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“Tax avoidance, tax evasion and tax mitigation: the distinction among those concepts in the ECJ practice”

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I. Introductory notes

Before facing the topic assigned to me, i.e. the European Court of Justice practice in the field of tax avoidance, tax evasion and tax mitigation, it is useful to introduce the relevant operational concepts.

"**Tax evasion**" is illegal. It implies a breach of tax provisions as it is a behavior consisting of hiding income, i.e. of not reporting income, or other acts or facts which are subject to taxation. A taxpayer found to have committed tax evasion may be prosecuted under the criminal law.

"**Tax avoidance**" purports to avoid the realisation of a tax norm or tax liability; it does not in itself imply a breach of a particular tax provision, but consists of an arrangement, or a series of arrangement, through which the taxpayer achieves the outcome of reducing its tax liability by exploiting loopholes in the tax legislation, in contrast with the intentions of the legislature; tax avoidance on the other hand is legal and may occur where the taxpayer reduces his liability to tax by taking advantage of a fiscally attractive option afforded to him by legislation. Some forms of "tax avoidance" are acceptable to the European Court (sometimes called "tax mitigation"), whilst other forms of "tax avoidance" are unacceptable.

"Tax mitigation" essentially consists of any technique which, amongst a number of alternatives which are all allowed by the legislature, chooses the alternative which (lawfully) implies a reduction of its tax liability. In a cross-border context, tax mitigation is made possible by regulatory competition among the national tax systems. Given that the power to levy direct taxes remains with the Member States, the latter are, for example, free to "organise, in compliance with [EU] law, [their] system for taxing

distributed profits and, in that context, to define the tax base and the tax rate which apply to the shareholder receiving them". ([1])

Starting our analysis from the perspective of the direct taxation, considering that Member States apply different income and corporation tax rates, we have that a natural (or legal) person may decide to exercise an economic activity in a Member State other than his or her (or its) State of residence so as to profit from tax advantages.(2)

In the field of direct taxation, it is of paramount constitutional importance to draw a conceptual distinction between "tax mitigation" (or "tax avoidance") and "tax evasion", since that distinction is essential for the European Court of Justice (the "ECJ") in determining the extent to which EU law places limits on the exercise of national taxing powers.

In the absence of harmonised rules, the ECJ plays a key role in balancing the interests of the Member States in the regulation of direct tax matters (an area in which they retain considerable competence) with the interests of natural and legal persons whose EU fundamental freedom rights may be restricted only in limited situations. This interaction with the national tax regimes of the Member States permeates into their anti—tax avoidance rules contained in their CFC and thin capitalisation regimes, cross-border loss relief rules, DTC limitation on benefit (LoB) clauses and withholding tax provisions.

As the ECJ wrote in **Barbier**, (3) "[An EU] national cannot be deprived of the right to rely on the provisions of the Treaty on the ground that he is profiting from tax advantages which are legally provided by the rules in force in a Member State other than his State of residence". Consequently, the application of the fundamental freedoms cannot be ruled out by the fact that the exercise of such freedoms is motivated by a desire to mitigate tax liabilities. On the other hand, an EU national may not rely on the

[1] See, e.g., Case C374/04 *Test Claimants in Class IV of the ACT Group Litigation* [2006] ECR I11673, paragraph 50;

2 "[An EU] national", the ECJ wrote in Barbier, "cannot be deprived of the right to rely on the provisions of the Treaty on the ground that he is profiting from tax advantages which are legally provided by the rules in force in a Member State other than his State of residence" (Case C364/01 Barbier [2003] ECR I-15013, paragraph 71).

[3] Case C364/01 *Barbier* [2003] ECR I-15013, paragraph 71

fundamental freedoms in a way that undermines the effectiveness of the tax system of the Member State that has jurisdiction to tax him or her.

In the ECJ's words, "nationals of a Member State cannot attempt, under cover of the rights created by the Treaty, improperly to circumvent their national legislation. They must not improperly or fraudulently take advantage of provisions of [EU] law" ([4]). Accordingly, EU law does not protect natural or legal persons who seek to pay less tax by creating situations that artificially fall within the scope of application of the fundamental freedoms. Restrictions on the free movement of companies and capital which seek to prevent tax evasion and do not go beyond what is necessary to attain that objective are compatible with EU law. In essence, while a Member State may not prevent genuine tax mitigation, EU law does not provide a shield for tax evaders.

Thus the question is how to draw a distinction between those two concepts.

II. The concepts of abuse of law and tax avoidance in relation to the internal market

The ECJ has elaborated the notion of "**abuse of law"** , according to which "a national measure restricting [a fundamental freedom] may be justified where it specifically relates to wholly artificial arrangements aimed at circumventing the application of the legislation of the Member State concerned" (5). This means that a Member State may adopt measures which, while constituting a restriction on free movement, seek to prevent abusive practices and are thus able to be justified.

The purpose of my contribution is thus to explore the concepts of "abuse of law" and "tax avoidance" as applied by the ECJ relating to the internal market .
In the end, a brief conclusion describes the steps that a national court must follow when determining whether a particular behaviour constitutes such an abuse.

[4] See, generally, DE LA FERIA, R.: VOGENAU-ER, S., (eds). *Prohibition of Abuse of Law: A New General Principle of EU Law*? Oxford: Hart Publishing, 2011.

[5] See, to that effect Case C264/96 *ICI* [1998] ECR I-4695, paragraph 26; Case C-324/00 *Lankhorst-Ho-horst* [2002] ECR I-11779, paragraph 37; C9/02 *Last-eyrie du Saillant* [2004] ECR I2409, paragraph 50; and Case C-446/03 *Marks & Spencer* [2005] ECR I-10837, paragraph 57

In the key passage of ***Van Binsbergen***, ([6]) the first case to which the doctrine of abuse can be related, the ECJ did not provide a definition of abusive practices, but restricted itself to acknowledging that Member States were, in principle, entitled to counter so-called "U-turn" or "circumvention" transactions (i.e. "situations where either persons or goods move from one Member State to another, although the final destination of the transaction is the original Member State; the central focus is the exercise of a right conferred by [EU] law, the right to free movement, in order to circumvent the national law of a Member State").

However, as later the ECJ made clear in *Kefalas* and *Centros*, the *Van Binsbergen* line of case law did not imply that Member States enjoy "*carte blanche* in the application of [their] own national anti-abuse provisions". The ECJ declined to hold that national measures prohibiting "U-turn" or "circumvention" transactions fall outside the scope of application of the fundamental freedoms. In so far as those measures constitute a restriction on free movement, the fact that they seek to combat abusive practices must therefore be examined in terms of a possible justification for such a restriction. As the ECJ pointed out in ***Centros***, ([7]) the exercise of the right to free movement could not, in itself, give rise to abuse. For the ECJ, "the fact that a national of a Member State who wishes to set up a company chooses to form it in the Member State whose rules of company law seem to him the least restrictive and to set up branches in other Member States cannot, in itself, constitute an abuse of the right of establishment". "The right to form a company in accordance with the law of a Member State and to set up branches in other Member States", the ECJ also wrote, "is inherent in the exercise, in a single market, of the freedom of establishment guaranteed by the Treaty".

Thus, Van Binsbergen, Kefalas and Centros foreshadow the need for a method of analysis capable of distinguishing situations involving the legitimate exercise of a fundamental freedom from those that give rise to abusive practices.

[6] C33/74 *Van Binsbergen v Bedrijfsvereniging voor de Metaalnijverheid* [1974] ECR1299, paragraph 27.

[7] Case C-212/97 *Centros* [1999] ECR I-1459, paragraph 24.

In **Emsland-Stärke** (8) the ECJ then developed a test that would allow national courts to draw a distinction between those two types of situations.

As to the facts of the case,

a German company exported several consignments of a potato-based product to Switzerland, for which it received an export refund. The German customs authorities came to know that soon after their release in Switzerland, the exported consignments in question were transported – unaltered and by the same means of transport – to Italy or back to Germany. As an effect, those authorities asked for a repayment of the export refund.

The decisive point of the case was whether, in the event of a purely formal dispatch from the EU territory with the sole purpose of benefiting from an export refund, Regulation No 2730/79 (9) precluded an obligation to repay that refund.

The ECJ gave a negative answer to the question, by stating that: "The scope of [EU] regulations must in no case be extended to cover abuses on the part of a trader". Then, the Court explained what is to be understood by "abuse".

"A finding of an abuse requires, first, a combination of objective circumstances in which, despite formal observance of the conditions laid down by the [EU] rules, the purpose of those rules has not been achieved.

It requires, second, a subjective element consisting in the intention to obtain an advantage from the [EU] rules by creating artificially the conditions laid down for obtaining it. The existence of that subjective element can be established, inter alia, by evidence of collusion between the [EU] exporter receiving the refunds and the importer of the goods in the non-member country".

Emsland-Stärke is therefore **an innovatory pronouncement which laid down,** for the first time, "**the criteria for determining the existence of abuse for the purposes of EU law".**

[8] Case C110/99 Emsland-Stärke [2000] ECR I11569.
9 Commission Regulation (EEC) No 2730/79 of 29 November 1979 laying down common detailed rules for the application of the system of export refunds on agricultural products, [1979] OJ L 317/1 (repealed).

In Halifax ([10]), a case concerning the interpretation of the Sixth VAT Directive, the ECJ extrapolated to the field of taxation that definition of abuse.

Halifax, a banking company, wished to build new call centres in Northern Ireland. Since most of its services were exempt from VAT, it could only recover a small percentage of the input VAT paid for construction works. So the company decided to set up a series of transactions involving different companies of the Halifax group which, in principle, enabled it to recover all of the input VAT paid in respect of those construction works.

The UK tax authorities however rejected its application for repayment of the input VAT paid on the ground that a transaction entered into solely for the purpose of VAT avoidance was neither itself a "supply", nor a step taken in the course or furtherance of an "economic activity" within the meaning of the Sixth Directive. Accordingly, the national judge referred the case to the ECJ asking whether the right to deduct input VAT was ruled out where the transactions on which that right was based constituted an abusive practice.

The ECJ first recalled the key passage in Emsland-Stärke, according to which "[t]he application of [EU] legislation cannot be extended to cover abusive practices by economic operators, that is to say transactions carried out not in the context of normal commercial operations, but solely for the purpose of wrongfully obtaining advantages provided for by [EU] law". Hence, the ECJ made clear that "[the] principle of prohibiting abusive practices [as defined by the case law] also applies to the sphere of VAT".

The Court went on to provide **some guidance on what constituted "abuse"** and on the concept of "acceptable tax-planning" against a backdrop of the principle of legal certainty. It highlighted **(a)** that "Community legislation must be certain and its application foreseeable by those subject to it" and that this requirement must be "observed all the more strictly" when the rules "entail financial consequences" so that the "extent of the obligations imposed" are clear to the persons concerned; and **(b)** that "tax considerations" could influence a taxpayer's decision in terms of structuring or planning a VAT transaction: "taxpayers may choose to structure their business so as to limit their tax liability".

[10] Case C-255/02 Halifax and Others [2006] ECR I1609

The ECJ was thus obliged to provide the national court with a method of analysis capable of distinguishing between legitimate and abusive VAT transactions, and formulated its **<u>two-pronged test for "abuse" in the VAT area</u>**:

- <u>First,</u> "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".

- <u>Second</u>, "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".

Conversely, the prohibition of abuse is not relevant where the economic activity carried out may have some explanation other than the mere attainment of tax advantages.

Of course, it was for the national court to make those determinations:

- with regard to the <u>first element,</u> the national court had to take into account the principles underpinning the VAT system, in particular the complete neutrality of taxation of all economic activities and the existence of a direct and immediate link between a particular input transaction and a particular output transaction. Accordingly, "[t]o allow taxable persons to deduct all input VAT even though, in the context of their normal commercial operations, no transactions conforming with the deduction rules of the Sixth Directive or of the national legislation transposing it would have enabled them to deduct such VAT, or would have allowed them to deduct only a part, would be contrary to the principle of fiscal neutrality and, therefore, contrary to the purpose of those rules.

- as to the <u>second element</u>, the national court had to "determine the real substance and significance of the transactions concerned. In so doing, it may take account of the purely artificial nature of those transactions and the links of a legal, economic and/or

personal nature between the operators involved in the scheme for reduction of the tax burden.

The Court went on to explain what should happen in the event of a finding of "abuse", namely, that the "transactions involved in an abusive practice must be redefined so as to re-establish the situation that would have prevailed in the absence of the transactions constituting that abusive practice".

The Court therefore propounded a two-prong test for abuse in the VAT sphere with a subjective and an objective element .([11])

This test was expanded into the direct tax area in Cadbury Schweppes where the United Kingdom's CFC rules were challenged on grounds of incompatibility with EU law.

III. The analysis of "wholly artificial arrangements" in "Cadbury Schweppes"

Unlike VAT, direct taxation is not harmonised at EU level. Arguably, it could be maintained that an autonomous EU concept of abuse of law, developed by the ECJ, may only be applied in those areas in which the EU legislator has exercised its competences whilst in the absence of such harmonisation, the definition of that concept should be left to national law. The case Cadbury Schweppes focussed on that very question.

It must be stated in advance that Cadbury Schweppes was not the first direct taxation case in which the ECJ had to examine the compatibility with EU law of national

[11] It is worth noting that, unlike *Emsland-Stärke*, *Halifax* contains no explicit reference to the "subjective element" of abuse[30]. That silence may be explained by the criticisms put forward by some scholars and Advocates General before the ECJ delivered its judgment in *Halifax* AG Poiares Maduro argued that the subjective intention of those claiming the EU right in question is not "decisive for the assessment of abuse. It is instead the activity itself, objectively considered". Arguably, a possible reading of Halifax suggests that the existence of objective factors may suffice to demonstrate that a transaction involves an abusive practice (PISTONE, P. Abuse of Law in the Context of Indirect Taxation: From (before) Emsland-Stärke 1 to Haifax (and Beyond) in DE LA FERIA, R.: VOGE-NAUER, S., (eds), supra note 4, 382, at 387 (who argues that Halifax confirms that "the existence of objective factors [is] sufficient for detecting the existence of abusive practices").

measures prohibiting "circumvention" transactions; on the contrary, the ECJ had already ruled that Member States could pass legislation "specifically target[ing] wholly artificial arrangements" (12), but had not come to lay down criteria identifying those arrangements, given that the national measures at issue had such a broad scope of application that it was clear that they were not "specifically designed" to counter them (13).

In Cadbury Schweppes (14) **the ECJ explained what the expression "wholly artificial arrangements" actually meant.**

The legal background of the case was as follows.

The UK legislation on controlled foreign companies ("CFCs", i.e. foreign companies in which the resident parent company owns a holding of more than 50%) established, as an exception to the general rule, that profits made by a CFC are attributed to the UK parent company and included in the parent company's tax base, although they had not been received by that company, where the CFC was subject, in the State in which it was established, to a "lower level of taxation". As to the facts of the case, Cadbury Schweppes ("CS"), the UK resident parent company of the Cadbury Schweppes group owned – indirectly through a chain of subsidiaries belonging to the group at the head of which was Cadbury Schweppes Overseas ("CSO") - two subsidiaries in Ireland, namely Cadbury Schweppes Treasury Services ("CSTS") and Cadbury Schweppes Treasury International ("CSTI"), exercising financial activities inside the group. The two subsidiaries were established in Ireland so that the profits related to the internal financing activities of the Cadbury Schweppes group could benefit from the tax regime of the International Financial Services Centre in Dublin ('the IFSC'), with a tax rate of 10%. Taking the view that CSTS and CSTI were subject to "a lower level of taxation", the UK tax authorities decided that the profits made by CSTI for the 1996 financial year had to be attributed to CSO.

[12] See recently, Case C330/07 *Jobra* [2008] ECR I9099.

13 See, e.g., ICI, supra note 5, paragraph 26. See more recently, Case C330/07 Jobra [2008] ECR I9099. See also LANG, M. Cadbury Schweppes' Line of Case Law from the Member State's Perspective in DE LA FERIA, R., and VOGENAUER, S., (eds), 435, at 436.

14 ECJ, 12 Sep. 2006, Case C-196/04, Cadbury Schweppes plc and Cadbury Schweppes Overseas Ltd v Commissioners of Inland Revenue, ("Cadbury Schweppes"), [2006] ECR I7995. For a detailed analysis of the case see, Tom O'Shea, "The UK's CFC rules and the freedom of establishment: Cadbury Schweppes plc and its IFSC subsidiaries – tax avoidance or tax mitigation?"EC Tax Review, 2007, 1, 13-33. For a recent analysis see Richard Wellens, "Cadbury Schweppes and Beyond: the Future of the UK CFC Rules: Part 1", I.T. Rep. 2009, Oct, 1-9 and Richard Wellens, "Cadbury Schweppes and Beyond: the Future of the UK CFC Rules: Part 2", I.T. Rep. 2009, Nov, 1-6.

See O'SHEA, T., *Tax avoidance and abuse of EU law*, in The EC Tax Journal, Volume 11, 2010-11.

Those authorities thus claimed back corporation tax from CSO in the sum of £8 million. CS and CSO challenged that decision on the ground that the taxation provided for by the legislation on CFCs was contrary to the freedom of establishment, the freedom to provide services and the free movement of capital.

At the outset, the ECJ held that legislation at hand fell within the substantive scope of the provisions of the Treaty on freedom of establishment. In addition the Court noted that even though Cadbury Schweppes plc, a United Kingdom resident company, had decided to establish subsidiaries in the International Financial Services Centre (IFSC) in Ireland to take advantage of the favourable 10% tax regime, that fact did not "in itself constitute abuse". Nor may that fact rule out the application of the freedom of establishment.

Next, the ECJ held that the UK legislation on CFCs constituted a restriction on the freedom of establishment. In fact, whilst the profits made by subsidiaries established in the UK were never attributed to their resident parent company, the same did not hold true in relation to subsidiaries established outside that Member State.

As to the justification, the UK Government argued that its CFC legislation was aimed at countering a particular type of "tax avoidance" involving the artificial transfer by a United Kingdom resident company of its profits to a low-tax State (Ireland) through the establishment of a subsidiary there. The Court, in response, noted that "any advantage resulting from the low taxation to which a subsidiary established in a Member State other than the one in which the parent company was incorporated is subject cannot by itself authorise that Member State to offset that advantage by less favourable treatment of the parent company".

Furthermore, the establishment of the subsidiary in Ireland could not "set up a general presumption of tax evasion and justify a measure which compromises the exercise of a fundamental freedom".

However, such CFC rules might be justified where they related "to wholly artificial arrangements aimed at circumventing the application of the legislation of the" United Kingdom.

The Court advised that, in these circumstances, it was necessary to consider the objective of the freedom of establishment when assessing the conduct of a person opening a secondary establishment in another Member State. That objective was "to allow a national of a Member State to carry on his activities there (...) [and] to participate, on a stable and continuing basis, in the economic life (...) and to profit therefrom".

The Court explained that this involved the "actual pursuit of an economic activity through a fixed establishment in that State for an indefinite period (...) it presupposes actual establishment (...) in the host Member State and the pursuit of genuine economic activity there".

Therefore, for the United Kingdom rules to be justified on the ground of preventing "abusive practices"

> "the specific objective of such a restriction must be to prevent conduct involving the creation of wholly artificial arrangements which do not reflect economic reality, with a view to escaping the tax normally due on the profits generated by activities carried out on national territory".

Such "artificial arrangements" jeopardised the right of Member States to exercise their tax jurisdiction and undermined the "balanced allocation between Member States of the power to impose taxes". Consequently, the Court was satisfied that the United Kingdom's CFC rules were suitable to achieve their objective because they could "thwart practices which have no purpose other than to escape the tax normally due on the profits generated by activities carried on in national territory".

The Court next had to ascertain whether the United Kingdom's CFC rules went beyond what was necessary to prevent artificial arrangements intended to solely escape tax and commented that two elements were needed to show that an "artificial arrangement" existed: a subjective and an objective element.

The subjective element comprised the "intention to obtain a tax advantage".

The objective aspect required the existence of "objective factors which are ascertainable by third parties with regard, in particular, to the extent to which the CFC physically exists in terms of premises, staff and equipment".

Should these objective factors lead to the conclusion that the CFC was a "fictitious establishment" (like a "letterbox" or brass-plate company) "not carrying out any genuine economic activity in the territory of the host Member State, the creation of that CFC must be regarded as having the characteristics of a wholly artificial arrangement".

However, the fact that the activities of the CFC could have been carried out in the United Kingdom "does not warrant the conclusion that there is a wholly artificial arrangement".

Moreover, if the CFC is treated as a wholly artificial arrangement by the United Kingdom tax authorities, the United Kingdom parent company must be given an opportunity "to produce evidence that the CFC is actually established and that its activities are genuine", i.e. that the transaction in question (the granting of a loan by a non-resident company) had a commercial justification.

In addition, where those transactions were considered to be "wholly artificial", "the re-characterisation of interest paid as a distribution [would be] … limited to the proportion of that interest which exceeds what would have been agreed had the relationship between the parties or between those parties and a third party been one at arm's length".

The Court concluded that it was for the national court to determine whether the United Kingdom's CFC rules, in particular, the "motive test", restricted taxation to wholly artificial arrangements or whether they went beyond what was necessary to combat abusive practises, taxing United Kingdom resident companies intending to obtain a reduction in United Kingdom taxation through the establishment of the CFC, "despite the absence of objective evidence" to indicate the existence of a wholly artificial arrangement, this way going beyond what was necessary to combat abusive practices. In this latter situation, the Court indicated that the CFC rules would be "contrary to Articles 43 and 48 EC".

As the best doctrine (15) has underlined, five direct implications can be drawn from the ruling of the ECJ in Cadbury Schweppes.

- First, and foremost, the ECJ stressed the fact that the home Member State must be able to counter wholly artificial arrangements which undermine its tax jurisdiction in relation to the activities carried out on its territory. Otherwise, the balance between Member States, in terms of allocation of the power to impose taxes, would be jeopardised.

- Second, national measures seeking to prevent tax evasion must be specifically designed to counter abusive practices, i.e. their scope must be limited to prohibiting wholly artificial arrangements which do not reflect economic reality.

- Third, the ECJ recalled that "the mere fact that a resident company establishes a secondary establishment, such as a subsidiary, in another Member State cannot set up a general presumption of tax evasion and justify a measure which compromises the exercise of a fundamental freedom guaranteed by the Treaty". It follows that Member States cannot prevent bona fide tax mitigation.

- Fourth, where the setting-up of a subsidiary in the host Member State does not reflect economic reality, the objective pursued by the freedom of establishment

[15] KOEN LENAERTS,*Tax mitigation vs. tax evasion in the case law of the European Court of Justice,* ISSN 1392-1274. TEISE' 2013.

has not been achieved. Hence, such establishment constitutes a wholly artificial arrangement which does not entitle taxpayers to obtain a more favourable tax treatment in the home Member State.

- Fifth, the concept of abuse of law comprises both subjective and objective elements. Subjectively, the person or company concerned must have the intention of obtaining a tax advantage. Objectively, in order to determine the existence of a wholly artificial arrangement, one must look at objective factors ascertainable by third parties which prove that the subsidiary at issue does not carry out a genuine economic activity in the host Member State.

For example, those factors could examine whether the subsidiary physically exists in terms of premises, staff and equipment. Moreover, the ECJ pointed out that there is no abuse of the freedom of establishment where the subsidiary carries out a genuine economic activity, regardless of whether its establishment in a particular jurisdiction is motivated by the desire to mitigate tax liability.

Some scholars hold that the concept of abuse of law applied by the ECJ in Cadbury Schweppes is narrower than that applied by the ECJ in Halifax (16). Indeed, whilst in the former case the ECJ defined "abusive practices" as "wholly artificial arrangements", in the latter case it held that "the essential aim of the transactions concerned is to obtain a tax advantage".

Later, in ***Part Service*** (17), another VAT case, the ECJ clarified that the expression "essential aim of the transaction" is not to be interpreted as meaning "the sole aim pursued by the transaction", but as denoting "the principal aim of the transaction or trans-actions in question". This means that, in the context of VAT, a national court may find that an arrangement constitutes abuse, "notwithstanding the possible existence, in addition, of economic objectives arising from, for example, marketing, organisation or guarantee considerations". And so a lack of business goal can be seen

[16] DE LA FERIA, R., *supra* note 9, at 428. See also VANISTENDAEL, F. *Cadbury Schweppes* and Abuse from an EU Tax Law Perspective, in DE LA FERIA, R.: VOGENAUER, S., (eds), *supra* note 4, 408, at 422

[17] Case C425/06 *Part Service [2008] ECR 1897.*

also with transactions that may bring about an economic result but in whose execution the tax aspects were the primary focus.

For some authors, the fact that Halifax and Part Service concerned purely internal situations may explain why the concept of abuse applied by the ECJ in the context of VAT litigation is broader than that applied in direct taxation cases. In his view, in those two cases, the national court "was dealing with [a problem of] interpretation that was very much akin to the interpretation of a national tax rule". In his view, the ECJ was right to adopt a more flexible concept of abuse which grants national courts a margin of appreciation.

However, situations involving a fundamental freedom are different. In Cadbury Schweppes, there was a clear EU interest in making sure that in order to prevent the reduction of tax revenues, national authorities did not "abuse" the concept of "abuse of law", by depriving individuals of the tax advantages accompanying a legitimate exercise of the right to free movement. To that end, the ECJ decided to limit the concept of abuse to "wholly artificial transactions".

IV. Concluding remarks

The abovementioned decisions provide national courts with useful guidance when they are called upon to determine whether a national measure prohibiting abusive practices complies with the fundamental freedoms.

To that end, a national court must, at the outset, (1) establish which of the fundamental freedoms applies. (2) Next, it must examine whether the national measure at issue in the main proceedings constitutes a restriction on the relevant freedom. If that is indeed the case, (3) it must look at the reasons that may justify such a restriction.

It is thus at the justification stage that the national court must take into account the concept of abuse developed by the ECJ in its pronouncements, namely in Cadbury Schweppes ([18]).

First, the fact that the company was established in a Member State for the purpose of benefiting from a more favourable tax treatment does not in itself suffice to constitute an abuse of the relevant fundamental freedom. It follows that tax mitigation which results from a legitimate exercise of the right to free movement is protected by EU law. Second, EU law does not offer a shield to tax evaders, since Member States may prevent taxpayers from obtaining tax advantages resulting from "wholly artificial arrangements" which do not involve the genuine exercise of an economic activity. Those arrangements constitute abusive practices. In order to determine whether an arrangement is wholly artificial, Cadbury Schweppes tells national courts to examine the intention of the taxpayer concerned and to look at objective factors which are ascertainable by third parties. Needless to say that those objective factors are not always the same but may vary in accordance with the arrangement in question.

For example, regarding the setting up of a subsidiary for the purpose of obtaining a more advantageous tax treatment, we gather from Cadbury Schweppes that those objective factors may, for example, relate to the physical existence in terms of premises, staff and equipment of the subsidiary concerned (as opposed to a mere "letter-box" subsidiary).

Moreover, it appears that the ECJ gives more weight to the existence of objective factors than to the intentions of the taxpayer concerned.

Indeed, in Cadbury Schweppes, the ECJ ruled that, regardless of the motivation behind the exercise of the rights to free movement, in the absence of objective factors proving the existence of a wholly artificial arrangement, there cannot be an abuse.

However, it would be very difficult for the taxpayer concerned to demonstrate that he did not intend to obtain a tax advantage where objective factors indicate the contrary.

[18] KOEN LENAERTS,*Tax mitigation vs. tax evasion in the case law of the European Court of Justice,* ISSN 1392-1274. TEISE' 2013.

Last but not least, regarding **the principle of proportionality**, the national measure at issue must be sufficiently finely calibrated so as to prohibit abusive practices only.

Application of the general tax avoidance rules must be proportional and mindful of the balance of different interests. The tax authority cannot have unlimited rights in resolving tax issues: it has to respect constitutional rights and freedoms, and it may not excessively suppress taxpayers' operations or cause undue trouble ([19]). The ECJ has established certain principles through case law for judging when tax avoidance measures are to be considered proportional. The principle of proportionality is of considerable weight in Community law and as such must be respected as part of the aims and basic values of the EC Treaty.

The principle of proportionality involves seeking to establish whether it is possible to achieve a legal result of higher value while bearing in mind all related interests. The effort put into prevention of tax avoidance should be proportional to the consequences of intervening in taxpayers' economic activity ([20]). Loss of tax revenue cannot by default be declared the dominant public interest to justify measures that do not respect fundamental freedoms. If fundamental freedoms may be compromised, the interest in opposition to them should be weighed with extra care (21).

Tax avoidance measures are not proportional if they do not consider specific details of transactions and are based only on predetermined circumstances. The measure taken must be usable as a general provision and be relevant to a variety of situations, provided that the transaction bears no economic substance and its only aim is to obtain a tax advantage. Interests under public and private law have to be taken into account equally. The principle of proportionality requires that the measures be appropriate, necessary, and reasonable, to be used only in cases of sham transactions and tax avoidance.

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

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

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

This means that general and irrefutable presumptions establishing that certain transactions constitute abusive practices fail to comply with the principle of proportionality. Procedurally, Member States must allow the individual or company concerned to rebut such presumptions and, in any event, national courts must be able to assess the existence of abuse on a case-by-case basis.