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**To What Extent is the Prohibition of Abuse of Law
Consistent with the Legal Certainty In VAT?**

by

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HARN60 Master Thesis

Master's Programme in European and International Tax Law

2017/2018

1 June 2018

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Summary

For more than 40 years the case-law of the European Court of Justice has been developing the principle of prohibition of abuse of law in the European Union. However, in the sphere of value-added tax, the principle was invoked by the Court for the first time in 2006 in the landmark case *Halifax*, creating a tension between this emerging principle and the principle of legal certainty observed and protected by the Union and all its Member States. Despite the tension between these principles, the abuse of law is justified by the necessity to procure a rational and congruent outcome where the law is applied to the transactions carried out by the economic operators.

Nevertheless, the European Court of Justice has been inconsistent developing the principle of abuse of law. As a result, the difficulty in the already challenging application of the principle by the national courts has been increased and the outcome is even less predictable. Therefore, economic operators are uncertain whether their tax schemes will be considered abusive by the national courts, restricting thus, the necessary advance planning of their economic activities in order to reduce costs and increase the efficiency of their businesses.

National courts are struggling to assess the abuse following the current guideline provided by the Court of Justice of the European Union, making almost unreachable the uniform application of the principle in the courts across the Member States.

Preface

In the years practicing tax law outside the EU, I was not aware of the principle of abuse of law in that field according to the case-law of the European Court of Justice, for that reason I developed a great interest in studying and understanding this “new principle”. Its application particularly raised my attention for the effect on the well-known principle of legal certainty. This thesis is the culmination of my research and personal journey in this fascinating area of EU law.

Being part of the Master’s Programme in European and International tax law in Lund University has been an intellectual, cultural and overall enriching experience.

I would like to thank all my professors and lecturers throughout the academic year for sharing their knowledge with discipline and excellence; also my classmates for their valuable insight on the different topics that we discussed in class.

Additionally I would like to thank Oskar for giving me the opportunity to be part of this programme and sharing his passion for VAT with me. Thanks to my family and friends for their unconditional support and last but not least, to my better half for being omnipresent in my daily life despite of thousands of kilometres that unsuccessfully tried to keep us apart.

Abbreviation list

AG	Advocate General
CJEU	Court of Justice of the European Union
EU	European Union
MS	Member State
Sixth Directive	Sixth Council Directive 77/388/EEC
TFEU	Treaty on the Functioning of the European Union
UK	United Kingdom
VAT	Value-added tax
VAT Directive	Council Directive 2006/112/EC

1. Introduction

1.1 Background

Taxes must be established in the law and the economic operators should be able to predict the legal consequences of their behavior in order to adjust the transactions carried out in their economic activities to achieve the highest profit, taking into consideration the economic impact that taxes imply for their businesses. However, national courts, applying the unwritten principle of abuse of law, are able to disregard transactions that comply with the formal requirements of the law, under the premise that those transactions constitute an abusive practice. Thus, disregarding the legal consequences of those law-abiding transactions in favor of a principle not established in primary or secondary European Union (EU) law.

The general principle of legal certainty arises from the rule of law¹ and any possible diminishment to this principle causes serious concerns. Accordingly, the principle of abuse of law has raised these concerns in EU due to its overlapping with the legal certainty, being subject to intense debate among scholars and practitioners, which are divided in their opinions regarding the multiple aspects and implications that the application of the principle of abuse of law has over the legal certainty and the legal framework of the EU and the Member States (MS). Even the assertion of whether the abuse of law is a general principle has been discussed over the years². Furthermore, it has been very difficult even to reach a consensus about how this unwritten source of law should be addressed: ‘misuse of law’³, ‘abuse of rights’⁴, ‘abuse of law’⁵ or ‘principle of prohibiting abusive practices’⁶, leading to a terminological discrepancy⁷.

The difficulty that entails the practical application of the principle of abuse of law and its possible negative implications on the legal certainty is one of the reasons that keep the concept of abuse being a controversial topic⁸.

¹ Terra, Ben J.M. & Kajus, Julie - *Introduction to European VAT (Recast), Commentaries*

² De la Feria, Rita & Vogenauer, Stefan "Preface" In De la Feria, Rita & Vogenauer, Stefan - *Prohibition of Abuse of Law: A New General Principle of EU Law?* London: Hart Publishing, 2011, p.v.

³ Opinion of AG Kokott in Case C-321/05 *Kofoed* ECLI:EU:C:2007:86, para.67.

⁴ Case C-255/02 *Halifax and Others* ECLI:EU:C:2006:121, paras.37, 41; Case C-653/11 *Newey* ECLI:EU:C:2013:409, para.30; Case C-251/16 *Cussens and others* ECLI:EU:C:2017:881, para.24.

⁵ Opinion of AG Bobek in Case C-251/16 *Cussens and others* ECLI:EU:C:2017:648, para.31.

⁶ Case C-255/02 *Halifax and Others* ECLI:EU:C:2006:121, para.70.

⁷ Vogenauer, Stefan. "The Prohibition of Abuse of Law: An Emerging General Principle of EU Law" In De la Feria, Rita & Vogenauer, Stefan - *Prohibition of Abuse of Law: A New General Principle of EU Law?* London: Hart Publishing, 2011, p. 524.

⁸ Maduro, Poaires "Foreword" In De la Feria, Rita & Vogenauer, Stefan - *Prohibition of Abuse of Law: A New General Principle of EU Law?* London: Hart Publishing, 2011, p.viii.

Therefore, the existing tension between the two principles is undeniable⁹; as well as the serious consequences that encompasses the application of the principle of abuse of law in the EU legal system and the effects on the taxable persons.

1.2 Aim

The purpose of this thesis is to establish whether the principle of abuse of law, as it has been developed by Court of Justice of the European Union (CJEU) in the sphere of Value-added tax (VAT), is consistent with the principle of legal certainty; whether the application of the doctrine prohibiting abusive practices in VAT cases is justified and to what extent it is not contrary to the values embraced by EU law and the national legislation of the MS.

The taxable persons should be aware on why and how the principle of abuse of law is applied in VAT cases due to its consequences on limiting their right to foresee the outcome derived from the direct application of the law that regulates their economic activities. Therefore, it is of great importance to define what kind of behavior is considered abusive and the effects that the finding of an abusive practice entails for the economic operators and their right to organize their economic transactions in the most favorable way, considering also the impact that VAT may have on their undertakings.

1.3 Method and material

The method adopted in order to reach a satisfactory conclusion on this topic is the legal-dogmatic research method, being the outcome supported by the critical analysis of the law as it positively stands¹⁰.

Primary and secondary EU law will be taken into account in the progress of the topic; doctrinal articles, literature and opinions from practitioners and scholars will also be considered to provide support or different points of view on the issues discussed. United Kingdom (UK) case-law will provide an empirical approach to the topic from the perspective of national courts in a MS.

The CJEU case-law is fundamental to accomplish the aim of this work since the principle of prohibition of abusive practices in the EU has been developed by the CJEU. The opinion delivered by the Advocate General (AG) in the most relevant cases will be studied. In spite of their lack of binding effect on the CJEU judgments, such opinions provide an in-depth analysis on the issues to be decided by the CJEU and also provide a

⁹ Opinion of AG Bobek in Case C-251/16 *Cussens and others* ECLI:EU:C:2017:648, para.80.

¹⁰ Douma, Sjoerd - *Legal research in International and EU tax law*. Deventer: Kluwer, 2014, p.17.

contrasting approach to the case in question when the CJEU did not follow that opinion.

1.4 Delimitation

The concept and notion of the principle of prohibition of abusive practices in EU is very broad and complex, its application in different fields of EU law has a distinctive origin in the CJEU jurisprudence. Moreover, due to the diverse legal nature in each field of EU law, the requirements to fulfill on the assessment of the abusive practice may vary.

This thesis will be focused on the relevant aspects of the principle of abuse of law in the sphere of VAT with special emphasis on the issues that may arise regarding the principle of abuse of law in contrast with the principle of legal certainty. Therefore, case-law in other areas of EU tax law, including direct taxation, will not be analyzed in depth.

The principle of abuse of law will be tested only against the principle of legal certainty and the protection of legitimate expectations as a principle closely connected with the former one. Hence, the possible impact of the principle of abuse of law on other principles of EU law, like fiscal neutrality and proportionality, will not be discussed in detail. That subject, therefore, is proposed to be analyzed in a further research.

1.5 Outline

The first part of this work will focus on the principle of legal certainty, its close connection with the protection of legitimate expectations and the relevance of these general principles of EU law in the sphere of VAT as it is acknowledged by the CJEU in its case-law.

The second part will deal with the principle of abuse of law, its origin in EU law and its development by the CJEU throughout the years to have an understanding of the principle as it stands now according to the VAT cases, always considering the impact that the case-law has on the topic in question.

The third part will present the reasons, whether the application of the principle of abuse of law is justified even if this means that the principle of legal certainty is undermined in the process.

The fourth part will analyze the effects of the application of the principle of abuse of law by the national courts of the MS in regards of the legal certainty recognized and protected by EU law, addressing the difficulties inherent to the assessment of the abusive practice.

2. Legal Certainty

Legal certainty is a general principle derived from the rule of law, primarily applicable to the relationship between the authorities and individuals¹¹ in order to protect the latter from an act of the former infringing the rule of law¹². In essence, it is a principle of public law¹³ located in the hierarchy of norms in a place below the constituent Treaties and above the legislative, delegated and implementing acts. Moreover, it can be invoked as a ground to invalidate arbitrary acts in contravention of this general principle, being useful also to interpret acts or Articles in the Treaty¹⁴. To understand the precise content of legal certainty is very difficult due to its ‘nature diffuse’¹⁵. However, some of its constitutive elements have been studied over the years from a theoretical point of view¹⁶, leading to a better understanding of its concept as it is acknowledged by the bodies of the EU, including the CJEU.

Accordingly, the CJEU recognized several general principles of Community law, including legal certainty and the principle of protection of legitimate expectations as having a constitutional status that made them binding for the Community institutions and binding for MS as well¹⁷. Initially the general principles of law were used to cover lacunas or gaps in the Treaty and laws of the Community. However, with the development of the Community legal order these principles have become necessary to its functioning¹⁸.

In that regard, developed legal systems must provide grounds of judicial review within a framework in which the courts exercise their powers. The principles of legal certainty and protection of legitimate expectations play a fundamental role in that area of judicial review under Articles 263 and 267 TFEU¹⁹. Additionally, the effective and efficient judicial review provides the necessary guarantee to protect the observance of the legal certainty against vague general clauses in administrative law²⁰.

¹¹ Tridimas, Takis - *The general principles of EU law*. Oxford: Oxford University Press, 1999, p.3.

¹² Ibid, p.5.

¹³ Terra, Ben J.M. & Kajus, Julie, *supra* n.1, at p.28.

¹⁴ Craig, Paul & De Búrca, Gráinne - *EU law: text, cases, and materials*. Oxford: Oxford University Press, 2011, p.109.

¹⁵ Tridimas, Takis, *supra* n.11, at p.164.

¹⁶ Raitio, Juha – “*Legal Certainty, Non-Retroactivity and Periods of Limitation in EU Law*” – *Legisprudence* Vol. II, N° 1, 2008, p.1.

¹⁷ Tridimas, Takis, *supra* n.11, at p.4.

¹⁸ Ibid, p.8.

¹⁹ Craig, Paul & De Búrca, Gráinne. *supra* n.14, at p.109.

²⁰ Raitio, Juha, *supra* n.16, at p.8.

The CJEU has emphasized that legal certainty and the protection of legitimate expectations requires consequences from the Community legislation which must be clear and predictable for those who are subject to it, precluding that those effects take place from a point of time before its publication. Only exceptionally this prerequisite can be accepted where the objective to be attained requires it, as far as the legitimate expectations of those concerned are appropriately observed²¹. Legal certainty thereby requires that Community law remains foreseeable²².

The great significance of the principle of legal certainty in the legal order is undeniable. It is a principle that can be seen as the reflection of the most basic social value which encompasses the protection against arbitrary interferences²³. Moreover, it can be regarded as one of the most important legal values²⁴.

2.1 Protection of legitimate expectations

The legal certainty and the protection of legitimate expectations are closely linked concepts present in many legal systems²⁵. The CJEU refers to the principle of protection of legitimate expectations as the corollary of the principle of legal certainty²⁶. However, a significant distinction can be pointed out regarding time factor, due to the requirement that imposes the principle of legitimate expectations on the authorities concerning the exercise of their powers in a frame of time that guarantees the foreseeability of the situations and consequences originated by direct application of Community law.

On the other hand, the legal certainty has a static character that can be distinguished as a rule of interpretation whereas from the legitimate expectations may arise substantive rights²⁷. As a result, the protection of legitimate expectations is particularly invoked where the laws are retroactively applied, causing the breach of the legitimate expectations previously attained and subsequently frustrated by the Community or any of its institutions²⁸.

²¹ Joined Cases C-212 to 17/80 *Salumi* ECLI:EU:C:1981:270, para.10.

²² Case C-63/93 *Duff and Others* ECLI:EU:C:1996:51, para.20.

²³ Gribnau, Hans – “Equality, Legal Certainty and Tax Legislation in the Netherlands. *Fundamental Legal Principles as Checks on Legislative Power: A Case Study*” - Utrecht Law Review Volume 9, Issue 2, 2013, p.53.

²⁴ *Ibid*, p.69.

²⁵ Craig, Paul & De Búrca, Gráinne, *supra* n.14, at p.533.

²⁶ Case C-63/93 *Duff and Others* ECLI:EU:C:1996:51, para.20.

²⁷ Tridimas, Takis, *supra* n.11, at p.170.

²⁸ *Ibid*, p.169.

In addition, the protection of the legitimate expectation entails the safeguard of those who act in good faith following the rule of law. Accordingly, they should not be punished with the arbitrary disregard of their expectations²⁹. However, as a limitation to the principle of the protection of legitimate expectation, the CJEU held that an economic operator cannot invoke that principle against his supplier to claim a right to deduct³⁰.

2.2 Relevance on the functioning of VAT

The principles of legal certainty and the protection of legitimate expectations have an increased significance in the area of indirect taxation that has been systematically integrated and harmonized (i.e. custom duties and VAT)³¹. These principles acquire more relevance particularly in economic law, which is based on the advance planning necessary to reduce the expenses on the transactions carried out, improving the efficiency of the economic activities significantly, hence having a direct impact on the production of adequate economic results³². Furthermore, in relation to the directives, legal certainty reinforces the binding character of Community law having as primary goal that national rules give to all the persons concerned a clear and precise understanding of their rights and obligations, enabling national courts to protect them³³.

The CJEU has been clear and precise when it established as one of the objectives of the common VAT system in EU to ensure the legal certainty³⁴. Moreover, it is settled case-law that the principles of protection of legitimate expectations and legal certainty can be described as being part of the Community legal order and must be respected by the institutions of the Community and MS³⁵. Therefore, in the legal framework of the common system of VAT, national tax authorities are compelled to observe the principle of protection of legitimate expectations³⁶.

Regarding the effect of the legal certainty on anti-abuse provisions of the VAT Directive, is important to point out that among these provisions, Article 131 concedes discretionary power to the MS to lay down the conditions for the application of the VAT exemptions ensuring the correct

²⁹ Raitio, Juha, *supra* n.16, at p.3.

³⁰ Case C-628/16 *Kreuzmayr* ECLI:EU:C:2018:84, para.47.

³¹ Weber, Dennis & Sirithaporn, Thidaporn “*Legal Certainty, Legitimate Expectations, Legislative Drafting, Harmonization and Legal Enforcement in EU Tax Law*” In Brokelind Cécile *Principles of Law: Function, Status and Impact in EU Tax Law*, IBDF, 2014, p.241.

³² Tridimas, Takis, *supra* n.11, at p.163.

³³ *Ibid*, p.165.

³⁴ Case C-108/99 *Cantor Fitzgerald International* ECLI:EU:C:2001:526, para.33.

³⁵ Joined Cases C-181/04 to C-183/04 *Elmeka* ECLI:EU:C:2006:563, para.31.

³⁶ *Ibid*, para.36.

and straightforward application of those exemptions and to prevent any possible evasion, avoidance or abuse. Notwithstanding this discretionary power of the MS, the CJEU stressed that when exercising their powers, MS must comply with the general principles of law which form part of the legal order of the EU, particularly including, the principles of legal certainty and proportionality³⁷.

The CJEU in its jurisprudence has been consistent on the protection of the legal certainty in the common VAT system due to the financial implications that the rules are liable to encompass, in which case, the legal certainty must be strictly observed³⁸.

³⁷ See, Case C-84/09 *X v. Skatteverket* ECLI:EU:C:2010:693, para.35; Case C-285/09 *Criminal proceedings against R* ECLI:EU:C:2010:742, paras.44-45.

³⁸ Case C-29/08 *SKF* ECLI:EU:C:2009:665, para.77.

3. Abuse of law

The EU legislation has not been instrumental in the development of the principle of abuse of law³⁹. Notwithstanding the implementation of a provision in the Charter of Fundamental Rights of the European Union which explicitly prohibits the abuse of rights aimed to undermine or limit the rights and freedoms derived from it⁴⁰. The principle prohibiting abusive practices in the EU has its source in the case-law of the CJEU, it is therefore indispensable to study the origin of the principle in EU law by analyzing the most relevant decisions in the sphere of VAT to understand the principle of abuse of law as it is applied in that field of tax law.

3.1 Origin of the principle in EU law

The first step of the CJEU on the development of the doctrine of abuse in EU law was *Van Binsbergen*⁴¹, decided in 1974. The case involved a Dutch lawyer who was acting as a legal representative of his client in the Netherlands. Nevertheless, in the course of the proceedings he transferred his residence from the Netherlands to Belgium, losing his capacity as a legal representative in the light *inter alia* of a Dutch provision implementing that only persons established in the Netherlands may act as legal representatives in courts⁴². The Dutch lawyer invoked provisions of the Treaty related to the freedom to provide services within the Community, leaving to the CJEU the interpretation of those Treaty provisions that forbids hindering such freedom with the requirement imposed by the national provision in question.

Accordingly, the CJEU decided that a MS has the right to take measures preventing the exercise of a service performed in its territory even if the service provider uses the Treaty provision related to the freedom of service with the purpose of avoiding the professional rules of conduct which would also be applicable if the provider of the service was established within that state⁴³.

It follows from the interpretation of the CJEU that, the Treaty provisions were being used with a different purpose as they were intended, only to circumvent the settled requirements to exercise a professional activity according to the national law. As a remedy for this situation, the CJEU granted the right to the MS to disallow such abusive practice. It is important

³⁹ Vogenauer, Stefan, *supra* n.7, at pp.522.

⁴⁰ *See*, Art.54, Charter of Fundamental Rights of the European Union (2000/C 364/01).

⁴¹ Case C-33/74 *Van Binsbergen* ECLI:EU:C:1974:131.

⁴² *Ibid*, para.4.

⁴³ *Ibid*, para.13.

to highlight that in the entire ruling, the word “abuse” is never mentioned, although, it is implied by the outcome of the decision.

This judgment raised questions regarding the application of those measures by the MS in order to prevent abusive behavior; the possibility to apply similar measures in any type of national rules and in diverse legal areas. It also raised questions in regards whether the intention of avoiding national rules or the achievement of a specific outcome with prejudice for third parties was the most important element in this conduct to identify⁴⁴.

Van Binsbergen marked the beginning in the development of a new principle of EU law. Nevertheless, it also started the debate about its consistency with the principle of legal certainty.

In the subsequent years, the new doctrine implemented by the CJEU proved to be very useful, especially in cases regarding abuse of the freedom of establishment⁴⁵, free movement of goods⁴⁶, free movement of workers⁴⁷ and freedom to provide services⁴⁸, where the CJEU highlighted the impossibility to disregard the legitimate interest of the MS by the application of provisions of the Treaty to wrongly avoid or circumvent the application of the national legislation. Moreover, MS are entitled to the right to prevent certain abuses committed with the sole aim or purpose to enjoy a situation or evade an obligation derived from the national legislation, adding that such abuses are not covered by the Community provisions.

3.2 Emsland-Stärke

*Emsland-Stärke*⁴⁹ was of great significance for shaping the principle of prohibition of abusive practices. For the first time the CJEU implemented a test to assess the existence of abuse in a behavior contrary to the purpose of EU law, for which it established a set of specific rules⁵⁰.

The case was in the area of common agriculture levy policies involving the German company Emsland-Stärke which exported products based on potato starch from Germany to Switzerland. The recipients of the goods were

⁴⁴ Cerioni, Luca – “The “Abuse of Rights” in EU Company Law and EU Tax Law: A Re-reading of The ECJ Case Law and the Quest for a Unitary Notion” - European Business Law Review, Vol. 21, Issue 6, 2010, p.785.

⁴⁵ Case C-115/78 *Knoors* ECLI:EU:C:1979:31, paras.20-25.

⁴⁶ Case C-229/83 *Leclerc v. Au ble vert* ECLI:EU:C:1985:1, para.27.

⁴⁷ Case C-39/86 *Lair v. Universitat Hannover* ECLI:EU:C:1988:322, para.43.

⁴⁸ Case C-148/91 *Veronica* ECLI:EU:C:1993:45, para.12.

⁴⁹ Case C-110/99 *Emsland-Stärke* ECLI:EU:C:2000:695.

⁵⁰ De la Feria, Rita – “Prohibition of Abuse of (Community) Law: The Creation of A New General Principle of EC Law Through Tax” - Common Market Law Review 45, 2008, p.410.

companies established in the same address and, managed and represented by the same persons. Emsland-Stärke was granted an export refund by the German authorities⁵¹. Nevertheless, after the release of the goods in Switzerland the consignments were transported back to Germany and also to Italy in the same means of transportation and without any transformation or alteration. Therefore the German authorities revoked the export refunds and demanded its repayment⁵².

The Commission pointed out the existence of the general principle of abuse of rights in the Community legal order applicable where conditions are artificially created to obtain an advantage contrary to the purpose of the Community law, having as a result the withdrawal of that advantage. Moreover, the Commission also claimed the existence of this principle in almost all MS and its previous application by the CJEU case-law despite the fact that the existence of such principle was never explicitly recognized before by the CJEU⁵³.

The CJEU stressed that all the formal requirements for the grant of the exports refunds were fulfilled according to the Community law. However, the scope of Community regulations cannot be extended to cover abuses with the sole purpose of the attainment of the export refunds. Consequently, the CJEU proceed to establish the requirements to find the abuse with the verification of two elements:

- “objective circumstances in which, despite formal observance of the conditions laid down by the Community rules, the purpose of those rules has not been achieved”⁵⁴.
- “a subjective element consisting in the intention to obtain an advantage from the Community rules by artificially creating the conditions laid down to obtain it”⁵⁵.

Regarding the principle of legal certainty, one of the arguments of Emsland-Stärke was that the repayment of the export refund would breach the principle of lawfulness since “the general principle of abuse of rights does not constitute a clear and unambiguous legal basis for the adoption of such a measure”⁵⁶. However, the CJEU replied that where the two elements of abuse are established, the principle of lawfulness would not be breached. Furthermore, the CJEU stressed that the obligation to repay is the consequence of the finding of the situation artificially created to obtain the

⁵¹ Case C-110/99 *Emsland-Stärke* ECLI:EU:C:2000:695, para.7.

⁵² *Ibid*, paras. 9,12.

⁵³ *Ibid*, paras. 37,38.

⁵⁴ *Ibid* para 52

⁵⁵ *Ibid* para 53

⁵⁶ *Ibid* para 24

benefit. Hence when not imposing a penalty, the measure does not need a clear and unambiguous legal basis⁵⁷.

The CJEU pointed out an important distinction. On the one hand, to comply with the requirement of a clear and unambiguous legal basis consistent with the legal certainty where the measure adopted by the MS entails a penalty. On the other hand, where the measure adopted by the MS is only the re-establishment of the situation in the absence of the abusive behavior there is no need to fulfill such requirement. It follows that, the principle of legal certainty is not breached as far as the outcome of the measure adopted by the MS in the application of the principle of prohibition of abusive practices does not encompass a penalty or a measure that goes beyond the simple re-establishment of the situation⁵⁸.

Emsland-Stärke reinforced the concept of the abuse of law principle in EU law with the introduction of the criteria to find the abusive practice by the CJEU. Furthermore, it raised the question whether this principle could only be used in the levy policy of the agricultural area or whether it could be used in other areas of taxation⁵⁹. Accordingly, this case could be considered as a significant advance to the acknowledgement of the prohibition of abusive practices as a general principle of EU law⁶⁰.

3.3 Halifax

Emsland-Stärke judgment settled the foundations on which the CJEU would extend the application of its criteria in order to find abusive practices in the sphere of VAT. Finally on February 2006, the CJEU applied, for the first time, the principle of prohibition of abusive practices in VAT. *Halifax*, was not only an important case regarding the pertinence of the principle in the sphere of VAT, but it was of great significance in the overall evolution of the concept of abuse as a principle of EU law⁶¹. Moreover, *Halifax* was decided months before the landmark case *Cadbury Schweppes*⁶² in which

⁵⁷ Ibid para 56

⁵⁸ Hettne, Jörgen – “European Legal Principles and National Legal Challenges” - In Brokelind, Cécile - *Principles of Law: Function, Status and Impact in EU Tax Law*, IBDF 2014, p.26.

⁵⁹ Lenaerts, Koen – “The Concept Of ‘Abuse Of Law’ In The Case Law Of The European Court Of Justice On Direct Taxation”- Maastricht Journal of European and Comparative Law, Vol. 22, issue: 3, 2015, p.333.

⁶⁰ Lenaerts, Annekatrinen – “The General Principle of the Prohibition of Abuse of Rights: A Critical Position on Its Role in a Codified European Contract Law” - European Review of Private Law 6, 2010, p.1135.

⁶¹ De la Feria, Rita, *supra* n.50, at p.423.

⁶² Case C-196/04 *Cadbury Schweppes* ECLI:EU:C:2006:544.

the CJEU developed the application criteria of the principle regarding direct taxation, referring to the *Halifax* judgment⁶³.

The facts of the case affected the British banking company Halifax, which required the construction of call centers at four different locations in UK for business purposes. The greatest proportion of the services provided by Halifax was exempt of VAT. Therefore, due to the application of the proportional deduction rules of the Sixth Directive⁶⁴, Halifax was only able to recover less than five percent of its input VAT⁶⁵.

Halifax designed a complex scheme⁶⁶ involving three fully owned subsidiaries with which it signed a number of agreements, including loans, leases, development and funding agreements. After those agreements were concluded, one of the subsidiaries of Halifax entered into agreements with arm's length builders for the construction of the call centers in each one of the sites. The successful achievement of these arrangements would result in Halifax being able to fully recover the input VAT for the construction and development of the call centers by the arm's length builders, rather than the recovery of the proportional five percent⁶⁷.

The tax authorities refused the deduction claims made by the subsidiaries, considering that those transactions between the subsidiaries and the arm's length builders did not fall under the scope of VAT. Moreover, the tax authorities stressed that only Halifax had the right to claim the deduction for those transactions, applying its normal recovery percentage. Halifax and its subsidiaries appealed the decision alleging that all the transactions made under the arrangement were genuine and also reported profits for the parties involved, despite the recognition that the scheme was structured in order to procure a tax benefit regarding VAT. The tax authorities considered firstly, that the transactions in question had the sole purpose of VAT avoidance, thus, it cannot be considered neither a supply nor a preparatory act to engage in an economic activity and secondly, that according to the principle preventing abuse of rights, those transactions should be disregarded⁶⁸.

The national court dismissed the appeal without any consideration on abuse of rights. Nevertheless, the VAT and Duties Tribunal in London, after Halifax and its subsidiaries appealed, raised questions for a preliminary ruling to the CJEU regarding the interpretation of the abuse of rights

⁶³ Ibid, para. 64.

⁶⁴ The calculation of the proportional deduction in the Sixth Directive is in Art.19. In the VAT Directive, the proportional deduction rules are in Art. 173, 174 and 175.

⁶⁵ Case C-255/02 *Halifax and Others* ECLI:EU:C:2006:121, para.12.

⁶⁶ See, Halifax VAT scheme in Annex I.

⁶⁷ Case C-255/02 *Halifax and Others* ECLI:EU:C:2006:121, para.30.

⁶⁸ Ibid, paras.33, 35, 37.

principle, since the evidence in the case showed that the sole purpose of the artificial scheme was to avoid VAT⁶⁹.

The CJEU first stressed the uniform definition of taxable transactions in the common VAT system established by the Sixth Directive and then proceeded to the interpretation of the Articles of the Sixth Directive concerning taxable person⁷⁰, supply of goods⁷¹, supply of services⁷² and the economic activity⁷³, concluding that the last three terms are objective in nature and should be applied disregarding the purpose or result of the transaction. Hence the objective criterion is satisfied even when the transaction is carried out for the sole purpose of procuring a tax advantage. However, the CJEU made a clear distinction with tax evasion by using false tax returns or improper invoices in which cases the objective criteria, established in the Sixth Directive, would not be satisfied. To reach that conclusion, the CJEU referred to the *BLP Group* judgment where it held that it would be contrary to the objectives of the common VAT system of ensuring legal certainty to impose an obligation for the tax authorities to perform inquiries in order to determine the intentions of the taxable person.⁷⁴

Regarding the abuse of rights, the CJEU highlighted that Community law cannot be relied on for abusive ends⁷⁵. Moreover, Community law cannot cover transactions performed out of the context of normal commercial operations with the sole purpose of wrongfully obtaining advantages provided by Community law⁷⁶. Therefore, in the sphere of VAT also applies the principle of prohibiting abusive practices as preventing abuse, avoidance and evasion is an objective of the Sixth Directive.

The CJEU, immediately after that conclusion, stressed the issue that encompasses the application of the principle of prohibition of abusive practices regarding legal certainty, which must be strictly observed when the rules entail financial consequences. Furthermore, the CJEU acknowledged the right of taxable persons to choose a business structure to mitigate their tax liability and highlighted the lack of a legal provision in the Sixth Directive imposing the requirement to choose, between two transactions, the one with the higher VAT amount where the Directive leaves open such freedom of choice to the economic operators⁷⁷.

⁶⁹ Ibid, para.42.

⁷⁰ Sixth Directive, Art.4(1)

⁷¹ Sixth Directive, Art.5(1)

⁷² Sixth Directive, Art.6(1)

⁷³ Sixth Directive, Art.4(2)

⁷⁴ Case C-4/94 *BLP Group* ECLI:EU:C:1995:107, para.24.

⁷⁵ Case C-367/96 *Kefalas and Others* ECLI:EU:C:1998:222, para.20.

⁷⁶ Case C-255/02 *Halifax and Others* ECLI:EU:C:2006:121, para.69.

⁷⁷ Ibid, paras.72-73.

After these considerations, the CJEU proceeded to settle two concurring requirements which must be fulfilled in order to find the existence of an abusive practice in the sphere of VAT:

- “the transactions concerned, notwithstanding formal application of the conditions laid down by the relevant provisions of the Sixth Directive and the national legislation transposing it, result in the accrual of a tax advantage the grant of which would be contrary to the purpose of those provisions”⁷⁸
- “it must also be apparent from a number of objective factors that the essential aim of the transactions concerned is to obtain a tax advantage”⁷⁹

The national courts must assess the existence of an abusive practice attending to national rules of evidence and the effectiveness of Community law. The CJEU provided guidance in the verification of the two limbs of the test. Firstly, emphasized the verification of the first requirement, since the full deduction of the transactions carried out by the subsidiaries of Halifax would be contrary to the purpose of the deduction rules of the Sixth Directive or its transposition into national law and contrary to the principle of fiscal neutrality⁸⁰. Secondly, stressed the verification of the subjective requirement as the sole purpose of the transactions concerned was to obtain a tax advantage.

Finally, the CJEU held that is for MS to establish the conditions under which the tax authorities may recover VAT without taking a measure that goes further than is necessary to guarantee the correct levying and collection of VAT in the prevention of abuse. Additionally, the protection of the neutrality of VAT as a fundamental principle of the common VAT system is indispensable. Accordingly, where the abusive practice is found, the measure of the MS must not lead to a penalty and the abusive transactions must be redefined only to the extent of re-establish the situation in the absence of such abusive transaction. It follows that the tax authorities may demand repayment of VAT deducted taking advantage of the abusive transactions. On the other hand, tax authorities must consider the VAT charged on the output of those abusive transactions and subtract them from the final amount⁸¹.

The judgment in *Halifax* was received with polarized opinions. On the one hand, to illustrate this point, AG Bobek stated that tax authorities in the MS,

⁷⁸ Ibid, para.74.

⁷⁹ Ibid, para.75.

⁸⁰ Ibid, para.80.

⁸¹ Ibid, paras.95-96.

fell in love with this judgment and embraced it with passion⁸². On the other hand, some scholars and practitioners did not share the same excitement due to its implication regarding the principles of neutrality and legal certainty⁸³. Concerns were raised about the possible use of the principle of prohibition of abuse as a tool against taxpayers where national legal measures to combat abuse cannot be applied, leading to the violation of the “constitutional principles of strict legality and prohibition of analogy”⁸⁴. Furthermore, concerns about the possible hindering of the VAT neutrality were also raised in cases where the principle of prohibition of abuse is invoked by the MS.

Regarding the principle of legal certainty, the CJEU followed the opinion of AG Maduro on the importance of the interpretation of the objective concept of economic activity as is laid down in the Sixth Directive, in the sense that not even the purpose of tax avoidance is capable to change the objective quality of the transactions⁸⁵. Consequently, an interpretation such as the UK tax authorities suggested, regarding the importance of the intentions of the taxable person for the characterization of the economic activities according to the relevant directive provisions, is not consistent with the principle of legal certainty⁸⁶.

AG Maduro referred to the applicability of the principle of the prohibition of abuse of Community law highlighting the issue concerning tax law and the requirement of predictability of the financial consequences on economic operators entailed by the legal certainty. Adding that, legal certainty must be balanced against other legal values in the system and “Tax law should not become a sort of legal ‘wild-west’ in which virtually every sort of opportunistic behaviour has to be tolerated so long as it conforms with a strict formalistic interpretation of the relevant tax provisions and the legislature has not expressly taken measures to prevent such behaviour”⁸⁷. Nevertheless, from the perspective of the legal certainty one can assert that tax law should also not become a sort of legal ‘wild west’ in which taxable persons comply with all the requirements in the provisions expecting the foreseeable outcome and suddenly the authorities arbitrarily disallow that behavior without any legal basis and without the implementation of new rules in the legal system.

⁸² Opinion of AG Bobek in Case C-251/16 *Cussens and others* ECLI:EU:C:2017:648, para.1.

⁸³ De La Feria, Rita, *supra* n.50, at p.424.

⁸⁴ Confédération Fiscale Européenne (CFE) - Opinion Statement on the ECJ Halifax Judgment (C-255/02), August 2007, pp.1-2.

⁸⁵ Opinion of AG Maduro in Case C-255/02 *Halifax and Others* ECLI:EU:C:2005:200, para.48.

⁸⁶ *Ibid* para.52.

⁸⁷ *Ibid* para.77.

AG Maduro is of the view that the notion of abuse operates as a principle of interpretation of Community law, it does not give rise to derogations from provisions of the Sixth Directive⁸⁸. The consequences of its application, whether the right claimed is conferred by a provision or not, will depend on the interpretation of the rule, which comprises more than its literal element. Hence the application of the prohibition of abuse is consistent with the uniform application of VAT rules in the MS⁸⁹.

3.3.1 The Halifax test

To find the existence of the abusive practice it is compulsory that the courts of the MS verify the two-requirement test, in the field of VAT these two elements of the test do not overlap as easily as they do under the Treaty freedoms. Both requirements must concur in order to assess the abusive practice, ensuring the observance of the legal certainty and the freedom of the taxable persons to limit their tax liability⁹⁰ within the legal framework established by the Community law.⁹¹

3.3.1.1 The Objective element

- Obtaining a tax advantage contrary to the purpose of the provisions laid down by the Sixth Directive and the national legislation despite formal application of the conditions settled in those provisions.

In the first part of the test, the national court is required to verify if the legislative objective was frustrated or not where the right to a tax benefit was granted⁹². To achieve this, the court must perform a teleological interpretation of the provisions on which the taxable person relied to obtain the tax advantage, due to the fact that according to the literal interpretation of those provisions the tax benefit must be granted. Therefore, the court must analyze in depth, not only the spirit or purpose of the norms, but it must also take into account the functioning of the common VAT system to guarantee an interpretation consistent with it as well.

⁸⁸ Ibid para.69.

⁸⁹ Ibid para.79.

⁹⁰ Blackwood, Anneliese – “Abuse of law and VAT: the ECJ’s decision in *Weald Leasing*”, 2011, p.5.

⁹¹ Weber, Dennis – “Abuse of Law in European Tax Law: An Overview and Some Recent Trends in the Direct and Indirect Tax Case Law of the ECJ – Part I” - European Taxation, June 2013, p.255.

⁹² Piantavigna, Paolo – “Tax Abuse in European Union Law: A Theory” - EC Tax Review 2011/3, p.143.

AG Maduro stressed the importance of this teleological element of the test in the protection of the economic operators where a legal provision that results in the mitigation of the tax liability is invoked and the consequence is not contrary to the purpose of the Community law, which left the choice open to the taxable persons to choose from different tax regimes. Despite that the transactions in question had the sole purpose of mitigating the tax liability⁹³. In other words, this stage of the test ensures the existence of VAT planning for economic operators and the freedom to choose the most beneficial tax scheme to diminish their tax liability where the VAT Directive and national legislation are not undermined. As a result, the courts must proceed with the evaluation of the legitimacy of the artificial choices of law⁹⁴.

It follows that the objective element of the test has great significance on the observation of the legal certainty of the VAT rules, taking into account what is the real purpose of the provisions and safeguarding the intentions of the legislator to include such provisions in the legal text. Accordingly, the teleological interpretation of the provisions ensures the achievement of the purpose intended by the lawmaker, even if that interpretation run counter the wording of those provisions⁹⁵. Moreover, without the implementation of the objective requirement of the test, only the artificial nature of the transactions carried out to procure the tax advantage would be sufficient to assess them as an abusive practice. Thereby the consistency of the principle of abuse of law with the principle of legal certainty would be seriously compromised and hardly would be the subject of intense debate as it currently is.

3.3.1.2 *The Subjective element*

- The essential aim of the transactions is to obtain a tax advantage, based on objective factors.

The courts are required to review the facts and the body of evidence according to their national legislation in order to conclude that there is no other explanation to the economic activities carried out than obtaining the tax advantage⁹⁶ not intended by the VAT provisions. It follows that, for the

⁹³ Opinion of AG Maduro in Case C-255/02 *Halifax and Others* ECLI:EU:C:2005:200, para.88.

⁹⁴ Saydé, Alexandre – “*Defining the Concept of Abuse of Union Law*” - Yearbook of European Law, Vol. 33, No. 1, 2014, p.157.

⁹⁵ Freedman, Judith. “*The Anatomy of Tax Avoidance Counteraction: Abuse of Law in a Tax Context at Member State and European Union Level*” In De la Feria, Rita & Vogenauer, Stefan - *Prohibition of Abuse of Law: A New General Principle of EU Law?* London: Hart Publishing, 2011, p.369.

⁹⁶ Opinion of AG Maduro in Case C-255/02 *Halifax and Others* ECLI:EU:C:2005:200, para.89.

principle of prohibition of abusive practices the purpose of the taxable person is relevant. Nevertheless, this element of intentionality cannot be presumed, only the objective evidence would provide the concrete basis to verify the real purpose of the economic operator to carry out the transactions concerned⁹⁷. The decisive factor in the subjective stage of the test is not the intention of the taxable person; it is instead the economic activity itself objectively considered⁹⁸. The national courts, in order to verify this requirement may consider that the transactions are artificially created and that the taxable persons involved in those activities may have a personal, economic or legal link⁹⁹ which objectively questions the real nature and purpose of the enterprise. That artificial aspect of the transactions performed by the economic operators plays a major role to assess the abuse due to the fact that such transactions usually lack of economic substance. Consequently, the intentions to improperly attain that tax advantage could be inferable from the artificiality of the situation verified by objective circumstances¹⁰⁰.

Furthermore, artificial transactions typically requires from the taxable person to carry out more steps than necessary to achieve the same economic objectives which would easily be achieved if that taxable person did not have the intention to obtain the tax advantage, those transactions encompass costs that would be avoidable. However, only the tax advantage sought justifies the investigation of the artificial transactions concerned¹⁰¹. The artificiality test does not enquire whether a real economic transaction took place; instead it enquires whether that transaction has an economic justification different than the regulatory tax benefit¹⁰².

The subjective element settled in *Emsland-Stärke* has a distinction with the test established in *Halifax*. In the former, the CJEU implied that the purpose of the taxable person in obtaining the tax advantage must be the exclusive explanation for the transactions to take place¹⁰³. On the other hand, in the latter, the CJEU specifically stated that the purpose of the taxable person in obtaining the tax advantage is just the essential aim of the transactions concerned¹⁰⁴. It follows that a transaction might be assessed as abusive even where the aim of obtaining the advantage is not the only explanation.

⁹⁷ Piantavigna, Paolo, *supra* n.92, at p.144.

⁹⁸ Opinion of AG Maduro in Case C-255/02 *Halifax and Others* ECLI:EU:C:2005:200, para.70.

⁹⁹ Case C-255/02 *Halifax and Others* ECLI:EU:C:2006:121, para.81.

¹⁰⁰ Opinion of AG Maduro in Case C-255/02 *Halifax and Others* ECLI:EU:C:2005:200, para.71.

¹⁰¹ Saydé, Alexandre, *supra* n.94, at p.147.

¹⁰² *Ibid*, p.150; Saydé is of the view that the artificiality test is about the economic rationality of the transactions concerned rather than the economic reality of those transactions.

¹⁰³ Case C-110/99 *Emsland-Stärke* ECLI:EU:C:2000:695, para.53.

¹⁰⁴ Case C-255/02 *Halifax and Others* ECLI:EU:C:2006:121, para.75.

However, that explanation must be the most important one¹⁰⁵. Therefore, that change on the subjective element of the test established in *Halifax* means that the CJEU wanted to broaden the scope of the prohibition of abusive practices¹⁰⁶ in the sphere of the common VAT system. This interpretation creates a conflict with the opinion of AG Maduro, who stated that the national authorities must verify only if the activity concerned has ‘some autonomous basis’ or some economic justification without taking into account the tax considerations¹⁰⁷. Furthermore, AG Maduro is of the view that the principle of prohibition of abusive practices is no longer relevant where the economic activity performed have some other explanation than the tax benefit. Otherwise the interpretation of the provisions based on an unwritten general principle would grant an excessively broad discretion to tax authorities where they have to decide which purpose of the economic activity carried out should be considered the most important one. Moreover, that situation would create uncertainty on the legitimate options of economic operators and would affect economic activities as well¹⁰⁸. That uncertainty in the legitimate options of taxable persons is precisely what the CJEU accomplished by widening the scope of the concept of abuse, using the expression: ‘*essential aim*’ rather than the expression ‘*sole aim*’. That leaves to the national courts the discretion to establish which of the purposes in a transaction is the essential one when it can be justified by other reasons than the attainment of the tax advantage.

The subjective element of the test has raised criticism for being considered impractical to apply regarding the difficulties to prove subjective motives of the taxable persons and also for the unreliableness to prove such motives only taking into account the transactions concerned¹⁰⁹. On the other hand, the requirement of objective evidence highlights the inconsequentiality of the intention of the taxable persons, due to the fact that the reasons should be concrete¹¹⁰.

3.4 Development of the principle after *Halifax*

After *Halifax*, the CJEU kept developing the concept of prohibition of abusive practices in VAT with important connotations to the principle of legal certainty.

¹⁰⁵ Cerioni, Luca, *supra* n.44, at p.799.

¹⁰⁶ De la Feria, Rita, *supra* n.50, at p.423.

¹⁰⁷ Opinion of AG Maduro in Case C-255/02 *Halifax and Others* ECLI:EU:C:2005:200, para.87.

¹⁰⁸ *Ibid*, para.89.

¹⁰⁹ Karimeri, Rami – “A Critical Review of the Definition of Tax Avoidance in the Case Law of the European Court of Justice” - *Intertax*, Vol. 39, Issue 6/7, 2011, p.302.

¹¹⁰ Piantavigna, Paolo, *supra* n.92, at p.145.

*Part Service*¹¹¹ settled the scope of the principle of abuse of law in the sphere of VAT. The CJEU made a clarification regarding the requirement of the subjective element of the *Halifax* test. The question raised by the national court was whether the Six Directive should be interpreted as the requirement to find the abusive practice is fulfilled when obtaining the tax advantage is the *principal aim* or the *sole aim* of the transactions concerned. The CJEU held that is the *principal aim* of the transactions in obtaining the tax advantage what should be taking into account in order to find the abusive practice¹¹². Additionally, the CJEU stated that this *principal aim* of the accrual of a tax advantage may concur with economic objectives like marketing, organization or guarantee considerations. Thus, even where multiple economic reasons justify the transactions carried out, the national court is still able to assess the abusive practice¹¹³.

It follows that, the CJEU certainly expanded the scope of the principle of prohibition of abuse of law in VAT, considering that transactions performed by the taxable persons can have economic justifications besides the tax advantage justification. Therefore, if the national court is of the view that none of those economic justifications is the principal aim of the transactions, then, the abusive practice can be assessed. This judgment of the CJEU empowered the already broad discretion of the judges in the national courts, conferring them the task to decide which one of the purposes of the transactions concerned is the principal one without mentioning how to reach to that conclusion and without any additional guideline to distinguish the principal aim from a secondary aim.

Despite the broad scope of application that the principle of abuse of law acquired in *Part Service* regarding the fulfillment of the requirement of the subjective element of the *Halifax* test, in *Weald Leasing*¹¹⁴ the CJEU took a more restrictive approach on the same topic. The CJEU did not use the expression *principal aim*, instead, the CJEU once again used the expression *sole purpose*¹¹⁵ as it was used in *Halifax* as well.

In addition, the CJEU confirmed its view (as it was held in *Halifax*) on the concept of abuse and it highlighted that the principle of prohibition of abusive practices is not applicable where the transactions concerned may have some justification other than obtaining a tax advantage¹¹⁶. Curiously, to support that view, the CJEU referred to a paragraph in *Part Service* where part of the statement laid down in *Halifax* that explicitly made that

¹¹¹ Case C-425/06 *Part Service* ECLI:EU:C:2008:108.

¹¹² *Ibid*, para.45.

¹¹³ *Ibid*, para.62.

¹¹⁴ Case C-103/09 *Weald Leasing* ECLI:EU:C:2010:804.

¹¹⁵ *Ibid*, para.26.

¹¹⁶ *Ibid*, para.30.

connotation was omitted¹¹⁷, hence making an ambiguous reference to the case-law.

The judgment also clarified that the nature of the commercial operations usually carried out by the taxable persons is not relevant to ascertain the finding of an abusive practice. On the contrary, the finding of an abusive practice will depend on the object, effect and purpose of the transactions concerned. Therefore, the fact that those transactions carried out by the taxable person are not in the context of its normal commercial operations does not affect the foregoing consideration¹¹⁸.

After the *Weald Leasing* judgment, the CJEU stressed, in *Newey*¹¹⁹ that, the contractual position of economic operators usually encompasses the economic and commercial reality of the concerned transactions that are relevant to assess them as a supply of services according to the Sixth Directive, hence complying with the requirements of legal certainty. Nevertheless, occasionally that contractual position does not wholly reflect the economic and commercial reality of the transaction. Furthermore, the effect of the principle of prohibition of abusive practices is to prevent that wholly artificial arrangements without any economic reality are carried out with the *sole aim* of attaining a tax advantage¹²⁰. Moreover, the national courts must perform an analysis of the circumstances of the case to determine if the contractual terms reflect the economic reality or are purely artificial arrangements. In such case, invoking the principle of abuse of law, national courts must redefined the artificial contractual terms and re-establish the situation.

In that regard, it is of great importance to highlight that the CJEU ratified in this judgment its position regarding the *sole aim* of the transactions concerned in obtaining the tax advantage, leaving aside the expressions *essential* or *principal aim* as it were used in *Part Service*. On the other hand, the CJEU did not emphasize the necessity of the national courts of verifying the fulfillment of the objective requirement of the *Halifax* test. This could be interpreted as meaning that the only decisive factor is the economic and commercial reality of transactions in order to assess the abuse¹²¹. That interpretation raises concerns, since the mandatory concurrent fulfillment of both requirements in the *Halifax* test is fundamental to ensure the consistency of the principle of abuse of law with legal certainty. Therefore, only to suggest the possibility of national courts finding the abusive practice exclusively taking into consideration the existence of a wholly artificial

¹¹⁷ See the omission referred comparing the Case C-255/02 *Halifax and Others* ECLI:EU:C:2006:121, para.75 with the Case C-425/06 *Part Service* ECLI:EU:C:2008:108, para.42.

¹¹⁸ Case C-103/09 *Weald Leasing* ECLI:EU:C:2010:804, paras.43-44.

¹¹⁹ Case C-653/11 *Newey* ECLI:EU:C:2013:409.

¹²⁰ *Ibid*, paras.44-46.

¹²¹ Terra, Ben J.M. & Kajus, Julie, *supra* n.1, at p.40.

arrangement without any economic and commercial reality with disregard of the fact that perhaps the tax advantage obtained was not contrary to the purpose of the law. This surely jeopardizes the consistency of the principle of abuse of law with the legal certainty.

After *Newey*, the CJEU established its criteria regarding specific national procedural rules in the context of the finding of abusive practices. In *Surgicare*¹²² the Portuguese tax authorities assessed that the company Surgicare abusively took advantage of a VAT refund, having as a consequence that the company had to pay the VAT wrongly deducted with interest for late payment. However, the tax authorities did not proceed according to the mandatory special procedure to assess the existence of the abusive practice established in the Portuguese legislation. As a result, Surgicare challenged the assessment of abuse for illegally disregarding the application of such mandatory preliminary administrative procedure¹²³.

The CJEU highlighted that the VAT Directive encourages the prevention of tax evasion, avoidance and abuse by conferring the power to the MS to adopt measures to ensure the fulfillment of that objective under the principle of procedural autonomy of MS in the absence of particular EU rules in the area¹²⁴. Although, in the exercise of that power, MS must safeguard that the national measures taken comply with the principles of equivalence and effectiveness, being the task of the national courts to verify the fulfillment of that requirement. The CJEU held that the national procedure in question is characterized by a preliminary hearing for the taxable person to submit the relevant evidence, which should guarantee the observance of the fundamental right of being heard. It concluded that the national procedure is not contrary to the objective of the prevention of abuse recognized in the case-law and the application of such preliminary procedure is not precluded by the VAT Directive¹²⁵.

It follows that, this judgment enhanced the observance of legal certainty in the application of the principle of the abuse of law where a MS used its power to establish specific anti-avoidance rules. Those specific procedural rules to assess the abusive practice cannot be disregarded by that the tax administration as long as those rules are not contrary to EU law and the principles of effectiveness and equivalence.

Following *Surgicare*, in *WebMindLicenses*¹²⁶, the CJEU dealt with wholly artificial arrangements performed by a Hungarian Company in order to obtain (in the view of the tax authorities) a tax advantage consisting in a scheme to apply the lower standard VAT rate applied in Portugal.

¹²² Case C-662/13 *Surgicare* ECLI:EU:C:2015:89.

¹²³ *Ibid*, paras.11-12.

¹²⁴ *Ibid*, paras.25-26.

¹²⁵ *Ibid*, paras.27, 32, 34.

¹²⁶ Case C-419/14 *WebMindLicenses* ECLI:EU:C:2015:832.

Nevertheless, according to the CJEU, to take advantage of a lower rate of standard VAT in another MS is not contrary to the VAT Directive. Thereby, that behavior cannot be considered abusive, as far as the supply of service is carried out in the MS with the lower VAT rate and not in the MS with the higher VAT rate¹²⁷. Furthermore, it is up to the national courts to establish, with objective factors, whether the transactions in question are effectively carried out in the MS with the lower VAT rate taking into consideration the physical existence of the company in that MS in terms of premises, staff and equipment¹²⁸.

In addition, the CJEU held that, where an abusive practice is found, the national court must re-establish the situation in the absence of such abusive transactions, highlighting that, as a consequence, the taxable person must pay VAT in the MS where it should have been paid (i.e. Hungary) even if it has been paid in the other MS (i.e. Portugal)¹²⁹. This situation can be problematic for the economic operators, due to the fact that, if an abusive practice is found, the taxable person will have to pay the VAT already paid in the other MS with the adjustment resulted by the application of the higher tax rate avoided in the first place. Additionally, is likely that the tax authorities also apply a fine and a penalty for late payment, as the Hungarian tax authorities demanded in this case¹³⁰. This circumstance could be contrary to the principle of legal certainty. The CJEU has been adamant about its view that the re-establishment of the situation in absence of abuse cannot lead to a penalty. Moreover, the taxable person paid the VAT in the MS where, according to its view, was the place of supply of the service. However, in this case, the penalty is a direct consequence of the extemporary payment of the VAT due and the payment made in the ‘wrong’ MS was caused by the abusive behavior of the taxable person in which it cannot rely upon to defer the payment of the VAT due in Hungary. Any other fine applied as a direct consequence for the finding of the abusive practice not related with the late payment of the VAT due could be inconsistent with the principle of legal certainty if that fine was not previously established in the national legislation and arbitrarily imposed by the tax authorities as a punishment for the mere finding of abuse.

3.4.1 Recent development of the principle

The most recent development of the principle of abuse of law is *Cussens*¹³¹. The particularity of this case is that the facts took place before the judgment

¹²⁷ Ibid, paras.40-41.

¹²⁸ Ibid, para.44.

¹²⁹ Ibid, para.53.

¹³⁰ Ibid, para.21.

¹³¹ Case C-251/16 *Cussens and others* ECLI:EU:C:2017:881.

in *Halifax* was delivered. Hence the abusive transactions occurred before the CJEU held the prohibition of abusive practices in the sphere of VAT applicable. Accordingly, its application in such transactions raised concerns about the consistency of the principle of abuse of law with the principles of legal certainty and of the protection of legitimate expectations due to the lack of national legislation transposing the principle prohibiting abusive practices¹³².

The CJEU empathized that the principle which prohibits abusive practices in the sphere of VAT is not a rule established in a directive, on the contrary, it is based on the case-law that reflects the general and comprehensive character inherent in general principles of EU law. Therefore, it does not require to be transposed in the national legislations in order to be applicable. Moreover, it does not require a specific legal rule to refuse a right or advantage obtained with abusive or fraudulent means and such refusal is just the consequence of that abusive behavior¹³³.

The CJEU stressed that its interpretation of EU law is applicable even to circumstances that took place before the judgment on request for interpretation, unless there are exceptional circumstances¹³⁴ where in observation of the principle of legal certainty the court can, temporarily, limit the effects of its judgment. Those exceptional circumstances only arise if the parties concerned acted in good faith and if there is a risk of serious difficulties produced by the effect of the judgment in question¹³⁵. Additionally, the CJEU noted that in *Halifax* the temporal effects of the principle that abusive practices are prohibited in the sphere of VAT was not restricted¹³⁶. Therefore, such application of EU law is consistent with the principles of legal certainty and of the protection of legitimate expectations¹³⁷.

The temporary effect of the principle of abuse of law and the possibility of its application even where there is a lack of transposition in the national provisions of MS consolidates its status of general principle of EU law. Nevertheless, the issue with this judgment comes when the CJEU, once again, reinforced its approach to the *essential aim* established in *Part Service*, concluding that the case-law regarding abuse does not require that the accrual tax advantage is the *only objective* of the transactions concerned. On the contrary, economic objectives can concur with the tax objectives and the principle of prohibition of abusive practices can still be relevant¹³⁸.

¹³² Ibid, para.21.

¹³³ Ibid, paras.27-32.

¹³⁴ Ibid, para.41.

¹³⁵ Case C-276/14 *Gmina Wrocław* ECLI:EU:C:2015:635, para.45.

¹³⁶ Case C-251/16 *Cussens and others* ECLI:EU:C:2017:881, para.42.

¹³⁷ Ibid, para.40.

¹³⁸ Ibid, paras.53, 60.

It seems that the CJEU has been consistent in its inconsistency regarding the *essential aim* or the *sole aim* of the transactions concerned in order to find the abusive practice. That inconsistency can only create more uncertainty for the taxable persons and seriously endangers the legal certainty and protection of legitimate expectations of the economic operators when the abusive practice is assessed by the national courts. Moreover, AG Bobek in his opinion, pointed out at the ‘stark contrast’ between the approach that the CJEU took in *Part Service* and its broad implications on the notion of abuse, being the *principal aim* of the transactions concerned to obtain the tax advantage and the more restrictive approach of the CJEU in *Halifax* and *Weald Leasing*. Concluding that, in his view, the latter approach must be applied to the fulfillment of the subjective requirement of the *Halifax* test¹³⁹. Adding that: “If the transactions at issue *may* have some economic justification other than a tax advantage, then the test is not fulfilled. That approach not only reflects the predominant case-law, it is also in line with the principle of legality”¹⁴⁰. From that interpretation it follows that AG Bobek is of the view that the approach of the CJEU in *Part Service* might not be consistent with the principle of legality and now *Cussens* can be added to that premise as well.

¹³⁹ Opinion of AG Bobek in Case C-251/16 *Cussens and others* ECLI:EU:C:2017:648, paras.99-100.

¹⁴⁰ *Ibid*, para.101.

4. Justification behind the prohibition of abusive practices

The dynamic character of the law determines the constant evolution and creation process due to which its ultimate certainty cannot be reached¹⁴¹. In spite of the undermining effect on the legal certainty and the protection of legitimate expectations inherent to the nature of the principle of abuse of law, its application can be justified based on the accomplishment of a rational and congruent result in pursuit of how tax law ought to be.

4.1 Rationality of law

The rationality of law is a value¹⁴² and the concept of legislative rationality not only encompass the basic requirements that the law must be intelligibly and coherent, it also incorporates teleological and pragmatic elements which procures that the law reaches their objectives and guarantees its effectiveness¹⁴³; in order to fulfill the purpose that lawmakers needed to achieve at the time of its creation. It follows that, not only the lawmakers are compelled to perform their legislative task taking into consideration all the requirements that the rationality of law entails. Judges are also bound by the same obligation when interpreting the law. They must ensure that the law will achieve its object and purpose, since the premise of legislative rationality includes the interpretation and adjudication of the law¹⁴⁴. Moreover, the interpretation of the law should enhance or maximize the rationality and each one of its constitutive elements, making it communicative, reasonable and coherent¹⁴⁵.

The abusive practices are the result of taxable persons trying to avoid the consequences imposed by the law by artificially created transactions aimed for that purpose. Therefore, where taxable persons incur in abusive practices the object and purpose of the law is not achieved, hence the outcome of that behavior is the application of the law without the teleological and the pragmatic elements that the rationality entails. However, the principle of

¹⁴¹ Sikka, Prem “*Smoke and mirrors: Corporate social responsibility and tax avoidance—A reply to Hasseldine and Morris*” - Accounting Forum 37, 2013, p.21.

¹⁴² Filipczyk, Hanna - *Tax Avoidance and Rationality of Law*. Warszawa: Wolters Kluwer, 2017, p.186.

¹⁴³ Marcilla, Gema “*Balancing as a Guide to Legislative Reasoning*” - *Legisprudence*, Vol.IV, N° 1, 2010, p.99.

¹⁴⁴ *Ibid*, p.94.

¹⁴⁵ Filipczyk, Hanna, *supra* n.142, at p.166.

prohibition of abusive practices is the corrective or ‘safety-valve’¹⁴⁶ for these situations. The application of the mentioned principle ensures that the tax law will produce the desired outcome that the lawmakers envisage not letting the formalistic application of the provisions (i.e. taking into account only its literal interpretation) undermine the rationality that tax law should have.

The application of the principle of abuse of law diminishes the legal certainty of the tax law. Notwithstanding legal certainty is not the only value of law¹⁴⁷ and it is the task of the judges, when the principle of abuse of law is invoked, to weigh this principle against the legal certainty and all the relevant principles of law in a particular case¹⁴⁸, aiming to establish a relationship of preference between those principles¹⁴⁹. Considering that abusive practices can be seen as tax avoidance, it is not contrary to the rule of law to counter such practices. Furthermore, tax avoidance is a source of violation of equality and human dignity, thus, the implementation of correctives, such as the principle of abuse of law, can be justified despite the diminishment that its application causes to the legal certainty¹⁵⁰. Additionally, in cases where the conditions of abusive practices are verified, the taxable person cannot seek to legitimize such undesired behavior based on the legal certainty or the protection of legitimate expectations¹⁵¹.

4.2 Legal congruence

The ideal outcome of the application of law, logically must lead to a coherent scenario where the interpretation of the provisions reflects the reality of the situation regulated by those provisions. However, the result will not always be congruent if only the literal interpretation of the law is taken into account. Therefore, courts may perform a teleological interpretation of the law or attending to the purpose of the norms in order to guarantee the correct application of the law in accordance with the real scenario that the law was regulating in the first place.

The teleological interpretation of a provision requires the flexibilization of such provision to enable judges to adjust the norms procuring a logical outcome each time the law is applied to a particular case. On the other hand,

¹⁴⁶ Opinion of AG Maduro in Case C-255/02 *Halifax and Others* ECLI:EU:C:2005:200, para.74.

¹⁴⁷ Filipczyk, Hanna, *supra* n.142, at p.307.

¹⁴⁸ Comanducci, Paolo - “*El abuso del derecho y la interpretación jurídica*” *Revista de Derecho Privado*, N° 21, p.108.

¹⁴⁹ Marcilla, Gema, *supra* n.143, at p.99.

¹⁵⁰ Filipczyk, Hanna, *supra* n.142, at p.203.

¹⁵¹ Opinion of AG Bobek in Case C-251/16 *Cussens and others* ECLI:EU:C:2017:648, para.54.

the literal interpretation of the provisions does not entail such flexibility, on the contrary, it encompasses a rigid or strict understanding of the law as it is written down. It follows that the literal interpretation of the provisions guarantees the predictability of the rules. The taxable persons, thus, are able to foresee the consequences of the application of the provisions that regulate their behavior, even if that behavior was not envisaged by the legislator when the necessity of such provision arose.

The rigorous interpretation of the rules may enhance legal certainty while leading to inequitable outcomes¹⁵². Consequently, rigid legal rules generate legal certainty, under the risk of generating absurd legal results whereas the flexible rules lead to legal congruence, under the risk of creating legal uncertainty¹⁵³. In that regard, the principle of abuse of law serves as the efficient remedy to the rigorous implementation of a rule of law¹⁵⁴.

The impossible task for the legislator to foresee every single scenario that might happen in reality is undeniable and with regard to those scenarios creates provisions to regulate every possible outcome. As a consequence, to rely only on the literal interpretation of the provisions is to overlook unforeseen scenarios that may lead to undesired results, hence having an incoherent outcome in reality. Moreover, the abusive practices occur in the gap between law and reality, that gap is wider where the law is literally interpreted and gets narrower where the law is interpreted by its purpose¹⁵⁵.

In addition, the teleological interpretation of the law procures a congruent outcome that undermines the legal certainty, conferring a wide range of discretion to the judges in order to bend the laws and have the desired outcome envisaged by the lawmakers. Therefore, the principle of abuse of law reflects the struggle between legal congruence and legal certainty¹⁵⁶ where the latter is the source of an abusive practice¹⁵⁷. That conflict has to be balanced by the national courts when interpreting domestic laws and EU law. National courts must give an interpretation in conformity with the directives to achieve the reconciliatory interpretation of the provisions¹⁵⁸, which entails the understanding of national laws in the light of the wording and the purpose of the directive concerned in order to achieve the result sought by the directive¹⁵⁹. As a result, only taking into account the literal meaning of the provisions in order to ensure legal certainty without taking

¹⁵² Saydé, Alexandre - *Abuse of EU Law and Regulation of the Internal Market*. London: Hart Publishing, 2014, p.169.

¹⁵³ *Ibid*, p.171.

¹⁵⁴ Lenaerts, Annekatrien, *supra* n.60, at p.1122.

¹⁵⁵ Saydé, Alexandre, *supra* n.152, at p.190.

¹⁵⁶ *Ibid*, p.215.

¹⁵⁷ *Ibid*, p.183.

¹⁵⁸ Terra, Ben J.M. & Kajus, Julie, *supra* n.1, at p. 80.

¹⁵⁹ Joined Cases C-131/13, C-163/13 and C-164/13 *Italmoda* ECLI:EU:C:2014:2455, para.53.

into consideration the purpose of the provisions, not only may have an absurd outcome, but also it may lead to the non-compliance of the duty to interpret the provisions consistently with EU law.

It follows that, national courts when applying the principle of abuse of law must take into account their duty of preserve legal certainty and their duty to avoid inequitable legal outcomes and find the right balance between these legal values¹⁶⁰.

¹⁶⁰ Saydé, Alexandre , *supra* n.152, at p.217.

5. Effect of the abuse of law on VAT planning

The existence of elaborated VAT schemes is, to a great extent, consequence of the lack of a fully neutral VAT system, to the point of asserting that, if the common VAT system were fully neutral, VAT planning would become superfluous¹⁶¹. In most of the cases, aggressive tax schemes are performed by taxable persons not able to fully deduct their input VAT, due to the fact that the majority of their undertakings are deemed as exempt by the VAT Directive, hence only have the right to deduct a percentage of their input VAT.

On the other hand, the principle of legal certainty, the protection of legitimate expectations and VAT planning are concepts that can be connected with each other due to the requirements of the legal certainty that rules must be clear, precise with foreseeable outcomes; precisely the element of predictability of the tax rules is what makes it possible for the economic operators to design a model to follow for their economic activity based on the tax implications that it may have, thereby being able to take into account the economic impact of the VAT on their businesses. In that regard AG Maduro stressed that: “tax law is frequently dominated by legitimate concerns about legal certainty, deriving, in particular, from the need to guarantee the predictability of the financial burden imposed on taxpayers and the principle of no taxation without representation”¹⁶².

In addition, economic operators are not in the legal obligation to choose a tax scheme favorable for the State in which they are performing economic activities; on the contrary, they have the freedom to rely on a tax scheme that entails the mitigation of their costs¹⁶³. Although, the application of the principle of prohibition of abuse of law would disregard a tax plan model or a specific tax scheme if the courts find that scheme abusive and consequently consider it inapplicable for being an aggressive VAT planning scheme. Therefore, economic operators must envisage the possibility that their tax scheme is not compatible with the purpose of the law and, beforehand, must perform a detailed analysis to determine an appropriate tax scheme to follow and minimize the risks that the VAT scheme is considered abusive. In that regard, since the assessment of the abusive practices is performed by the courts of the MS with the considerations of the

¹⁶¹ Ecker, Thomas in Summary Report of “*CFE Forum 2013: Tax Planning: What Is (Un)acceptable?*” In Popa, Oana & Kulcsár, Tamás – European Taxation, August, 2013, p.398.

¹⁶² Opinion of AG Maduro in Case C-255/02 *Halifax and Others* ECLI:EU:C:2005:200, para.77.

¹⁶³ *Ibid*, para.85.

circumstances and evidence of each particular case, it is very difficult to draw a clear line, to categorize, in a generalized way, what is acceptable and what is not acceptable in terms of VAT planning. However, the analysis of CJEU case-law helps to build the parameters of what is more likely to be considered a legitimate VAT planning scheme.

5.1 What is acceptable according to the CJEU case-law

The CJEU in *Gemeente Leusden and Holin Groep*¹⁶⁴ gave some indications to the economic operators to acknowledge what kind of tax scheme is acceptable by the CJEU and to what extent. In the judgment, the Court established the necessary requirements to be fulfilled in order to find abuse as it was laid down in *Emsland-Stärke*. It stressed that taxpayers certainly are able to take advantage of provisions and lacunas in the law to pay less taxes as far as their behavior is not abusive¹⁶⁵, authorizing taxable persons to define their VAT planning and minimize their tax costs. Thereby, the CJEU settled the contrast between the permitted practice of paying less tax by the direct application of a provision or by taking advantage of lacunas in the legislation and the forbidden practice of paying less tax by the conception of artificial transactions or VAT avoidance¹⁶⁶.

In *Weald Leasing*¹⁶⁷, the CJEU emphasized that an economic operator cannot be criticized for choosing a transaction which entails a tax advantage, rather than choosing a transaction which does not encompass any tax advantage, in this case the advantage was the spreading of the payment of the VAT liability in the form of a lease, rather than a purchase transaction that does not provide such tax advantage¹⁶⁸. The CJEU justified its position by adding that the amount of VAT paid in the lease of an asset does not necessarily mean that it will be less if that asset is purchased instead¹⁶⁹.

It follows from that interpretation, that a deferral of the VAT liability is not considered an abusive practice. Conversely, the reduction of the VAT liability is more likely to be considered abusive.¹⁷⁰ Furthermore, the opinion of the AG Mazák in the case highlights that is not contrary to the purpose of the Sixth Directive the adoption of a lease scheme of equipment with the sole purpose of obtaining the deferral of the VAT liability in a monthly

¹⁶⁴ Joined Cases C-487/01 and C-7/02 *Gemeente Leusden and Holin Groep*

¹⁶⁵ *Ibid*, para.77.

¹⁶⁶ De la Feria, Rita – “The European Court of Justice's solution to aggressive VAT planning - further towards legal uncertainty?” - EC Tax Review 2006/1, p.29.

¹⁶⁷ Case C-103/09 *Weald Leasing* ECLI:EU:C:2010:804.

¹⁶⁸ *Ibid*, para.34.

¹⁶⁹ *Ibid*, para.38.

¹⁷⁰ Blackwood, Anneliese, *supra* n.90, at p.6.

basis, rather than the immediate payment of the VAT if a purchase of the same assets takes place¹⁷¹.

Additionally to the deferral of VAT liability, the CJEU held in *WebMindLicences*, that it is not contrary to the VAT Directive to perform transactions oriented to take advantage of a lower standard VAT rate in a MS, this is merely the result of the lack of the fully harmonization of the common VAT system and the discretion among MS to set different standard tax rates observing the conditions imposed by the Directive¹⁷². However, the supply for consideration must take place in the MS with the lower standard tax rate in order to be considered a non-abusive behavior.

The prohibition of abusive practices must not have a negative impact on the freedom of taxable persons to choose a business plan in order to mitigate their VAT liability¹⁷³. Nevertheless, the negative impact on the legal certainty and protection of legitimate expectations may arise when the taxable persons are not aware of the limitations that they have when designing a VAT scheme. This undesirable negative effect emerges in the assessment of abuse performed by the national courts. Therefore it is indispensable to understand the difficulties inherent to the application of the principle of abuse of law in the national courts.

¹⁷¹ Opinion of AG Mazák in Case C-103/09 *Weald Leasing* ECLI:EU:C:2010:633, paras.20-21.

¹⁷² See Art.97 of the VAT Directive, standard tax rate may not be lower than 15 percent.

¹⁷³ Piantavigna, Paolo, *supra* n.92, at p.143.

6. Assessment of the abuse by national courts

The assessment of the abuse is, without any doubt, the most critical moment between the principle of abuse of law and the principle of legal certainty. Firstly, the national courts have a wide discretionary power to decide whether an abusive practice took place in the context of VAT. Secondly, in the exercise of that broad discretion, the national courts are able to interpret provisions in the opposite approach as their literal meaning dictates. Therefore the national courts are responsible to perform this assessment in the most diligent manner, following the guidelines provided by the jurisprudence of the CJEU, with the observance of the particularities derived from every case, the facts and evidence available and also the interpretation of the VAT provisions in order to guarantee the correct functioning of the common VAT system. Moreover, the national courts must ensure that the effectiveness of the Community law is being respected in the course of the process.

The principle of abuse of law will be tested against the principle of legal certainty every single time that a national court performs the assessment of the abusive practice with the *Halifax* test. The national courts must find the balance between these principles on a case-by-case basis¹⁷⁴, going through the complexity of the common VAT system provisions and the intricacies of the elaborated VAT schemes that the economic operators designed in order to limit their tax liability. In that regard, taking into account the particular circumstances of the case in order to find the abusive practice procures a more equitable outcome, despite being the source of uncertainty¹⁷⁵. Nevertheless, invoking the principle requires a high degree of responsibility from the courts. Thereby, AG Mázák is of the view that the principle must only be applied in exceptional cases where the abuse is evident and the remedies applied must only reach to the extent of the abuse concerned¹⁷⁶.

Discrepancies regarding the proper application of the principle prohibiting abusive practices arise in the national courts across the MS leading to different results when finding the abuse in the VAT schemes, even in presence of identical or similar situations. That asymmetry of criteria between courts has a negative impact on the application of the principle of abuse of law in detriment of the principle of legal certainty. It can also be

¹⁷⁴ Filipczyk, Hanna, *supra* n.142, at p.200.

¹⁷⁵ Dourado, Anna Paula – “No Taxation without Representation in the European Union: Democracy, Patriotism and Taxes” In Brokelind, Cécile – *Principles of Law: Function, Status and Impact in EU Tax Law*, IBDF 2014, p.218.

¹⁷⁶ Opinion of AG Mázák in Case C-103/09 *Weald Leasing* ECLI:EU:C:2010:633, para.11.

the source of distortions where a VAT scheme is assessed as abusive in one MS whereas the same VAT scheme is not considered abusive in other MS.

The judgment of the Supreme Court of UK in *Pendragon*¹⁷⁷, is a clear example of the complications that arise in the national courts when it comes to the understanding and application of the principle of abuse of law. It also provides the evidence on how national courts of the same MS, taking into account the same facts and proofs reach to opposite conclusions on the assessment of the abusive practice under the same guidelines laid down by the CJEU in *Halifax*. It is not the purpose of this thesis to establish which court was right and which court was wrong. However, the outcome of having such contrary judgments in the same case necessarily means that at least one of the courts wrongly performed the *Halifax* test.

6.1 Pendragon

The car sales group Pendragon, designed a VAT scheme to take the advantage provided by the national legislation regarding a margin scheme for dealers of second-hand goods to charge VAT for the sale of the goods only to the extent of their profit margin. The distribution companies in the Pendragon Group acquired new cars from the manufacturers in order to use them as demonstrators for test drives and other internal purposes, for which they paid VAT on the full price, being able to deduct it as input tax. The companies in the group effectively recovered the input VAT of the new cars acquired as demonstrators and afterwards they sold the cars to consumers avoiding the payment of output VAT on the price as the cars were sold as second-hand goods under the margin scheme¹⁷⁸.

In that regard, the transactions carried out by Pendragon complied with all the formal requirements laid down in the national legislation. Nevertheless, the tax authorities challenged the efficacy of the scheme and sought the recovery of the VAT avoided by the Pendragon Group using such scheme¹⁷⁹. Accordingly, the margin scheme established in the national law constitutes an exception to the principle that VAT must be charged on the full consideration for a sale on goods that previously left the supply chain (i.e. when the goods are sold to a final consumer) and afterwards enters again in the supply chain (i.e. when the goods are acquired and resold by a taxable person). The purpose of such treatment by the national legislation is to allow a partial relief of VAT to economic operators selling goods that already were net taxed at an early stage. However, Pendragon used the

¹⁷⁷ The Supreme Court, Judgment given on 10 June 2015, *Commissioners for Her Majesty's Revenue and Customs (Appellant) v Pendragon plc and others (Respondents)*. [2015] UKSC 37.

¹⁷⁸ *Ibid*, paras.1-2.

¹⁷⁹ *Ibid*, paras.4-2.

scheme in different circumstances; in this case the net VAT was not charged on the cars before¹⁸⁰, on the contrary, the cars were never sold to a final consumer until Pendragon sold them as second-hand goods.

At the first instance, the First Tier Tribunal decided that the tax advantage obtained by Pendragon was not contrary to the purpose of the VAT law since the objective of the provisions concerned was not the avoidance of double taxation; hence the objective element of the *Halifax* test was not satisfied. That would be sufficient to assess the non-existence of an abusive practice. However, the First Tier Tribunal also decided that obtaining the tax advantage was not the essential aim of the transactions concerned, since the principal or central aim of the scheme, in its view, was to obtain secure finance from a financial institution and the diversification of Pendragon's sources of credit. Therefore, it concluded that neither of the two elements laid down in *Halifax* were satisfied and the scheme was not abusive¹⁸¹.

At the second instance, the Upper Tribunal, after the verification of the two elements required in the *Halifax* test, reached the conclusion that the tax scheme was abusive, stressing that the purpose of the provisions on which Pendragon relied was the avoidance of double taxation and distortion of competition, highlighting that the First Tier Tribunal had gone wrong in law. The Upper Tribunal had the view that the 'real reason' of the scheme was the tax avoidance¹⁸².

At the third instance, the Court of Appeal examined the scheme and the transactions concerned, concluding that the First Tier Tribunal's decision was based on the evaluative exercise, being entitled to decide as it is. Without any own conclusion on the difference between the Tribunal's decisions, the Court of Appeal restored the decision of the First Tier Tribunal¹⁸³.

Finally, the Supreme Court, after an extensive analysis of the principle of abuse of law, *Halifax* and the jurisprudence of the CJEU concluded that, the Upper Tribunal was right on its assessment concerning the objective element of the *Halifax* test. However, the Supreme Court disagreed with the decision of the Upper Tribunal regarding the subjective element of the *Halifax* test, considering that the tax scheme in question had the sole purpose to achieve the tax advantage and no other commercial rationale concurred with it as the Upper Tribunal concluded. Nevertheless, the Supreme Court reached the same conclusion as the Upper Tribunal,

¹⁸⁰ Ibid, para.15.

¹⁸¹ Ibid, paras.35-36.

¹⁸² Ibid, paras.35, 37.

¹⁸³ Ibid, para.35.

considering the subjective element of the *Halifax* test satisfied as well, hence having a positive assessment of abuse¹⁸⁴.

The Supreme Court emphasized that “The difficult concept of ‘abuse of law’ as developed by the European Court”¹⁸⁵ is a general principle of central importance for VAT plans. However, two main difficulties arise where that principle is applied: first, the notion of normal commercial operations made by the CJEU in *Halifax*; second, to identify the ‘essential aim’ of the transactions concerned where a tax scheme has concurrent purposes to the tax avoidance one.¹⁸⁶ Furthermore, the Supreme Court held that the different outcome in the decisions of the First Tier Tribunal and the Upper Tribunal were related to the understanding of the principle of abuse of law in the view of those courts and their evaluation of facts in the light of that understanding¹⁸⁷. The Supreme Court should have made a reference to the CJEU for a preliminary ruling, due to the conflicting decisions in the lower courts¹⁸⁸.

This judgment not only represents the evidence on contradictory outcomes in the finding of abuse, but it also reflects the criticism of the highest court of a MS to the inconsistent, confusing and ambiguous development of the prohibition of the abuse of law by the CJEU in the sphere of VAT. As a result, the difficulty on the application of the principle of abuse of law has been increased exponentially leading to an outcome less predictable and rendering its uniform application excessively difficult to be achieved, contravening the aim of the common VAT system to ensure that uniformity¹⁸⁹.

¹⁸⁴ Ibid, paras.33, 34, 37.

¹⁸⁵ Ibid, para.50.

¹⁸⁶ Ibid, paras.10-13.

¹⁸⁷ Ibid, para.51.

¹⁸⁸ Case C-160/14 *Ferreira da Silva e Brito and Others* ECLI:EU:C:2015:565, paras.43-45.

¹⁸⁹ VAT Directive, Recital (61).

7. Conclusions

The general principle of legal certainty is fundamental for the functioning of the common VAT system; it requires that provisions must be clear, precise and foreseeable. Therefore, the outcome of the application of the VAT rules must be predictable for the taxable persons in order to be able to organize their businesses and reduce their tax liability with the creation of tax schemes that are not contrary to the VAT Directive or the national law transposing it.

Accordingly, the principle of legal certainty is tested in each case in which the principle of abuse of law is invoked. Despite the negative effect on the predictability of the VAT rules, where an abusive practice is found by the national court the application of the principle prohibiting that behavior is justified. EU law cannot tolerate economic operators that take tax advantages by relying on abusive practices. Conversely, if the national courts in the MS admit this abusive behavior in order to protect the legal certainty and limit themselves to interpret the provisions rigidly, considering only its wording, then the outcome would be provisions that may not accomplish their object and purpose, leading to an incongruent scenario where the application of the provisions has an absurd result. Therefore, the national courts should balance these principles of EU law in order to attain a rational and coherent outcome, attending to the particular circumstances and evidence in each case.

The finding of abuse must be assessed only where the two elements of the *Halifax* test are fulfilled. Therefore, the two limbs of the *Halifax* test cannot be integrated into one requirement or verification of the mere existence of artificial transactions with the purpose of obtaining a tax advantage, which would not be sufficient to assess the abuse due to the fact that it is also necessary that the tax advantage attained is contrary to EU law or the national law transposing it. This will guarantee the right of taxable persons to design the most beneficial VAT scheme when the EU law leaves to the economic operators the freedom to choose from different regimes.

The principle of the abuse of law, as developed by the CJEU, is not flawless. On the contrary, the principle of abuse of law, as it stands today is not clear, precise or predictable due to the inconsistent interpretation of the principle that along the years, from *Halifax* to *Cussens*, the CJEU has provided. Especially the expression *essential aim* has been very problematic, the Court decided to use that expression in *Halifax* instead of the expression *sole aim* or *solely objective*, despite that in the same judgment was held that the prohibition of abusive practices is not relevant when is other explanation to carry out the transactions concerned. Moreover, the CJEU after *Halifax* interpreted back and forth that the principle of abuse

of law may be invoked where the economic objectives of the transactions concerned concur with the purpose of the attainment of the tax advantage, as it did in *Part Service*, only to interpret later in *Weald Leasing* that the principle prohibiting abusive practices is irrelevant where other explanation than the tax advantage appears to justify the transactions concerned.

As a result, the national courts have been struggling to correctly apply the principle, as it was shown in *Pendragon*, due to the difficult task of interpreting the VAT provisions and the complex VAT schemes designed by the taxable persons. Moreover, the national courts also have to consider which one is the essential or principal aim of the transactions concerned. In order to accomplish that task, judges have to ask themselves: How substantial must be the economic objective of a transaction to be considered the principal aim? How important to the undertaking of the taxable person must be the economic purpose of the transactions to be considered the essential aim? The answers to these questions represent a real challenge for the national courts and imply the exercise of an extremely broad discretion by the judges. As a consequence, the outcome of the application of the principle of abuse of law under such broad approach is less predictable.

The uncertainty determining the essential aim of the transactions has also a negative impact on the economic operators due to the fact that the transactions performed in their VAT scheme not only must have a purpose different than obtaining a tax advantage, but also that purpose must be the essential one according to the opinion of a particular judge. As a result, it is very plausible the possibility that a VAT scheme regarded as abusive by a national court might be regarded as not abusive by a different national court. It follows that; the essential aim of the transactions could be extremely difficult to be uniformly assessed under the current development of the principle of abuse of law. Therefore, to regard as not relevant the principle of prohibiting abusive practices where economic objectives to perform the transactions are found is the most reasonable approach.

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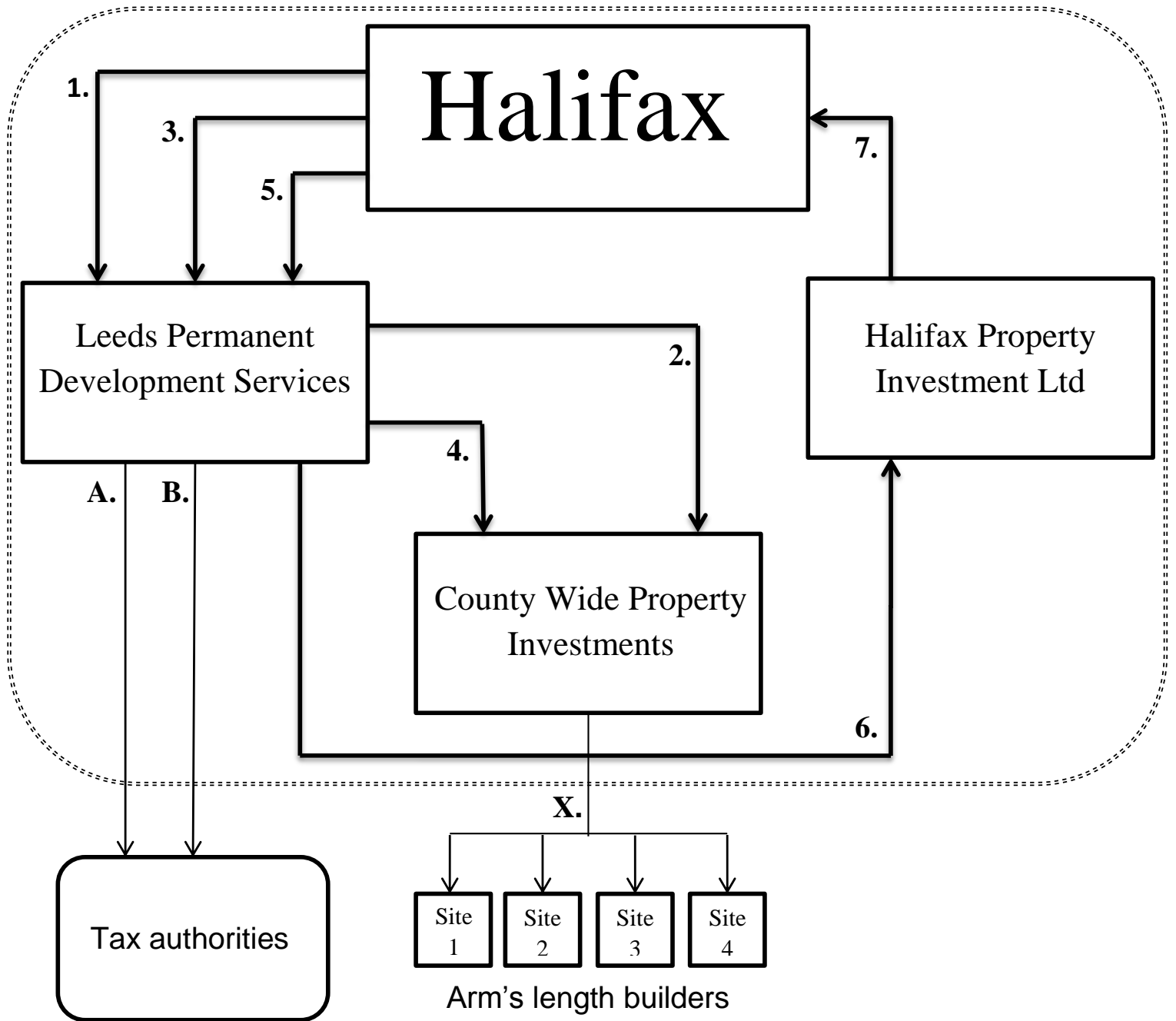
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Annex I

Halifax VAT scheme



Transactions carried out by Halifax and subsidiaries on February 29th 2000:

- 1.** Loan, development agreement and lease of 3 sites.
- 2.** Development agreement (£6,700,000 in VAT included)

Transactions carried out by Halifax and subsidiaries on March 13th 2000:

- 3.** Loan, lease and work agreement of fourth site.
- 4.** Development and funding agreement (£ 455,000 in VAT included)

Transactions carried out by Halifax and subsidiaries on April 6th 2000:

- 5.** Grant of the leases for all sites.
- 6.** Assign of the leases for all sites.
- 7.** Underlease of all sites.

VAT recovery made by Halifax subsidiary on February 29th 2000:

A. £ 6,700,000

VAT recovery made by Halifax subsidiary on March 13th 2000:

B. £ 455,000

X. Agreements with arm's length builders to carry out the works in each of the sites