entered into in connection with a trade or business or an activity engaged in for the production of income.

(C) Determination of application of doctrine not affected
The determination of whether the economic substance doctrine is relevant to a transaction shall be made in the same manner as if this subsection had never been enacted.

(D) Transaction
The term "transaction" includes a series of transactions.

Supplement C – The Chinese GAAR

中华人民共和国企业所得税法 [已被修订]

第四十七条　企业实施其他不具有合理商业目的的安排而减少其应纳税收入或者所得额的，税务机关有权按照合理方法调整。

Enterprise Income Tax Law of the People's Republic of China [Revised]

Article 47 In case an enterprise makes any other arrangement not for any reasonable commercial purpose, which causes the decrease of its taxable revenue or income, the tax organ may, through a reasonable method, make an adjustment.

Supplement D – The EU GAAR

Council Directive (EU) 2016/1164 of 12 July 2016 laying down rules against tax avoidance practices that directly affect the functioning of the internal market.

Article 6

General anti-abuse rule

1. For the purposes of calculating the corporate tax liability, a Member State shall ignore an arrangement or a series of arrangements which, having been put into place for the main purpose or one of the main purposes of obtaining a tax advantage that defeats the object or purpose of the applicable tax law, are not genuine having regard to all relevant facts and circumstances. An arrangement may comprise more than one step or part.

2. For the purposes of paragraph 1, an arrangement or a series thereof shall be regarded as non-genuine to the extent that they are not put into place for valid commercial reasons which reflect economic reality.

3. Where arrangements or a series thereof are ignored in accordance with paragraph 1, the tax liability shall be calculated in accordance with national law.

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