

Review of ‘Anti-avoidance measures of general nature and scope- GAAR and other rules’ (IFA 2018)¹

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The 2018 IFA Cahiers (volume a) contains 42 country reports, 1 General Report, 1 EU Report and 1 OECD report. The aim of the 2018 Cahiers was to analyze general anti-avoidance statutory rules (GAARs) and judge-made doctrines by considering the following four aspects: the main elements in the design of such rules (tax scheme, tax benefit and taxpayer’s purpose); the interaction between domestic GAARs, treaty GAARs and domestic SAAR; case law in the operation of GAARs; and the safeguards (if any) for the taxpayers.

Comparative functional approach

For these 2018 Cahiers, the General Reporters have chosen to provide a comparative taxation approach with the aim to facilitate the exchange among countries of common problems and best practices in the drafting and application of GAARs. By providing an overview of the main elements in the design of GAARs, the Cahiers aims at allowing countries to learn from each other “on how to draft GAARs, identify comparable features, solve similar issues and analyze significant judicial responses”.⁴

Following this comparative approach, the General Reporters have also chosen to address the GAARs as a tax transplant which is being analyzed following the function of the rules transplanted. For the General reporters the functionality approach aims “at relating solutions to common policy issues by identifying patterns for comparability between tax systems”.⁵ To our knowledge, the term “tax transplants” has

¹ IFA Cahiers, *Anti-avoidance measures of general nature and cope GAAR and other rules*. Cahiers de droit fiscal international vol. 103a, 2018, Online Books IBFD.

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⁴ P. Rosenblatt & M.E. Tron. *General Report*, in *Anti-avoidance measures of general nature and cope GAAR and other rules* (IFA Cahiers vol. 103a, p.14, 2018), Online Books IBFD.

⁵ In Rosenblatt & Tron, *supra* n. 4, at p.17, footnote 22, in the functional approach, reference is made to Carlo Garbarino. See C. Garbarino, *Comparative Taxation and Legal Theory: The Tax Design Case of the Transplant of General Anti-Avoidance Rules* 11 Theo. Inq. L 2, pp. 765-790 (2010).

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been used for the first time by IFA in relation to GAARs, which makes this analysis innovative in comparison to previous IFA reports where the issue of tax avoidance has been analyzed, i.e. the IFA reports on tax avoidance/tax evasion (Venice Congress 1983), Form and Substance in Tax Law (Oslo Congress, 2002) and Tax treaties and tax avoidance: application of anti-avoidance provisions (Rome Congress, 2010).⁶

The General Reporters have also addressed the contextual and cultural approach in which the GAARs are developed which includes the cultural, historical and linguistic particularities and the way judges see their constitutional rule⁷. The general reporters acknowledged that “every GAAR is unique, a product of tax system’s history, culture, effectiveness, approach to statutory interpretation, tax morale and so forth”.⁸ For the General Reporters, “GAARs and other general anti-avoidance measures are drafted in mixed ways, due to the variety of legal culture, system, structure and responses to tax avoidance”⁹. Despite these references no further analysis is made in the IFA General Report to the application of this contextual approach in the analysis of GAARs.

This is one shortcoming of this report, since the context¹⁰ and legal (tax) culture¹¹ are also important elements to find out why a rule changes upon transplantation and what are the elements that make a rule what it is. Therefore, further research should be carried out to take into account the role of the context and the legal culture in the adoption of GAARs.

From a comparative law approach, the countries covered are common law countries (e.g. New Zealand, the United Kingdom, South Africa, the United States, Canada, India), civil law countries (e.g. France, Argentina, Italy, Mexico, Spain), and some mixed, i.e. common law/civil law, countries (South Africa, the Netherlands, and Turkey).¹² These countries represent some geographical areas (i.e. Europe, Asia and Northern America) However, other regions are under-represented. Few countries from Middle America (only Mexico), Africa (only South Africa), and Asia (Chinese Taipei, Hong Kong, Singapore, Republic of Korea, Sri Lanka, Indonesia) are represented. This is mainly due to the willingness of countries to submit

⁶ The topic of tax transplants has been also by one of the authors at the EATLP Academic meeting in June 2019. See slides presentation at <https://globtaxgov.weblog.leidenuniv.nl/files/2019/06/Mosquera-tax-competition-and-legal-transplants.pdf>

⁷ Rosenblatt & Tron, *supra* n. 4, at 31.

⁸ Rosenblatt & Tron, *supra* n. 4, at 16.

⁹ Rosenblatt & Tron, *supra* n. 4, at 17.

¹⁰ On the role of the context in comparative law, see O. Y. Marian, *The Discursive Failure in Comparative Tax Law*, 58 Am. J. Comp. L. 1, pp. 415-470 (2010). This author also provides a critique to the functional approach of Garbarino, *supra* n. 5.

¹¹ Research carried out in the past by Mosquera in the field of leasing shows that the differences in culture provide the local (fine) tuning that makes that for a transplanted concept, thus, the rules are different in the recipient country than the ones in the donor country. For leasing, it was concluded that the role of Legislative, Executive, Judiciary, lessee, lessor and leasing associations referred to as legal culture, deviates from country to country. I.J. Mosquera Valderrama. *Leasing and Legal Culture - Towards consistent behaviour in tax treatment in civil law and common law jurisdictions*, dissertation (2007). The role of culture has also been addressed by Burgers as an obstacle to a common approach towards the place of effective management. I.J.J. Burgers, *Some Thoughts on Further Refinement of the Concept of Place of Effective Management for Tax Treaty Purposes*, 35 Intertax 6/7, p. 378 (2007), Kluwer Law International.

¹² See for a classification of mixed systems in comparative law E. Özücü, *What is a Mixed Legal System: Exclusion or Expansion?*, 12.1 Electronic Journal Comparative Law 5 (2008), available at <https://www.ejcl.org/121/art121-15.pdf>.

a report. Therefore, in our view, it is important that IFA works on encouraging the participation of IFA branches located in under-represented regions in order to enhance the exchange of best practices between countries in all geographical areas including also developing and least developed countries.¹³

This is also important taking into account the topic addressed in these Cahiers i.e. GAARs, since many (131 as of 1 July 2019) jurisdictions have committed to implement the minimum standards of the BEPS project which includes developed, developing and least developed countries. One of the minimum standards is the principal purpose test contained in BEPS Action 6 which, in essence, is a GAAR to tackle tax treaty abuse. For countries which are not familiar with the analysis of the elements of a GAAR (tax scheme, tax benefit and taxpayer’s purpose) and the interaction between domestic GAARs and treaty GAARs, the application of the principal purpose test may raise questions to which this report does not contribute¹⁴. Even though the challenges arising from the application of the principal purpose test are outside the scope of this IFA Cahiers (see below), for the reasons mentioned above in our view the participation of developing and least developed countries in all geographical areas should be encouraged.

Caveat IFA Cahiers regarding the EU/OECD developments

An important caveat of these Cahiers is that, despite the introduction of (i) BEPS Action 6, (ii) the changes to the OECD Model (art. 29 2017 OECD Model and its Commentary); and (iii) the European Union Anti-Tax Avoidance Directive (ATAD 1), the General Reporters specifically stated that these three developments are in principle outside the scope of study of the Report. In some cases, the IFA General Report refers to the EU IFA Report and the OECD IFA Report, but without addressing their findings in the analysis and recommendations of the IFA General Report.

The OECD and EU developments are only referred to when explaining the actual effect of these developments in domestic GAARs or other anti-avoidance measures. Therefore, the EU IFA report and OECD IFA reports remain separated from the General IFA Report. By doing so, the IFA Cahiers misses the opportunity to address the current discrepancies highlighted by scholarship regarding the EU application of anti-avoidance rules to ‘wholly artificial arrangements’¹⁵, the EU general principle of abuse of law that

¹³ Some countries that have been addressed which are not OECD or G20 countries are for instance, Peru, Sri Lanka, Poland, Serbia. However, these countries are not in the UN list of least developed countries. United Nations Committee for Development Policies, List of Least Developed Countries (2018), available at <https://www.un.org/development/desa/dpad/least-developed-country-category/ldcs-at-a-glance.html>

¹⁴ See on the challenges for introducing a GAAR in developing countries. T. Dubut, *Designing Anti-Base-Erosion Rules for Developing Countries: Challenges and Solutions in Tax Design Issues Worldwide* ch.5 (V. Thuronyi & G. Michielse eds., Series in International taxation, 2015, Kluwer Law International) and C. Waerzeggers & C. Hillier, *Introducing a general anti-avoidance rule (GAAR)—Ensuring that a GAAR achieves its purpose*, at p.1, Tax Law IMF Technical Note 2016/1, IMF Legal Department, available at: <https://www.imf.org/external/pubs/ft/tltn/2016/tltn1601.pdf>

¹⁵ A.G. Prats et al. *European Union Report in Anti-avoidance measures of general nature and cope GAAR and other rules* (IFA Cahiers vol. 103a, p. 62, 2018) Online Books IBFD.

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provides for the analysis of a “genuine economic activity”¹⁶ and the interaction with the interpretation of the principal purpose test¹⁷.

Since from the 42 reports submitted in the IFA Cahiers, 41 countries have committed to the Minimum Standard of BEPS Action 6 (exception is Chinese Taipei), the Cahiers would have been useful to find out how the countries see the interaction between the domestic anti-avoidance GAARs, and treaty GAARs including the principal purpose test of Action 6. As addressed in tax scholarship, the introduction of the principal purpose test presents some challenges regarding the threshold for the application of the principal purpose test, the burden of proof, and the relationship between general anti-avoidance rules, treaty abuse rules, and the principal purpose test amongst others¹⁸.

One example is the analysis of the taxpayer’s purpose or intent in the GAAR. There are different approaches applicable by countries and by courts (i.e. broad: one of the purposes; intermediate: one of the main purposes; narrow: exclusive/sole purpose). The intermediate approach (i.e. one of the main purposes) is the approach recommended by the OECD BEPS Action 6 and introduced in the EU legislation (i.e. ATAD 1). Therefore, the analysis in the General IFA Report of the introduction of an intermediate approach would have been useful for countries who follow a narrow (Belgium, Brazil, France, Luxembourg, Spain and Turkey) or broad approach (India, New Zealand).¹⁹ Two questions can be raised: are these countries going to change their approach due to the principal purpose test? And if not, will courts change their interpretation? Will approaches be applied separately (for principal purpose test an intermediate approach and for GAARs a narrow or broad approach)?

¹⁶ See Prats, *supra* 15, at p. 85 and European Commission Recommendation (EU) 2016/136 of 28 January 2016 on the implementation of measures against tax treaty abuse, OJ L 25 (2016), sec.2, p. 67 [hereinafter Commission Recommendation C(2016)271].

¹⁷ At EU level, the interaction between EU approach and domestic GAARS have been recently analyzed in the LUX: ECJ, 26 Feb. 2019, Case C-115/16, *N. Luxembourg v. Skatteministeriets* (Joined cases C-115/16, C-118/16, C-119/16, C-299/16 and C-116/16 and C-117/16, *Danish Beneficial Ownership Cases*) [2019] ECLI:EU:C:2019:134, ECJ Case Law IBFD, in light of the application of the Council Directive (EU) 2016/1164 of 12 July 2016 laying down rules against tax avoidance practices that directly affect the functioning of the internal market OJ L 193, (2016), *EU Law IBFD* [hereinafter the Anti-Tax Avoidance Directive (2016/1164)], the Council Directive 2011/96/EU of 30 November 2011 on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States, OJ L 345, (2011), *EU Law IBFD* [hereinafter the Parent and Subsidiary Directive (2011/96)] and the Council Directive 2003/49/EC of 3 June 2003 on a common system of taxation applicable to interest and royalty payments made between associated companies of different Member States OJ L 157, (2003), *EU Law IBFD* [hereinafter the Interest and Royalty Directive (2003/49)].

¹⁸ Some of the main articles are V. Chand, *The principal purpose test in the Multilateral Convention. An in-depth analysis*, 46 Intertax 1 (2018) pp. 18-44, Kluwer Law International; V. Chand, *The Interaction of the Principal Purpose Test (and the Guiding Principle) with Treaty and Domestic Anti-Avoidance Rules*, 46 Intertax 2 (2018), Kluwer Law International; D. Duff, *Tax Treaty Abuse and the Principal Purpose Test Part 1*, 66 Can. Tax J. 3 (2018) pp. 619-677 and *Tax Treaty Abuse and the Principal Purpose Test Part. 2*, 66 Can. Tax J. 4, pp. 947-1011, (2018); B. Kuźniacki, *The Principal Purpose Test (PPT) in BEPS Action 6 and the MLI*, 10 WTJ 2, (2018), Journals IBFD; I.J. Mosquera Valderrama, *Output Legitimacy Deficits and the Inclusive Framework of the OECD/G20 Base Erosion and Profit Shifting Initiative*, 72 Bull. Intl. Taxn 3, (2018), Journals IBFD; P. Piantavigna, *The Role of the Subjective Element in Tax Abuse and Aggressive Tax Planning*, 10 WTJ 2, (2018), Journals IBFD; D. Weber, *The Reasonableness Test of the Principal Purpose Test Rule in OECD BEPS Action 6 (Tax Treaty Abuse) versus the EU Principle of Legal Certainty and the EU Abuse of Law Case Law*, 10 Erasmus Law Review, 1, (2017) pp. 48-59 and S. van Weeghel, *A Deconstruction of the Principal Purpose Test*, 11 WTJ 1, (2019).

¹⁹ Rosenblatt & Tron, *supra* n. 4, at pp. 23-24.

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Another example is the analysis of whether the burden of proof is placed either among the tax administration or the taxpayer or whether it is shared between both. According to the OECD IFA report, in the principal purpose test, the burden of proof lies with the tax administration.²⁰ However, tax scholars have argued that with the principal purpose test the burden of proof lies with the taxpayer.²¹ The General IFA report only mentions the OECD IFA report, without addressing the problems addressed by tax scholars regarding the burden of proof in the principal purpose test.

The elements in the design of GAARs (tax scheme, tax benefit and taxpayer’s purpose)

In general, it can be argued that GAARs aim to counteract tax avoidance. However due to the broad scope of a GAAR, there are problems in the interpretation of the elements of a GAAR that can result in uncertainty in the application of the GAARs.²² For the General Reporters, since GAARs are based in broad standards some countries have introduced generic attributes such as unacceptable, impermissible, unjustified. These broad standards bring more uncertainty since the definition of these attributes will be a matter of judgment (personal, moral or social).²³

The scope of the GAAR depends on whether the GAAR applies to one part of the transaction, or to the overall transaction, or to a series of combination of steps.²⁴ For instance, some courts in common law countries²⁵ have analyzed the individual schemes or steps in the transaction. In some cases, the courts adopted a broad interpretation, and in other cases a restricted interpretation. Countries have introduced changes to their GAARs, among others to address the divergent approaches by the judiciary and to define the scope of a scheme. The analysis of the GAAR may take into account the overall assessment of the arrangement rather than the individual steps as it is for instance the case in France in respect of the abuse of law prohibition.²⁶ The analysis of the elements of statutory GAARs have raised also problems regarding the tests used to interpret the GAAR (e.g. artificiality, lack of commerciality, fictitiousness) the application of which is rightly regarded by the General Reporters as inconsistent and granting discretion to tax authorities.

Furthermore, the test of the nature of the arrangement (legal or economic) and the analysis of economic reality as developed by the US and the UK is being applied in several other countries. One example is the use of substance over form or economic substance in several civil law countries and common law countries either (i) as an anti-avoidance doctrine (India, Japan, Liechtenstein, Ukraine, Sweden); (ii) as one of the criteria of the statutory GAAR (Austria, Chile, Finland, India, Indonesia, Italy

²⁰ See E. Barret & M. Evers, *OECD Report in Anti-avoidance measures of general nature and cope GAAR and other rules* (IFA Cahiers vol. 103a, p. 100, 2018) Online Books IBFD and Rosenblatt & Tron, *supra* n. 4, at p. 45.

²¹ This is mainly due to the wording of the principal purpose test that allows the tax administration to present *reasonable* evidence while the taxpayer will need to establish that granting of a benefit is in accordance with the object and purpose of the relevant treaty provisions. See for instance, Chand, *supra* n. 18 at p. 21; Duff, *supra* n. 18 at part 2, p. 52, and v. Weeghel, *supra* n. 18.

²² See I.J. Mosquera Valderrama et al. *Tools used by Countries to Counteract Aggressive Tax Planning*. 46 Intertax 2 (2018), at p. 146, Kluwer Law International.

²³ Rosenblatt & Tron, *supra* n. 4, at p.18.

²⁴ Rosenblatt & Tron, *supra* n. 4, at p.18.

²⁵ Rosenblatt & Tron, *supra* n. 4, refers to Australia, Canada, New Zealand, Hong Kong, Israel, Japan, Singapore, South Africa, Sri Lanka and India. These are mainly common law countries.

²⁶ Rosenblatt & Tron, *supra* n. 4, at p. 18.

and Norway); or (iii) as one of the criteria of an avoidance arrangement (Australia and Hong Kong).²⁷ The General Reporters also stated in the General IFA Report that with regards to the analysis of the elements of a GAAR there is a trend among countries to codify the judge-made doctrines to provide certainty, but by doing so, the analysis of the legal form of the arrangement rather than economic substance can prevail in detriment of the economic reality.²⁸

There are also differences in the approach by countries to the second element of the GAARs, i.e. the tax benefit, advantage or gain. Some countries provided for a comparative requirement “between the taxpayer’s economic situation before and after the scheme was entered into or carried out”²⁹. Some countries also refer to the tax advantage either as an implicit (Argentina, Austria, Brazil, Denmark, Serbia and Turkey) or as a not defined element (Chinese Taipei, Finland, Liechtenstein, Luxembourg, Israel and the United States). Other countries (Australia and Poland) provide “for a broad definition coupled with a statutory list of features that correspond to a tax benefit”³⁰.

The third element is the taxpayer’s purpose or intent. For the analysis of the taxpayer’s purposes or intent one problematic issue is the weight of the purposes (e.g. business (non-tax) purpose vs. family purpose vs. tax purposes vs. bona fide purposes) which depends on the discretion of the tax administration and the courts.

In light of the above, and in order to reduce the uncertainty due to the lack of a clear definition of the elements of GAARs, the General Reporters recommended to law-makers “to use terms with a clear content (either specifically defined) or as a matter of law, i.e. terms that are traditionally already in use in that specific country”³¹.

Interaction between domestic GAARs, treaty GAARs and domestic SAARs

One of the problems that also creates uncertainty for taxpayers is the application of a GAAR and its interaction with SAARs. For the General Reporters, GAARs “should not always predominate, because under legislative purpose, there might be choices and incentives provided by the ordinary tax provisions”.³² There is no clarity in the interaction between GAARs and SAARs. In domestic situations, GAARs are used to complement SAARs, which creates in some cases conflicts and overlaps. In cross-border situations, tax treaty GAARs and domestic GAARs can apply independently or simultaneously, thereby creating conflict and overlapping, as well. The result is uncertainty. It can lead to tax authorities going “GAAR shopping”. Therefore, in the IFA General Report the General Reporters stated that there is a lack of consensus in how to resolve the conflicts between domestic GAARs and treaty GAARs and domestic GAARs and SAARs, which should also receive the attention by countries.³³

Problems of legal certainty and adequate safeguards for the taxpayer

²⁷ Rosenblatt & Tron, *supra* n. 4, at p. 20.

²⁸ Rosenblatt & Tron, *supra* n. 4, at p. 21.

²⁹ Rosenblatt & Tron, *supra* n. 4, at p. 21.

³⁰ Rosenblatt & Tron, *supra* n. 4, at p. 22.

³¹ Rosenblatt & Tron, *supra* n. 4, at p. 47.

³² Rosenblatt & Tron, *supra* n. 4, at p. 23.

³³ Rosenblatt & Tron, *supra* n. 4, at p. 41.

The general reporters also referred to the difficulties to find a balance between tax advisors who advocate for legal certainty and tax administrations who advocate for tax fairness and equal treatment of taxpayers. These difficulties are enhanced by the lack of a general definition of tax avoidance, the difficulties to find the boundaries between legitimate and illegitimate tax planning and the judicial responses regarding the application of GAARs and judicial anti-avoidance doctrines.³⁴ For the general reporters, the role of the courts can make the GAARs or anti-avoidance rules “ineffective, by reducing [their] scope or creating burdensome tests; or they might increase uncertainty due to casuistic, incoherent or inconsistent decisions”.³⁵ This creates more uncertainty to the application of GAARs.

Therefore, the application of safeguards is important to provide legal certainty. For the general reporters “as much as having deterring and counteracting effects, a GAAR is also a matter of building trust. Legal certainty is not achieved if safeguards are revoked or not applied, or if judicial anti-avoidance doctrines are invoked whenever the GAAR is inapplicable -especially to circumvent difficult statutory tests or procedural requirements”.³⁶

In the IFA General Report, the General Reporters argued that the discussion of safeguards is of paramount importance. Even if there is not a wish list of safeguards, important safeguards that should be taken into account by countries are proportionality regarding the application of the fines and the protection against criminalization of legitimate tax planning³⁷. Further safeguards that may be considered are privacy, confidentiality and secrecy regarding the taxpayer’s information, taxpayers’ right of information and defense that includes the right to access to information on the operation of the GAAR in any state, and the right against excessive taxation.³⁸

Final remarks

The findings of this report show that it is of paramount importance to study the relationship between the principal purpose test of BEPS Action 6 and the use of domestic or treaty GAARs or SAARs. This study should be comparative so that exchange among countries of common problems and best practices is facilitated.³⁹

³⁴ Rosenblatt & Tron, *supra* n. 4, at p. 7 states that: “In fact, GAARs are in the core of the debate on the (im)proper functioning of tax systems and the protection of the tax base. Described as a war or a game, avoidance reflects a ruthless relationship between tax authorities and the taxpayer, insofar the boundaries of legitimate and illegitimate tax planning remain blurred”.

³⁵ One example was Australia where the introduction of a new test for the application of the GAAR created uncertainty (AU: HCA 43 [High Court of Australia], 28 Sep. 1994, 181 CLR 359 [Peabody case]). This test was later abandoned in another case (AU: HCA 26 [High Court of Australia], 27 May 2004, 217 CLR 216 [Hart case]). See Rosenblatt & Tron, *supra* n. 4, at pp. 34-35 and S. Blakelock & Stewart Miranda. Country Report: Australia in *Anti-avoidance measures of general nature and scope GAAR and other rules* (IFA Cahiers vol. 103a, pp.146-148, 2018), Online Books IBFD.

³⁶ Rosenblatt & Tron, *supra* n. 4, at p. 43.

³⁷ Rosenblatt & Tron, *supra* n. 4, at p. 45.

³⁸ Rosenblatt & Tron, *supra* n. 4, at pp. 46 and 48.

³⁹ One recent example of such analysis is the recent analysis of the UK GAAR in J. Freedman, *The UK General Anti-Avoidance Rule: Transplants and Lessons*, 73 Bull. Intl. Taxn. 6/7 (2019), IBFD Journals.