"WHOLLY ARTIFICIAL ARRANGEMENTS" AND PRESUMPTIONS OF TAX AVOIDANCE*

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1. Introductory remarks

The aim of this article[2] is to explore whether and to what extent irrebbutable presumptions of tax avoidance that bar taxpayers from producing evidence to deny the existence of wholly artificial arrangements are permissible under EU law.[3]

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* Before articles have been accepted for publication in EC Tax Journal's peer-reviewed section, they have been subject to double-blind peer-review; that is, two academic reviewers who shall remain anonymous to the author and to each other and neither of whom are from the same country as the author have evaluated the article's academic merit. Only articles confirmed by the reviewers to show the highest standards of scholarship are accepted for publication in this section.

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2 This article is based on the presentation on the subject "Wholly artificial arrangements and presumptions of tax avoidance" held in the 6th Avoir Fiscal Conference that took place in the Institute of Advanced Legal Studies in London on 28 January 2011.

3 From the relevant bibliography see indicatively: R. Szudoczky, Comment on the judgment *Établissements Rimbaud SA*, *H&I* 2011/1.2 (pp.19 et seq); T. Ronfeldt, Anti-abuse clause or harmonization?, *Intertax* 2011, 12; S. de Mones et al., Abuse of tax law across Europe, Part I, *EC Tax Review* 2010/2, 85 and Part II, EC Tax Review, 2010/3, 123; L. Cerioni, 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, *EBLR* 2010, 783; B. Kiekebeld, Anti-abuse in the field of taxation: is there one overall concept?, *EC Tax Review* 2009/4, 144; A. Zalazinski, Some basic aspects of the concept of abuse in the tax case law of the European Court of Justice, *Intertax*, 2008, 156; M. Lang & S. Heidenbauer, Wholly artificial arrangements in: L. Hinnekens & Ph. Hinnekens (eds), *A vision of taxes within and outside European borders*, Kluwer Law International 2008, pp. 597-615; A. Zalazinski, Proportionality of anti-avoidance and anti-abuse measures in the ECJ's Direct Tax Law, *Intertax*, 2007, 310; K. Perrou**,** The Judicial Application of Anti-Avoidance Doctrines in Greece and its Impact on International Tax Law, *Intertax*, 2006, 110; D. Weber, *Tax Avoidance and the EC Treaty Freedoms,* Kluwer Law International 2005, a sections 4.3 and 4.4. See also the document COM (2007) 785 FINAL of 10-12-2007 "The application of anti-abuse measures in the area of direct taxation – within the EU and in relation to third countries".

Although the focus in this analysis is placed on direct taxation, most of the considerations examined in this context also apply for indirect taxation matters, such as VAT in the context of which the concept of wholly artificial arrangements was developed before it was transferred into the field of direct taxation.[4]

In this article four questions will be dealt with:

- What are "wholly artificial arrangements"?
- Who bears the burden of proof of the existence of "wholly artificial arrangements"?
- Is the use of presumptions of tax avoidance permissible under EU law?
- In particular, is the use of irrebbutable presumptions of tax avoidance permissible under EU law?

Each of these questions will be dealt with separately in the following paragraphs. Based on the findings of the Court's case law the validity of two irrebuttable presumptions of tax avoidance that are currently discussed in Greece (one enacted, the other proposed) will be tested. This article will close with some final remarks summarizing the conclusions of the analysis.

2. What are "wholly artificial arrangements"?

The extent to which EU member states may introduce measures that aim at combating tax avoidance but create restrictions on the exercise of the fundamental freedoms protected by the Treaty has been subjected to the Court's scrutiny already since 1986 and the publication of the judgment of the Court in the *Avoir Fiscal* case.[5]

In 1986, in the *Avoir Fiscal* judgment, the risk of tax avoidance was not considered by the Court as a valid argument that could justify the French legislation that introduced a discrimination against branches of EU based companies that were established in France. According to the Court the French Government could not rely on the risk of tax avoidance in order to introduce measures that limit the freedom of

4 For the application of anti-tax avoidance clauses in the field of VAT and the development of the concept of wholly artificial arrangements in that area see, indicatively, ECJ, 21 February 2006, Case C-255/02, *Halifax plc, Leeds Permanent Development Services Ltd and County Wide Property Investments Ltd v Commissioners of Customs & Excise,* [2006] ECR I-01609.

5 ECJ, 28 January 1986, Case 270/83, *European Commission v French Republic ("Avoir Fiscal"),* [1986] ECR I-00273.

establishment that was at stake in the *Avoir Fiscal* case.[6]

In the twenty years that have passed since the delivery of the *Avoir Fiscal* judgment until the delivery of the *Cadbury Schweppes*[7] judgment in 2006, the way the Court treated national measures aimed at combating tax avoidance changed. Thus, by the time of the judgment in *Cadbury Schweppes*, it was already established case law that:

> *"a national measure restricting freedom of establishment may be justified where it specifically relates to wholly artificial arrangements aimed at circumventing the application of the legislation of the Member State concerned".*[8]

But what situations constitute "wholly artificial arrangements"? A definition of this concept is not found in the Court's case law regarding direct taxation unless 2006 and the judgment in *Cadbury Schweppes,* where the Court gave some guidance on what may be considered as "wholly artificial arrangements". Before 2006 the term "wholly artificial arrangements" had appeared in a number of judgments but with no further discussion as to what it meant.

(a) The Court's reference to "wholly artificial arrangements" before the *Cadbury Schweppes* judgment

In a short overview of the Court judgments that made reference to the term "wholly artificial arrangements" before the *Cadbury Schweppes* judgment, it is observed that the Court, with the exception of *Marks & Spencer*,[9] never accepted that the aim of combating tax-avoidance (which is a legitimate aim) can justify a national general anti-avoidance measure that restricted a basic freedom. In all the cases that the Court had dealt with a national anti-avoidance measure that restricted a fundamental freedom the measure was not upheld as it was not aimed ***specifically*** at combating tax avoidance by discouraging the use of wholly artificial arrangements that are aimed solely at avoiding the payment of taxes according to the legislation of the concerned member state.

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6 See paragraph 25 of Case 270/83, *Avoir Fiscal* judgment, according to which:
«25 Furthermore, the risk of tax avoidance cannot be relied upon in this context. Article 52 of the EEC Treaty does not permit any derogation from the fundamental principle of freedom of establishment on such a ground».

7 ECJ, 12 September 2006, Case C-196/04, *Cadbury Schweppes plc, Cadbury Schweppes Overseas Ltd v Commissioners of Inland Revenue,* [2006] ECR I-7995.

8 See C-196/04, *Cadbury Schweppes*, paragraph 51.

9 ECJ, 13 December 2005, Case C-446/03, *Marks & Spencer plc v David Halsey (Her Majesty's Inspector of Taxes)*, [2005] ECR I-10837; this case is discussed further down.

The most important cases in this respect are:

(i) The judgment in *ICI* (16 July 1998)[10]:

Where the Court noted that - «*As regards the justification based on the risk of tax avoidance, suffice it to note that **the legislation at issue in the main proceedings does not have the specific purpose of preventing wholly artificial arrangements, set up to circumvent United Kingdom tax legislation**, from attracting tax benefits, but **applies generally to all situations** in which the majority of a group's subsidiaries are established, for whatever reason, outside the United Kingdom. However, the establishment of a company outside the United Kingdom does not, of itself, necessarily entail tax avoidance, since that company will in any event be subject to the tax legislation of the State of establishment*» (emphasis is added).

(ii) The judgment in *X & Y* (21 November 2002)[11]:

Where the Court stated that - *"The provision at issue here **is not specifically designed to exclude from a tax advantage purely artificial schemes designed to circumvent Swedish tax law**, but concerns, **generally, any situation in which, for whatever reason,** the transfer at undervalue is to a company established under the legislation of another Member State or a branch set up in the Kingdom of Sweden by such a company.*

*However, **tax evasion or tax fraud cannot be inferred generally** from the fact that the transferee company or its parent company is established in another Member State and cannot justify a fiscal measure which compromises the exercise of a fundamental freedom guaranteed by the Treaty"* (emphasis is added).

(iii) The judgment in *Lankhorst-Hohorst* (12 December 2002)[12]:

Where the Court commented that - *"As regards more specifically the justification based on the risk of tax evasion, it is important to note that the legislation at issue here **does not have the specific purpose of preventing wholly artificial arrangements, designed to circumvent German tax legislation**, from attracting a tax benefit, but **applies generally to any situation** in which the parent company has its seat, for whatever reason, outside the Federal Republic of Germany. Such a situation does not, of itself, entail a risk of tax evasion, since such a company will in*

10 See ECJ, 16 July 1998, Case C-264/96, *Imperial Chemical Industries (ICI) v Kenneth Hall Colmer*, [1998] ECR I 4695, at paragraph 26.

11 See ECJ, 21 November 2002, Case C-436/00, *X and Y v Riksskatteverket,* [2002] ECR I – 10829, at paragraphs 61 and 62.

12 See ECJ, 12 December 2002, Case C-324/00, *Lankhorst-Hohorst GmbH v Finanzamt Steinfurt,* [2002] ECR I-11779, at paragraph 37.

any event be subject to the tax legislation of the State in which it is established" (emphasis is added).

(iv) The judgment in *De Lasteyrie du Saillant* (11 March 2004)[13]:

Where the Court observed that -*"As regards justification based on the aim of preventing tax avoidance, referred to by the national court in its question, it should be noted that Article 167a of the CGI* ***is not specifically designed to exclude from a tax advantage purely artificial arrangements aimed at circumventing French tax law****, but is aimed* ***generally at any situation*** *in which a taxpayer with substantial holdings in a company subject to corporation tax transfers his tax residence outside France for any reason whatever"*[14] (emphasis is added).

(v) The judgment in *Marks & Spencer* (13 December 2005)[15]:

In *Marks & Spencer*, the argument of preventing tax avoidance was accepted by the Court for the first time in direct taxation matters as a valid justification that may justify a national measure that restricts one of the basic freedoms, in this instance, the freedom of establishment. The aim of combating tax avoidance was not accepted as a stand-alone justification but rather as only one component of a complex justification that was based on the combined effect of three legitimate aims that had to be taken into consideration "together"[16] and not separately:

- the balanced allocation of taxing powers between States

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13 ECJ, 11 March 2004, Case C-9/02, *Hughes de Lasteyrie du Saillant v Ministère de l' Economie, des Finances et de l' Industrie,* [2004] ECR I-2409.

14 See C-9/02, *de Lasteyrie du Saillant* case, paragraph 50.

15 ECJ, 13 December 2005, Case C-446/03, *Marks & Spencer plc v David Halsey (Her Majesty's Inspector of Taxes)*, [2005] ECR I-10837.

16 See also ECJ, 21 January 2010, C-311/08, *Société de Gestion Industrielle (SGI) v État belge*, [2010] ECR I-0000, in which the Court followed an argumentation similar to the one in *Marks & Spencer*; in C-311/08, *SGI* the Court considered that a national measure aimed at excluding wholly artificial arrangements from benefiting from a tax advantage may be justified by the objective of preventing tax avoidance ***taken together*** with that of preserving the balanced allocation of the power to impose taxes between the member states; see on this point paragraph 66 of case C-311/08, *SGI* and paragraph 69 where the Court stated that:

> *"In the light of those* ***two considerations****, concerning the need to maintain the balanced allocation of the power to tax between the Member States and to prevent tax avoidance,* ***taken together****, it must be held that legislation such as that at issue in the main proceedings pursues legitimate objectives which are compatible with the Treaty and constitute overriding reasons in the public interest and that it is appropriate for ensuring the attainment of those objectives"* (emphasis is added).

For an analysis of *SGI* case see T. O'Shea, ECJ upholds Belgian transfer pricing regime, 2010 WTD 19-1

- the avoidance of the danger of losses being taken into account twice and
- the risk of tax avoidance.

As the Court put it in the judgment:

> *"In the light of those* ***three justifications, taken together****, it must be observed that restrictive provisions such as those at issue in the main proceedings pursue legitimate objectives which are compatible with the Treaty and constitute overriding reasons in the public interest and that they are apt to ensure the attainment of those objectives"*[17] (emphasis is added).

And, in another part of the judgment, the Court pointed out that:

> *"It is also important, in that context, to make clear that Member States are* ***free to adopt or to maintain in force*** *rules having the* ***specific purpose of precluding from a tax benefit wholly artificial arrangements whose purpose is to circumvent or escape national tax law****"*[18](emphasis is added).

(b) The definition of "wholly artificial arrangements" in *Cadbury Schweppes* (12 September 2006)[19]

Given this body of case law and the constant denial of the Court to uphold general national measures that aim at combating tax avoidance but also given the difficulties in interpreting and applying judgment of the Court in *Marks & Spencer*, the need for some further guidance from the Court became obvious. This was provided by the Court in *Cadbury Schweppes*, in which the Court gave guidance to Member States as to what constitutes "wholly artificial arrangements".[20]

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17 See C-446/03, *Marks & Spencer*, at paragraph 51.

18 See C-446/03, *Marks & Spencer*, at paragraph 57.

19 ECJ, 12 September 2006, Case C-196/04, *Cadbury Schweppes plc, Cadbury Schweppes Overseas Ltd v Commissioners of Inland Revenue,* [2006] ECR I-7995.

20 The findings of the *Cadbury Schweppes* judgment were repeated in ECJ, 13 March 2007, Case C-524/04, *Test Claimants in the Thin Cap Group Litigation v Commissioners of Inland Revenue ("Thin Cap GLO"),* [2006] ECR I-02107; see paragraph 74 of C-524/04, *Thin Cap GLO* in which the Court stated that:

> *"In order for a restriction on the freedom of establishment to be justified on the ground of prevention of 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****"* (emphasis is added).

(i) The criteria for assessing "wholly artificial arrangements"

To this end, the Court made use of two criteria in order to assess whether a certain situation can be characterized as a "wholly artificial arrangement" or not: the first one is a subjective criterion, the second is an objective one. The *subjective element* consists in assessing the intention of the taxpayer in setting up a certain arrangement: if the intention of the taxpayer is simply to circumvent national legislation with the purpose to avoid the payment of taxes or to benefit from a tax advantage to which he would not have been otherwise entitled.[21] The *objective element* consists in assessing certain objective circumstances which are capable of revealing whether and to what extent the aims pursued by the Treaty or in other words the essence (not the letter) of the treaty provisions protecting the basic freedoms is served.[22]

Such objective circumstances that distinguish genuine arrangements from wholly artificial ones are:

a. The ***actual establishment*** of the taxpayer in the other member state and

b. The pursuit of ***genuine economic activities*** through that establishment.

On the other hand artificiality exists when:

c. The establishment in the other member state does not reflect economic reality and

d. The establishment in the other member state was set up in order to avoid payment of taxes in the origin state.

The Court has also given some clarification on the criteria that may be used by the States in order for the competent tax authorities to assess whether an establishment is genuine or artificial. Such criteria must fulfill certain requirements set-out by the Court. In particular, such criteria must be based on objective factors that can be

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21 See paragraph 64 of C-196/04, *Cadbury Schweppes* judgment:
"In order to find that there is such an arrangement there must be, in addition to a ***subjective element*** *consisting in the intention to obtain a tax advantage,* ***objective circumstances*** *showing that, despite formal observance of the conditions laid down by Community law, the objective pursued by freedom of establishment, as set out in paragraphs 54 and 55 of this judgment, has not been achieved"* (emphasis is added).

22 See C-196/04, *Cadbury Schweppes*, paragraphs 54-55:
"54. (...) ***actual establishment of the company concerned in the host Member State*** *and the* ***pursuit of genuine economic activity there.***
55. (...) 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"* (emphasis is added).

ascertained by third parties.[23] These objective factors are aimed at proving whether economic reality exists in a given situation or not.[24] The existence of economic reality, in turn, may be assessed on the basis of the existence of the two elements that were mentioned earlier:

(vi) Actual establishment and

(vii) Genuine economic activity.

The first one, the existence of an actual establishment, can be assessed on the basis of the physical presence of the tax payer in the host member state, such as the existence of premises, staff and equipment in the establishment in the other member state. The second one, the existence of genuine economic activity, can be assessed on the basis of considerations regarding the extent of the commercial risk assumed by the establishment in the other member state or on whether the transactions between the establishment in the origin state and the establishment in the host state comply with the arm's length principle.[25]

(ii) Cases that are always considered as wholly artificial

Based on those criteria the Court has concluded that in principle "letterbox" or "front" subsidiaries will not meet the requirements of "actual establishment" and "genuine economic activity" described earlier and they would be classified as artificial arrangements.[26] The same may apply in cases where there is a deviation from the arm's length principle in the transactions between associated enterprises that are established in different member states,[27] although in this case it must not be

23 Compare case C-311/08, *SGI*, paragraph 71, where the Court refers to ***"objective and verifiable elements"***.

24 See for example C-524/04, *Thin Cap GLO*, paragraph 74:

> *"In order for a restriction on the freedom of establishment to be justified on the ground of prevention of 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****"* (emphasis is added).

25 For an example of the deviation from the arm's length principle as a strong indication of the existence of a wholly artificial arrangement see C-311/08, *SGI*; the Court stated at paragraph 71 of C-311/08, *SGI* that in order for a measure that aims at excluding wholly artificial arrangements to be proportionate, national legislation must provide that the taxpayer is given an opportunity, without being subject to undue administrative constraints, to provide evidence of any commercial justification that there may have been for that transaction

> *"on each occasion on which there is a* ***suspicion*** *that a transaction* ***goes beyond what the companies concerned would have agreed under fully competitive conditions***".

26 See C-196/04, *Cadbury Schweppes* at paragraph 68.

27 See the opinion of AG Geelhoed in C-524/04, *Thin Cap GLO* case, at paragraph 66.

a priori excluded the possibility that the transaction is genuine and it was not entered into with the aim to avoid taxes.[28]

(iii) Cases that do not constitute wholly artificial arrangements in themselves

On the other hand the Court has also identified some cases that cannot be considered as artificial in themselves. In these cases the general application of the national rule failed to satisfy the proportionality requirement and thus led the Court in not accepting the relevant measure as a valid justification for the restriction of the Treaty freedoms. Such cases are:

- The fact of the establishment of a subsidiary in another MS[29]The fact that the activities of a secondary establishment in another MS could be pursued by the taxpayer in the home state[30]
- The cases in which the decision on where to establish a subsidiary was based on legitimate tax considerations[31]
- The objective of minimizing the tax burden
- The existence of lower level of taxation in the other MS[32]
- The existence of a special favorable regime in the other MS[33]
- The fact that the company benefits in the other MS from state aid that is incompatible with the Treaty[34]

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28 See C-524/04, *Thin Cap GLO* judgment, at paragraph 81:
"The fact that a resident company has been granted a loan by a non-resident company on terms which do not correspond to those which would have been agreed upon at arm's length constitutes, for the Member State in which the borrowing company is resident, an objective element which can be independently verified in order to determine whether the transaction in question represents, in whole or in part, a purely artificial arrangement, the essential purpose of which is to circumvent the tax legislation of that Member State. In that regard, the question is whether, had there been an arm's-length relationship between the companies concerned, the loan would not have been granted or would have been granted for a different amount or at a different rate of interest."

29 C-264/96, *ICI*, paragraph 26.

30 C-196/04, *Cadbury Schweppes*, paragraph 69.

31 C-196/04, *Cadbury Schweppes*, paragraph 37.

32 ECJ, 26 October 1999, Case C-294/97, *Eurowings Luftverkers AG v Finanzamt Dortmund-Unna,* [1999] ECR I-07447, at paragraph 44.

33 C-196/04, *Cadbury Schweppes*, paragraphs 36-38.

- The mere fact of the transfer of the residence of the taxpayer in another MS[35]

- The hire out assets for remuneration to another undertaking which uses them primarily in other Member States.[36]

The situations mentioned above are not capable and sufficient in themselves (that is: without the concurring existence of the other criteria set by the Court) to lead to the conclusion that an establishment is artificial, aimed at circumventing national legislation and avoiding tax obligations in a member state. On the contrary such situations as those mentioned above are in principle expressions of the exercise of the basic freedoms and they may not be hindered or in any other way restricted by national legislation. Thus, the introduction or maintenance in force of ***general*** national measures that restrict the basic freedoms, although they serve a legitimate aim of combating tax avoidance, such measures fail to pass the proportionality test, as they go beyond what is necessary in order to achieve the aim that they are designed to achieve.[37]

Having this guidance from the Court as to what can be classified as "wholly artificial arrangements" the next question that comes up is: who has the burden of proof of the existence of a wholly artificial arrangement, the tax payer or the tax authorities?

3. Who bears the burden of proof of the existence of "wholly artificial arrangements"?

First of all, it must be pointed out that the rules on the burden of proof are national rules that fall within the competence of the member states. States enjoy in that respect a certain level of autonomy on how to organize the applicable procedural rules (national procedural autonomy). National procedural rules, such as those regarding the burden of proof, are also subject to the EU law principles of effectiveness and equivalence.

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34 See on this point the opinion of AG Leger in the case C-196/04, *Cadbury Schweppes*, paragraphs 55-60.

35 C- 9/02, *Lasteyrie du Saillant*, paragraph 51.

36 C-330/07, *Jobra*, paragraph 36.

37 See for example C-9/02, *Lasteyrie du Saillant* judgment, at paragraph 52:

> *"Article 167a of the CGI cannot, therefore, without* ***greatly exceeding what is necessary in order to achieve the aim which it pursues****,* ***assume an intention*** *to circumvent French tax law on the part of every taxpayer who transfers his tax domicile outside France"* (emphasis is added).

As regards the division of the burden of proof the Court has accepted that

> “*the tax authorities of a Member State **are entitled** to require the taxpayer to provide such **proof** as they may consider necessary in order to determine whether the conditions for a tax advantage provided for in the legislation at issue have been met and, consequently, whether to grant that advantage*”[38].

The Court appears to suggest that the initial burden of proof of the existence of a wholly artificial arrangement lies with the tax authorities; this is consistent with the basic procedural principle that each party has the obligation to prove its arguments and leads to a balanced allocation of the burden of proof. The Court gave some clearer guidance as to how the burden of proof should be organized in the cases of tax abuse in the *Cadbury Schweppes* judgment. According to the Court the burden of proof should be divided and both sides, the tax payer and the competent national authorities, have rights and obligations. The tax payer on the one hand, who is best placed for that purpose,

> *“must be given an opportunity to produce evidence that the CFC is actually established and that its activities are genuine”*.[39]

On the other hand the competent national authorities, taking into account the evidence and other information furnished by the taxpayer should verify that information by making use of the options that the existing legal framework offers, such as the mutual assistance directive[40] that provides for collaboration and exchange of information between national tax administrations in the field of direct taxation or the relevant provisions of the applicable double taxation convention.[41]

The formula followed by the Court does not create obligations only for one party (the tax payer or the tax authority) but provides for a division of the burden of proof: in case the facts (or the tax authorities) point to the existence of a wholly artificial arrangement, the tax payer must (be able to) provide the evidence required by the relevant provisions and the tax authorities must be able to confirm the validity of the evidence so provided.

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38 See the recent Joined Cases C-436/08 and C-437/08, *Haribo*, paragraph 95 with further references to earlier cases (see, Case C-136/00 *Danner* [2002] ECR I-8147, paragraph 50; Case C-422/01 *Skandia and Ramstedt* [2003] ECR I-6817, paragraph 43; and Case C-318/07 *Persche* [2009] ECR I-359, paragraph 54).

39 C-196/04, *Cadbury Schweppes*, paragraph 70.

40 Council Directive 77/799/EEC of 19 December 1977 concerning mutual assistance by the competent authorities of the Member States in the field of direct taxation and taxation of insurance premiums.

41 See C-196/04, *Cadbury Schweppes*, paragraph 71; see also more recently Joined Cases C-436/08 and C-437/08, *Haribo*, at paragraph 66.

In this context national legislation often makes use of presumptions of tax avoidance that in fact result in a reversal of the burden of proof, to the advantage of the tax authorities. So, the next question that comes up is whether and to what extent presumptions of "wholly artificial arrangements" and their use to prove tax avoidance are permissible under EU law. This issue is dealt with in the following paragraphs.

4. Is the use of presumptions of tax avoidance permissible under EU law?

As a general observation regarding the use of presumptions, it must be pointed out that the use of presumptions as a means of proof is not contrary to EU law. On the contrary the use of presumptions is rather beneficial as it provides legal certainty for all parties (taxpayers and tax authorities) and they also guarantee the workability of national anti-avoidance provisions.[42] Such presumptions though, being procedural rules affecting the division of the burden of proof, are, as mentioned before subject to the requirements of effectiveness, equivalence and proportionality. Thus, any presumptions used must be reasonable and proportionate[43] and they cannot be general, as the Court has emphasized in many cases.

For example, the Court made this distinction clear in its judgment in *Thin Cap GLO* case:[44]

> *"The mere fact that a resident company is granted a loan by a related company which is established in another Member State* ***cannot be the basis of a general presumption of abusive practices*** *and justify a measure which compromises the exercise of a fundamental freedom guaranteed by the Treaty.*
>
> *In order for a restriction on the freedom of establishment to be justified on the ground of prevention of abusive practices, the* ***specific objective*** *of such*

42 See the Opinion of AG Geelhoed in the case C-524/04, *Thin Cap GLO*, paragraph 66 where he observed that:
" Moreover, it is in my view valid, and indeed to be encouraged, for Member States to set out certain reasonable criteria against which they will assess compliance of a transaction with the arm's length principle, and in case of non-compliance with these criteria for them to ***presume that the transaction is abusive****, subject to proof to the contrary. The setting out of such criteria is, to my eyes, in the interests of* ***legal certainty for taxpayers, as well as workability for tax authorities.*** *This approach is to be contrasted, for example, with the use of a single fixed criterion to be applied in all cases – such as a fixed debt-equity ratio – which does not allow other circumstances to be taken into account"* (emphasis is added).

43 See paragraph 67 of the Opinion of AG Geelhoed in the case C-524/04, *Thin Cap GLO*:
"However, the formulation and application in practice of such a test must also satisfy the requirements of proportionality".

44 See the case C-524/04, *Thin Cap GLO*, paragraphs 73 and 74.

> *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"* (emphasis added).

Since, therefore, the ***general*** presumptions of tax avoidance are excluded as they go beyond what is necessary for the achievement of the desired aim, the next question is whether ***irrebbutable*** presumptions, that are not general in nature but are aimed specifically at combating tax avoidance, are permissible under EU law.

5. Is the use of irrebbutable presumptions of tax avoidance permissible under EU law?

In order to answer to this question a distinction must be made between cases that involve purely intra-EU relationships and cases where the relationship under consideration involves an EU-member state and a non-member state. Each one of these two cases will be dealt with separately in the following paragraphs.

(a) Purely intra-EU cases

The introduction or maintenance in force of an irrebbutable presumption of tax avoidance that would apply to purely intra-EU cases appears to be contrary to the principle of proportionality and, therefore, is not tolerable under EU law. According to the reasoning developed by the Court, since EU member states have the legislative framework that enables them to ask and receive information regarding the tax position of a taxpayer in another member state, all that the competent national authorities have to do is to set in motion the procedures provided for in the mutual assistance directive or in the applicable double taxation convention.

Moreover, the Court has expressly stated that in cases where presumptions of tax avoidance exist, the taxpayer must be given the opportunity to prove that a transaction or an establishment does not constitute a "wholly artificial arrangement". The tax payer must always be given the opportunity to prove the validity or genuineness of his situation and he cannot be *a priori* excluded from providing any relevant information or evidence in order to reverse the presumption.[45] In cases

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45 See for example the case C-311/08, *SGI*, at paragraph 71 where the Court stated that:
> *"National legislation which provides for a consideration of objective and verifiable elements in order to determine whether a transaction represents an artificial arrangement, entered into for tax reasons, is to be regarded as* ***not going beyond what is necessary*** *to attain the objectives relating to the need to maintain the balanced allocation of the power to tax between the Member States and to prevent tax avoidance where, first,* ***on each occasion*** *on which there is a suspicion that a transaction goes beyond what the companies concerned would have agreed under fully competitive conditions,* ***the taxpayer is given an opportunity, without being subject to undue administrative constraints, to provide evidence of any commercial justification*** *that there may have been for that transaction"* (emphasis is added).

where national legislation provides for a presumption of tax avoidance but there is no opportunity for the taxpayer to provide justification for his actions, any such presumption is contrary to EU-law as it fails to meet the requirement of proportionality.[46]

The proportionality principle, therefore, puts some limitations to the use of presumptions. Legitimate presumptions must fulfill the following particular requirements:

- they should not go beyond what is necessary to prevent abusive practices

- they must provide for an opportunity for the taxpayer to provide evidence of commercial justification and

- they must not put undue administrative constraints on the taxpayer.

The Court developed these considerations in its subsequent case law regarding presumptions of tax avoidance in direct taxation and, in *Européenne et Luxembourgeoise d'investissements SA* (*ELISA*)[47] held that national legislation that excludes *a priori* taxpayers from providing justification in order to avoid the application of a presumption of the existence of a "wholly artificial arrangement" is not compatible with EU-law.[48]

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46 See the judgment in the case C-524/04, *Thin Cap GLO*, at paragraph 82 where the Court, following the opinion of AG Geelhoed, stated that:

> *"national legislation which provides for a consideration of objective and verifiable elements in order to determine whether a transaction represents a purely artificial arrangement, entered into for tax reasons alone, is to be considered as not going beyond what is necessary to prevent abusive practices* ***where, in the first place, on each occasion on which the existence of such an arrangement cannot be ruled out, the taxpayer is given an opportunity, without being subject to undue administrative constraints, to provide evidence of any commercial justification that there may have been for that arrangement****"* (emphasis is added).

47 ECJ, 11 October 2007, Case C-451/05, *Européenne et Luxembourgeoise d'investissements SA (ELISA) v Directeur général des impôts et Ministère public ("ELISA"),* [2007] ECR I-08251. For an analysis of the issues raised in the ELISA case see, indicatively, D. Gutmann, Pending case filed by French Courts: The Société Elisa case, in: M. Lang et al. (eds.), ECJ – Recent developments in direct taxation 2007, Linde Verlag 2007, pp. 33 et seq. and T. O'Shea, French rule obstructs free movement of capital, ECJ concludes, *Tax Notes Int'l*, January 7, 2008, p. 30.

48 On this point see paragraph 96 of the case C-451/05, *ELISA*:

> *"Thus, the taxpayer should not be excluded a priori from providing relevant documentary evidence enabling the tax authorities of the Member State imposing the tax to ascertain, clearly and precisely, that he is not attempting to avoid or evade the payment of taxes".*

Further references are made by the Court to the Case C-254/97 *Baxter and Others*, paragraphs 19 and 20, and Case C-39/04 *Laboratoires Fournier*, paragraph 25.

To conclude this section, it is clear from the Court's case law that in intra-EU cases irrebbutable presumptions of tax avoidance are not compatible with EU-law and the taxpayer must in all cases be given a reasonable opportunity to provide evidence to rebut the presumption that points to the existence of a wholly artificial arrangement.[49]

(b) Cases involving EU member states and non-member countries

Different considerations apply for the cases concerning transactions between EU member states and non-member countries. Contrary to what applies for purely intra-EU situations, irrebbutable presumptions of tax avoidance seem to be tolerated in cases that involve non-member countries. An example of this category is offered by *Établissements Rimbaud SA*,[50] which is the sequel to the *ELISA* case, referred to in the previous section. The difference between the two cases is that whereas in *ELISA* the situation involved two EU member states, France and Luxembourg, in the *Établissements Rimbaud SA* case the situation involved an EU member state (France) and a non-member country (Liechtenstein).

The question posed by the company *Établissements Rimbaud SA* was whether the findings of the Court in the *ELISA* case were also applicable in this case. In order to answer to this question the Court made a distinction between a purely internal situation, concerning two EU-member states, and a situation which concerned an EU member state and a non-member state. This was not the first time the Court had to deal with a situation concerning a non-member state and the extent to which the protection offered by the freedom of capital movements extends.

According to the Court, the case law concerning purely internal situations is not comparable to situations involving a non-EU member state, as the legal framework that applies in each case is not the same, especially as far as the obligation on

49 See for example the comments of the Court in ECJ, 4 December 2008, Case C-330/07, *Jobra Vermögensverwaltungs-Gesellschaft mbH v Finanzamt Amstetten Melk Scheibbs*, [2008] ECR I-09099, where the Court, at paragraph 38, made reference to the fact that the Austrian legislation at stake did not allow taxpayers to adduce evidence that no abuse is taking place. The Court however did not comment any further on that point as it had already concluded that the Austrian legislation due to the fact that the general assumption established by it is not aimed at wholly artificial arrangements; see C-330/07, *Jobra*, at paragraphs 37-39.

50 CJ, 28 October 2010, Case C-72/09, *Établissements Rimbaud SA v Directeur général des impôts et Directeur des services fiscaux d'Aix-en-Provence*, [2010] ECR I-0000. For a discussion of the issues raised in this case see, indicatively, D. Gutmann, France: The *Rimbaud* and *Accor* cases, in: M. Lang et al. (eds.), ECJ – Recent developments in Direct Taxation 2009, Linde Verlag 2010, pp. 45 et seq.

exchange of information and administrative assistance is concerned.[51] The result of this difference in the legal framework and the gap in the level of the obligations imposed on EU member states on the one hand and those assumed by third countries on the other hand is that the case law developed in the context of intra-EU situations cannot be transposed as such in cases where non-EU states are involved. In particular, as the Court put it:

> *"that case-law, which relates to restrictions on the exercise of freedom of movement within the Community, cannot be transposed in its entirety to movements of capital between Member States and third countries, since such movements take place in a different legal context."*[52]

The position of the Court was made even clearer in *Établissements Rimbaud SA*, where the Court pointed once again to the difference between the two situations and it made clear that the possible justifications to the restrictions of the free movement of capital that may be accepted by the Court in intra-EU situations are not the same as those that may be accepted in cases that involve non member states. In the Court's reasoning:

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51 In addition to the obligations imposed on member states by the mutual assistance directive, the Community harmonization measures on company accounts also guarantee that the evidence produced by the taxpayer will be reliable and verifiable, compared to the evidence produce by a company that is established in a non-member country that does not apply the same rules on the preparation and filing of company accounts; on this point see the ECJ, 18 December 2007, C-101/05, *Skatteverket v A*, [2007] ECR I-11531), at paragraphs 61-62:

> *In the first place, relations between the Member States take place against a common legal background, **characterised by the existence of Community legislation, such as Directive 77/799, which laid down reciprocal obligations of mutual assistance**. Even if, in the fields governed by that directive, the obligation to provide assistance is not unlimited, the fact remains that that directive established a framework for cooperation between the competent authorities of the Member States which does not exist between those authorities and the competent authorities of a third country where the latter has given no undertaking of mutual assistance.*
>
> *In second place, as the Advocate General pointed out at points 141 to 143 of his Opinion, with regard to the documentary evidence which the taxpayer may provide to enable the tax authorities to ascertain whether the requirements under national legislation are satisfied, **the Community harmonisation measures on company accounts which apply in the Member States allow the taxpayer to produce reliable and verifiable evidence** on the structure or activities of a company established in another Member State, whereas the taxpayer is not ensured of such an opportunity in the case of a company established in a third country which is not required to apply those Community measures"* (emphasis is added).

For an analysis of the *A* case and the comments of the Court regarding the "different legal context" that applies in relation to third countries see T. O'Shea, Swedish tax treatment of third-country dividends, WTD 9 January 2008,

52 See C-101/05, *A*, at paragraph 60. The Court reached a similar conclusion in ECJ, 19 November 2009, Case C-540/07, *Commission of the European Communities v Italian Republic ("Commission v Italy"),* [2009] ECR I-10983, at paragraph 69.

> *"the case which gave rise to the judgment in ELISA involved a set of facts concerning Member States of the European Union, not non-member States. As a consequence (....)* ***the answers provided by that judgment to the questions referred concern only relations between Member States of the European Union***.
>
> *(...)* it should be borne in mind that the case-law concerning restrictions on the exercise of the freedoms of movement within the European Union ***cannot be transposed in its entirety to movements of capital between Member States and non-member States, since such movements take place in a different legal context"*** [53](emphasis is added).

The different legal context to which the Court makes reference concerns the obligations undertaken by the EU member states by the mutual assistance directive and the administrative cooperation framework that exists between competent authorities of EU member states that enables them to exchange the relevant information that each competent tax authority might need for the determination or the verification of the tax position of a tax payer, regarding the taxes that are covered by the material scope of application of the mutual assistance directive.[54]
This cooperation framework established by the EU mutual assistance directive does not exist in the relationships of EU member states with third countries. Indeed, in the absence of an instrument providing for a similar legal framework, and in particular in the absence of an agreement for mutual administrative assistance in the field of direct taxation, there is no obligation on the third country to provide information in order for the EU state to exercise effective supervision of the information provided by the taxpayer.[55] In this context, the Court concluded that a national measure that provides that a tax advantage or exemption is granted to a taxpayer who has its seat in a third country on the condition of the existence of a convention on administrative assistance between the Member State and the non-member State for the purposes of combating tax evasion and avoidance is not contrary to EU law.[56] On the contrary, such a condition is rather required as in the absence of an obligation undertaken by

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53 See the judgment in the case of C-72/09, *Établissements Rimbaud SA, at paragraphs* 39-40.

54 On this point compare also the judgment of the Court in the case C-540/07, *Commission v. Italy,* at paragraph 60. The Court repeated this argument recently in CJ, 10 February 2011, Joined Cases C-436/08 and C-437/08, *Haribo Lakritzen Hans Riegel BetriebsgmbH (C-436/08) and Österreichische Salinen AG (C-437/08) v Finanzamt Linz,* [2011] ECR I-0000), at paragraph 66.

55 See the judgment of the Court in the case C-72/09, *Établissements Rimbaud SA,* at paragraph 41. See also the argument of the Court regarding the comparability of evidence based on company accounts that may be produced by companies but which are not comparable with the EU standards when they come from non member states that do not follow the EU rules on the preparation of company accounts in the case C-101/05, *A,* at paragraph 62.

56 See the judgment of the Court in the case C-72/09, *Établissements Rimbaud SA,* at paragraph 52.

the third country similar to that undertaken by the EU member states in the framework of Directive 77/799/EEC, otherwise two different situations would be treated in a similar way and that would result in reverse discrimination against the intra-EU situations.[57]

The fact that the taxpayer is not allowed to provide evidence or any other information in order to prove the economic reality of a transaction or the genuineness of an establishment in the third country with which no agreement on the exchange of information and administrative assistance exists, amounts to an irrebbutable presumption of tax avoidance that functions to the detriment of the taxpayer. Such an irrebbutable presumption of tax avoidance though is according to the Court justified by overriding reasons relating to the general interest in combating tax evasion and the need to safeguard the effectiveness of fiscal supervision. Furthermore it is also appropriate to ensure the attainment of the objective pursued, without going beyond what is necessary to attain that objective.[58]

6. The application of the Court's case law on irrebbutable presumptions of tax avoidance in Greece

There are two recent Greek tax law provisions that relate to the problems analyzed in the previous sections:

(a) The first is found in the Greek 15% special tax on real property legislation,[59] which is similar to the legislation that was the subject in the *ELISA* and *Établissements Rimbaud SA* cases and

(b) the other is found in the Greek income tax code and concerns the deductibility of expenses incurred in non-cooperative non-member countries .

The first one provides that companies with real property in Greece that have their seat in a third country with which Greece has not signed a convention on the

57 Compare the judgment of the Court in the case C-72/09, *Établissements Rimbaud SA,* at paragraph 50.

58 See the judgment of the Court in the case C-72/09, *Établissements Rimbaud SA*, at paragraph 51. See however the criticism on this point by R. Szudoczky, Comment on the judgment *Établissements Rimbaud SA, H&I* 2011/1.2 (pp.19 et seq.) who supports that the decision of the Court may have been motivated by political rather than legal or logical considerations as there could be less strict measures than an irrebbutable presumption of tax avoidance. Szudoczky supports that this decision sends a message to third countries that unless they engage in the exchange of information with the EU they cannot be treated in the same way as EU member states.

59 Article 15 para. 4 of Law No. 3091/2002, as amended by law No. 3842/2010 of 23 April 2010.

exchange of information and on the provision of administrative assistance that covers the 15% special tax on real property may not produce evidence or information on the natural persons holding the shares of the companies in order to be exempted from the 15% special tax. The aim of the legislation is to combat tax avoidance and the provision appears to be in line with the case law of the Court, and especially with the *Établissements Rimbaud SA* judgment.

The second one is a provision in the opposite direction, concerning the relaxation of the conditions set for the deductibility of expenses incurred by Greek taxpayers in third countries with which Greece has not signed an administrative assistance convention and are considered as uncooperative in fiscal matters. Under the existing income tax law provisions the expenses incurred in third countries with which no administrative assistance convention exists are not deductible for income tax purposes.[60] A proposed amendment[61] to that provision provides that Greek companies incurring expenses in certain third countries that are characterized as uncooperative states in fiscal matters, may deduct such expenses if they prove that the transactions are not artificial; they were not incurred with the purpose of transferring profits out of Greece to the non-member country but that they reflect economic reality and they are based on genuine transactions. The burden of proof of the genuineness of the transaction (and the relevant expenses for the Greek company) falls entirely on the taxpayer. This may indeed seem as a more balanced provision in that transactions with non-member countries are not *a priori* considered as artificial arrangements entered into with the aim to avoid the payment of taxes in Greece but proof to the contrary may be furnished by the taxpayer. In our view, such a provision, if it is eventually adopted by the Greek parliament,[62] will not be workable in practice. The problem is that since there is no convention providing for the administrative assistance between Greece and the non-member country the Greek tax authorities will not have the means to effectively exercise their powers of taxing supervision, as they will not be able get the relevant information from the tax authorities of the non-member country.[63]

60 Articles 51A and 51B of the Greek Income Tax Code.

61 The amendment is provided for in article 13 para. 2 of the bill that the Ministry of Finance submitted to the Hellenic Parliament; the text is available in Greek at www.hellenicparliament.gr (last visited on the 21/02/2011).

62 The bill is introduced in the Parliament on 21 February 2011 and it is expected to be adopted by the Parliament.

63 Compare for example the recent considerations of the Court in the joined cases C-436/08 and C-437/08, *Haribo*, at paragraph 67, in which the Court repeated its findings in the *Rimbaud* case and stated that:

> *"where the legislation of a Member State makes the grant of a tax advantage dependent on satisfying conditions **compliance with which can be verified only by obtaining information** from the competent authorities of a non-member State party to the EEA Agreement, it is **in principle legitimate for the Member State to refuse to grant that advantage** if - in particular, because that non-member State is not bound under an agreement to provide information - **it proves impossible to obtain the requisite information from it**"* (emphasis is added).

7. Final remarks

In the previous parts the development of the case law of the Court regarding national anti-avoidance measures and their compatibility with EU law was presented through some of the most important cases that the Court has dealt with. According to the case law of the Court, irrebbutable presumptions of tax avoidance are not permissible under EU law as far as intra-EU cases are concerned since EU member states may rely on the mutual assistance directive in order to verify any information furnished by the taxpayers, and totally excluding any opportunity for the taxpayer to produce evidence to show the economic reality of its actions would not satisfy the principle of proportionality.

In the case however where non-member countries are concerned, and in the absence of a legal obligation that binds the non-member countries and by which they undertake the obligation to provide information to the EU member state competent authorities the Court concludes that the use of irrebbutable presumptions of tax avoidance is permissible. The Court reached that conclusion after establishing that since the legal framework on the exchange of information that applies in relation with the non-member countries is not the same as the one that exists between EU member states. This difference creates a gap in the powers of the EU member states' competent authorities to exercise effective fiscal supervision vis-à-vis non-member countries and, therefore, the establishment of irrebbutable presumptions of tax avoidance are considered as permissible restrictions of the free movement of capital justified by overriding reasons of public interest, namely the combating of tax avoidance.

Based on these conclusions derived from the Court's case law, it appears that the provision creating an irrebbutable presumption of tax avoidance in the case of companies that own real property in Greece while having their seat in non-member countries with which Greece has not signed a convention on the exchange of information is permissible under EU law. On the other hand the proposed amendment of the income tax code to the effect that expenses in non-member countries with which Greece has not signed a convention for the exchange of information may be deductible in Greece if the Greek company proves that these expenses are not artificial, although it seems balanced and fair for the taxpayers, it may jeopardize the effectiveness of the fiscal controls by the competent authorities.