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ABUSE OF RIGHTS IN EC LAW

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1 The United Kingdom Customs' Attack

The United Kingdom Commissioners of Customs & Excise, who have charge of the administration of value added tax and duties of Customs and Excise, are currently asserting in litigation[2] that there is a rule of EC law known as "abuse of rights" or "abuse of law" or "fraud on the law" and that such a rule operates to nullify the "avoidance" of United Kingdom value added tax. They rely on certain judgments of the European Court of Justice in non-tax cases. If they are correct, this is a rule of constitutional importance. In this article, I consider whether such a rule exists and, if so, what its proper ambit might be.

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2 The first case in point of time was the decision of the Value Added Tax and Duties Tribunal given on February 1st 2001 in *Halifax plc v Commissioners of Customs & Excise*, which is discussed in my article *When is a Supply not a Supply? Halifax plc v Commissioners of Customs & Excise* in *The EC Tax Journal,* Volume 4, Issue 3 page 153 and, so far as concerns the abuse of rights argument, in the article *"The Law Ends Where Abuse Begins"* by Jonathan Peacock QC in *The EC Tax Journal* Volume 4, Issue 3, page 141. At the time of writing, there has been an appeal to the Chancery Division of the High Court, which remitted the case back to the Tribunal for further findings of fact. Depending on what findings are made, either the appeal will be allowed or the matter will be referred to the European Court of Justice for a preliminary ruling. The Tribunal found against the appellant on other grounds and did not find it necessary to explore the abuse of rights argument.

I should declare an interest: I represent, together with Dr Timothy Lyons, the appellants in another of these cases, *BUPA Hospitals Limited v Commissioners of Customs & Excise*, which was determined by the Tribunal in March 2002 and which is currently under appeal to the High Court.

2 The British[3] Reaction

The instinctive reaction of a British lawyer is that such a doctrine is complete anathema. We, together with our cousins in the United States and the other parts of the common law world whose legal systems are still based on British values, hold dear the principles of individual rights, of governments whose powers are subordinated to those rights and of an independent judiciary to declare and uphold those rights. The very idea that we should be told that we cannot exercise our rights "abusively" is a contradiction in terms. Are we to be given them with one hand so that they can be taken away with the other? We shudder at the thought of countries whose grandiose constitutions guarantee the right of freedom of speech but then dispatch you to a concentration camp if you abuse your right by making an anti-Soviet speech; of countries where there is freedom of religion, but where you will be burnt at the stake if you abuse your right by following any religion other than the Roman one.[4] A right to do whatever the executive approves of is no right at all.

We might, in our initial exasperation ask: "Was it for this that we fought off absolute monarchs of France and Spain, Princes of Rome and Kaisers and Führers of Germany? Was it for this we tried to bring standards of decency to the countries of the former British Empire?". We recall that most of the countries of the EC sixty years ago were either run or overrun by Fascists. We may be tempted to ask what on earth we are doing in bed with people whose political traditions are so different from our own.

That would, in my view, be an over-hasty and intemperate reaction, albeit an understandable one. Many of the countries of Europe have come a long way since 1945 and, while it is true that in some EC states there are practitioners who do not share or care for British values and while corruption in government and public life is even greater than in the United Kingdom, none the less we should never forget that there are academics, judges and practitioners who do share our standards and who are as concerned as we are with the rule of law or the principle of legal certainty and with legitimacy.

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3 I use the word "British" advisedly, to include all the inhabitants of the British Isles, as my comments hold good for all the legal systems one finds there.

4 I deliberately choose what one hopes are obsolete examples. The reader can easily supply for himself more up-to-date ones. A recent chilling example was the suppression of the free media by the Venezuelan President on the grounds that, in criticising him, they had "abused" their freedom of expression.

3 Language as Obfuscation

Much of the language and concepts of foreign lawyers seem alien to English lawyers. That should not of itself frighten us. The study of comparative law quickly teaches us that different jurisdictions can use what are essentially similar judicial techniques in solving problems to reach broadly the same results, even though the terminology and even the precise concepts may differ. What matters is the substance of the rule, not its label.

Let us therefore look at the substance. To do so, we must first analyse the language of rights.

4 What is a Right?

The word "right" is highly ambiguous. The word is commonly used in at least three different distinct meanings.

It can mean a *right proper*. The test of such a right is that there must exist in relation to it a corresponding or correlative duty, owed by another to the owner of the right. If I have a right to be paid £100 by you, you are under a duty to pay me £100. If I have a right that you do not come on my land without my permission, then you are under a duty not to come on my land without my permission. This type of right does not normally give rise to much difficulty. One normally starts by ascertaining whether there is a duty owed to the propositus; if there is, then he has the correlative right.

Secondly there is the type of right which does not entail a correlative duty on the part of anyone else but merely the absence of a duty on the part of the possessor of the right. It is sometimes called a *"liberty"*, which is a much more accurate and less ambiguous term. When, for example, I assert that I have a right to communicate with others, that does not entail any correlative duty on them to allow me to communicate with them or to assist me in any way to communicate with them. This is simply a matter in which the law does not interfere, positively or negatively. Consequently, my right/liberty may be of very limited value if I do not have the means to turn it to good account. I plead a right/liberty if someone alleges that I have broken a duty imposed on me, whether by the civil or the criminal law, not to communicate with others. My plea is effectively that I was under no such duty.

"Right" is sometimes used to mean *"power"*. "Power" itself has several meanings. The sense of "power" in which the word "right" is used is that of the ability to change the rights and duties and/or powers of oneself and/or others. If I have the

right to transfer my property to others, I have the power to extinguish rights proper which I possess, and correlative duties owed to me, and to create rights proper in another and, consequently, correlative duties owed to him. Usually, where I have a right/power, I have also a right/liberty to exercise it. Yet, conceptually, the two are different. If I have contracted to sell an asset I own to A, I am under a duty not to transfer it to B, and thus have no right/liberty to convey it to B, yet I still have the power to convey title to it to B. If I do so, I have still validly exercised by power/right even though I had no right/liberty to do so and breached a duty in so doing.

5 What is an Abuse of Rights?

My thesis is that, no matter which type of right you are dealing with, it is a contradiction in terms to speak of an abuse of a right. What does make sense is to assert that, in the circumstances, the apparent right does not exist and therefore cannot be exercised. But of course one is then not really abusing a right at all! Hence, we British need not be unduly concerned. We are quite used to the scope of rights being defined and to their being subject to conditions and qualifications. We can have no objection at all to that, provided it is done in conformity with the Rule of Law. The most that we can object to is that language is being used less precisely than it ought to be in a legal context.

Planiol said "Le droit cesse là où l'abus commence". This has been translated "The law ends where abuse begins".[5] It sounds magnificent, but what on earth does it mean? I confess I cannot make any sense out of it. I can, however, make sense of the French, which I translate as "The *right* [6] ceases where abuse begins". In other words, in a case of "abuse", there is in fact no right. If my translation is correct, then, in my respectful view, Planiol was absolutely right. For that is the only intellectual basis on which a doctrine of abuse of rights can be defended.[7]

Now it is true that we British do not speak of "abuse of rights", but we do speak of conditional or limited rights. I have a right (liberty) of free speech. If I incite another to murder, I can be indicted. If I accuse another of chicanery, I can be compelled to pay damages unless I can prove the allegation was true. We British

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5 See the English translation of the Opinion of Mr Advocate General La Pergola delivered on 16th July 1998 in *Centros Ltd v Erhvervs- og Selskabsstyrelsen* Case C-212/1997.

6 While "droit" can mean "law" as in "droit civil" (civil law), it can also mean "right" as in "les droits de l'homme" (the rights of man, human rights).

7 It is also the basis which appealed to Mr Advocate General La Pergola in *Centros*.

would say that the right of free speech is not unlimited but is subject to these (and other) restrictions. If I do incite to murder or defame another, we would not say that I have abused my right of free speech; merely that I had no right to do so in the first place. We shall not go far astray provided we remember that, when our Continental partners speak of "abuse of rights", they mean simply that a person purporting to exercise an apparent right has not validly done so because he in fact had no such right or, if you like, any right he does have does not extend to the situation in question.

There are apparent exceptions to this rule only where one is concerned with what turn out to be two or more rights of different types or where there are two or more persons involved. For example, I may contract with A not to convey property to B. I am under a duty to A not to convey to B, so that, vis-à-vis A I have no right (in the sense of either right proper or liberty) to do so. Yet I may still have the right, in the sense of power, to convey to B. It would not be an abuse of English to say that in conveying to B, I have exercised my right and yet abused it.[8]

There is in fact English terminology which is very close to that of "abuse of rights", namely "abuse of powers". The analogy is very close. In the case of abuse of powers, the legal analysis is simply that the power has in the circumstances not been exercised at all because the exercise was subject to conditions precedent which have not been complied with. The doctrine is very important in British public law, as, of course, it is on the Continent. It applies also to certain private law powers.[9]

6 The Customs' Argument on Abuse of Rights

Customs' argument on "abuse of rights" has not been fully particularised. One rather suspects that they are throwing a half-baked idea to the courts to see if they will cook it to the mutual satisfaction of both of them. In the Halifax and BUPA cases, it appeared to involve the following propositions:

(a) There is a rule of EC law which concerns the "abuse" of a right granted by that law.

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8 Then again, whereas, vis-à-vis A I have no right to convey to B, vis-à-vis C I do have that right, as I owe no duty to C not to.

9 As in the doctrine of "fraud" on a power of appointment. "Fraud" is used here in a misleading and technical sense. There is a fraud if the power is (purportedly) exercised for an improper purpose, e.g. a power to appoint capital of a trust fund to X is exercised so as to benefit Y, who is not an object of the power.

(b) It applies to the right to deduct input tax conferred by Sixth Directive Title XI.

(c) The rule has by some unspecified means become incorporated into United Kingdom law and operates in relation to the right to deduct input tax conferred by section 26 of the Value Added Tax Act 1994.

(d) The exercise of a right to deduct value added tax which amounts to "tax avoidance" - whatever that may mean - is an abuse of that right.

(e) The consequence of the right being "abused" is not, at least in the present context, that the abuser commits a tort or other wrongful act but that the right is not validly exercised.

This can be viewed as either the most extreme abuse of rights doctrine or the most innocuous one. If all that Customs are saying is that, in the circumstances of each of these cases, the Sixth Directive does not, on its true construction, give rise to a right to deduct input tax, that would be at least intelligible and coherent. Whether it is right or wrong is beyond the scope of the present discussion. But for them firstly to accept (as, in my view, accept they must) that there is a right to deduct input tax vested in the appellants and then, *uno flatu*, to assert that because of their abuse they cannot exercise it, goes well beyond anything which is defensible as a matter of constitutional propriety or of logic. That is a doctrine of abuse of rights in its most extreme and anti-democratic form.

7 The British Tradition

A rule or principle of abuse of rights in its extreme form is anathema to British[10] law. It is unconstitutional and contrary to the Rule of Law. In English law, one either has a right or one does not. The right may be subject to conditions precedent, but that goes to the content of the right. Once the true extent of the right has been ascertained, it is exercisable for any reason – good, bad or capricious – which the holder thinks fit. No tribunal can deprive the holder of the right simply because it disapproves of his reasons for exercising it.

The general position in English law is that "if conduct is presumptively unlawful, a good motive will not exonerate the defendant, and that, if conduct is lawful apart from motive, a bad motive will not make him liable" (*Winfield & Jolowicz on Tort*

10 While the cases cited are English, I believe the law in each of the five British jurisdictions (England and Wales, Scotland, the Isle of Man, the Province of Northern Ireland and the Republic of Ireland) to be the same.

(15th ed.) at p.55 as approved by Lord Steyn in *Three Rivers D.C. v Bank of England (No.3)* [2000] 2 WLR 1220 at 1230).

The classic case is *Mayor of Bradford v Pickles* [1895] AC 587, especially per Lord Halsbury LC at 594: "If it was a lawful act, however ill the motive might be, he had a right to do it. If it was an unlawful act, however good his motive might be, he would have no right to do it. Motives and intentions in such a question as is now before your Lordships seem to be absolutely irrelevant". That was an action in "tort" (non-contractual liability, corresponding approximately to the Civilian delict and quasi-delict) based on the alleged wrongful use of land.

In *Allen v Flood* [1897] AC 1, a case of an alleged tort of conspiracy to cause loss to another, Lord Herschell said, at page 124, that the principle "is not applicable only to rights of property but is equally applicable to the exercise by an individual of his other rights", while Lord Macnaghten said (at page 151):

> "I do not think that there is any foundation in good sense or in authority for the proposition that a person who suffers loss by reason of another doing or not doing some act which the other is entitled to do or to abstain from doing at his own will and pleasure, whatever his real motive may be, has a remedy against a third person who, by persuasion or by some other means not in itself unlawful, has brought about the act or omission from which the loss comes, even if it could be proved that such person was actuated by malice towards the plaintiff, and that his conduct if it could be inquired into was without justification or excuse."

Fitzroy v Cave [1905] 2 KB 364 was, by contrast, a contract case. There, an assignment of debts owing by the claimant was taken by the defendant so that he could bankrupt the claimant and remove him from his position in a company. The main point dealt with was whether the assignment was in fact vitiated by "maintenance". The Court, however, having considered that this was not the case, Collins MR said, at 370: "if the transaction as described in the document was free from all taint of maintenance, the title of the assignee was absolute, and could not be impeached because he acted maliciously in contemplation of law in enforcing it".

Chapman v Honig [1963] 2 QB 502, was a case between landlord and tenant. Pearson LJ at page 520:

> "Motive is disregarded as irrelevant. A person who has a right under a contract or other instrument is entitled to exercise it for a good reason or a bad reason or no reason at all".

The statement in Salmond & Heuston on the Law of Tort (21st ed.) at 19 is particularly relevant to tax cases:

> "The rule is based partly on the danger of allowing a tribunal to determine the liability of a defendant by reference to its own opinions and prejudices as to the propriety of his motives, and partly on the difficulty of ascertaining what those motives really were."

The House of Lords in the criminal case of *Director of Public Prosecutions v Bhagwan* [1972] AC 60 held that it is no offence under the law of England to do or to agree with others to do acts which, though not prohibited by legislation nor criminal nor tortious at common law, are considered by a judge or by a jury to be calculated to defeat, frustrate or evade the purpose or intention of an Act of Parliament. If it were otherwise, freedom under the law would be but an empty phrase. See in particular the speech of Lord Diplock at page 82:

> "But it is no function of a judge to add to the means which Parliament has enacted in derogation of rights which citizens previously enjoyed at common law, because he thinks that the particular case in which he has to apply the Act demonstrates that those means are not adequate to achieve what he conceives to be the policy of the Act."

Equally, it is no function of the judge to derogate from rights conferred on citizens because he disapproves of their exercise in certain ways.

It is clear from many United Kingdom authorities dealing with tax planning/tax avoidance that the motive of the taxpayer is irrelevant. The classic case is *The Commissioners of Inland Revenue v The Duke of Westminster* [1936] AC 1. As Lord Tomlin said in a famous passage:

> "Every man is entitled if he can to order his affairs so that the tax attaching under the appropriate Acts is less than it otherwise would be. If he succeeds in ordering them so as to secure this result, then, however unappreciative the Commissioners of Inland Revenue or his fellow taxpayers may be of his ingenuity, he cannot be compelled to pay an increased tax."

Although the precise scope of the *Duke of Westminster* principle is now subject to the doctrine in *W T Ramsay Ltd v IRC* [1982] AC 30, it was in general approved by Lord Wilberforce in *Ramsay*, at the bottom of page 323. It is now firmly established that *Ramsay* itself is simply a rule of statutory construction and cannot be used to undermine rights (or immunities) clearly conferred by a statute or to impose duties which the statute does not impose: see *MacNiven (Inspector of Taxes)*

v Westmoreland Investments Ltd [2001] UKHL 6 [2001] STC 237. As Lord Hoffmann said in *Norglen Ltd (in liquidation) v Reeds Rains Prudential Ltd* [1999] 2 AC 1 at 13-14:

> "If the question is whether a given transaction is such as to attract a statutory benefit, such as a grant or assistance like legal aid, or a statutory burden, such as income tax, I do not think that it promotes clarity of thought to use terms like stratagem or device. The question is simply whether upon its true construction, the statute applies to the transaction. Tax avoidance schemes are perhaps the best example. They either work *(Inland Revenue Commissioners v Duke of Westminster* [1936] AC 1) or they do not *(Furniss v Dawson* [1984] AC 474.) If they do not work, the reason, as my noble and learned friend, Lord Steyn, pointed out in *Inland Revenue Commissioners v McGuckian* [1997] 1 WLR 991, 1000, is simply that upon the true construction of the statute, the transaction which was designed to avoid the charge to tax actually comes within it. It is not that the statute has a penumbral spirit which strikes down devices or stratagems designed to avoid its terms or exploit its loopholes."

In the BUPA appeals, Customs eventually disclaimed any reliance on *Ramsay*. What they are trying to do is to introduce via the back door of the EC a principle which has been so recently and so firmly rejected by the highest court in the United Kingdom as being unconstitutional. It is for the courts to construe statutes, including taxing statutes. While they are not limited in their construction to considering merely the literal meaning of the words and can quite legitimately have regard to the purpose of the statute, yet, once they have construed it, they cannot, at the end of the day, then deny the individual rights so conferred because of some hierarchically superior judicial doctrine. To do so would be unconstitutional. The courts are not legislators. And this is as true of the European Court of Justice as it is of the British courts. The extreme abuse of rights doctrine is just such a penumbrae spirit. The sooner it is exorcised, the better.

8 The European Court of Justice Jurisprudence

8.1 Ambiguity of Language

Judgments of the European Court of Justice are, understandably, not couched in the language of English lawyers. Transparency of meaning can suffer in the translation from one language to another and from the concepts of one legal system to

another.[11] Words like "fraud" and "abuse" can mean different things in different contexts. Many of the cases are simply ones of fraud in the good old-fashioned sense, i.e. lies and deceit. The taxpayer never had a right: he simply pretended to have one. These cases, properly understood, give rise to no problems.

In other cases, highly ambiguous and emotive words such as "abuse" are used with no concern to define them. Such authorities are simply not sufficiently unequivocal to form the foundation of sound case law.

8.2 Author's View

Let me state in advance that, in my view, the only conceivable basis for a doctrine of abuse of rights is that a right is "abused" only where, on its true construction, it is subject to implied conditions precedent which are not satisfied, so that it does not exist. An "abuse of rights" doctrine is acceptable provided it is really about the content and scope of the right.

Indeed, it would be unconstitutional for the European Court of Justice to invent a judicial doctrine constraining the exercise of rights duly granted under Community law. For the function of the Court is to interpret that law, not to subvert it. Nowhere is this more clear than in the case of a preliminary reference from a national court. Indeed, were – fantastic as the notion is – the European Court of Justice to overreach itself by "inventing" law inconsistent with such rights, then its ruling would be of no effect in English law. It would, vis-à-vis the English system have acted beyond its powers, and its ruling would be a nullity.

It should be noted that all the cases so far concern claims in national courts that a person has a directly effective EC right which overrides national law. Could the doctrine of abuse of powers extend to rights granted under the municipal law of Member States? While that is primarily a matter for the municipal law of each state, it could in my view do so only if the primary view I hold is correct and abuse of rights is simply a question of the true construction of EC law. The English courts, for example, try to construe United Kingdom legislation "sympathetically" with EC law. In order to do that, one must first ascertain what the EC law is.

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[11] For a discussion of the difficulties of translation (and mis-translation) which the concepts of "tax evasion" and "tax avoidance" have given rise, see my article *When is a Supply not a Supply? Halifax plc v Commissioners of Customs & Excise* section 5.2 in *The EC Tax Journal* Volume 4, Issue 3, page 153.

8.3 Fraud as Deceit

In cases such as the decision of the European Court of Justice of 2nd May 1996 in *Brennet AG v Vittorio Paletta* case C-206/94 [1996] ECR I-2357, "abuse" means no more than fraud. See paragraph 24 of the judgment.

8.4 No General Principle: *Centros*

It is clear that there is no EC general principle of abuse of rights. In *Centros Ltd v Erhvervs- og Selskabsstyrelsen* [1999] ECR I-1459, the question was whether it was contrary to Articles 52 and 58 of the Treaty, as they then were, for a Member State to refuse to register a branch of a company formed in accordance with the legislation of another Member State in which it has its registered office but where it does not carry on any business, when the purpose of the branch is to enable the company concerned to carry on its entire business in the State in which that branch is to be set up, while avoiding the formation of a company in that State, thus "evading" application of the rules governing the formation of companies which are, in that State, more restrictive so far as minimum paid-up share capital is concerned. The Court rejected the argument that the rights conferred by Articles 52 and 58 cannot be relied on where the sole purpose of the company formation which they have in mind is "to circumvent the application of the national law governing formation of private limited companies and therefore constitutes abuse of the freedom of establishment". The position would be different in a case of "abuse" in the sense of fraud.

I respectfully agree with Advocate General La Pergola, at paragraph 20 of his Opinion: "the problem of abuse is resolved in the last analysis by defining the material content of the particular situation and thus the scope of the right conferred on the individual concerned. In other words, it is claimed that to determine whether or not a right is actually being exercised in an abusive manner is simply to define the material scope of the right in question". This is entirely consistent with the English approach. The right to deduct input tax incurred for the purpose of making a taxable supply in the current VAT cases is, to quote the language of the Advocate General "part of the material content of the right in question". Consequently, it cannot be held that a person takes 'an improper advantage, manifestly contrary to the objective' pursued by the Sixth Directive in exercising a right to a VAT deduction.

The Advocate-General continued (in footnote 46):

> "In *The Queen v Secretary of State for Transport, ex parte Factortame and Others* [1991] ECR I-3905, "the Court appears to have recognised (albeit

implicitly) that the registration in the register of British fishing vessels of vessels originally registered in Spain and flying the Spanish flag and the acquisition of British vessels flying the British flag by companies incorporated under the laws of the United Kingdom owning or operating such vessels, most of whose directors and shareholders were Spanish nationals, did not constitute an 'abuse of the right of establishment', despite the fact that the wholesale recourse to such registrations in the British shipping register had resulted in the practice known as 'quota hopping', that is to say 'plundering' the fishing quotas allocated to the United Kingdom under the Common Fisheries Policy, and had led in effect to 'circumvention' of the system of national fishing quotas designed to conserve fish stocks and guarantee a reasonable standard of living for the communities dependent on fishing."

The Court said:

"24. It is true that according to the case-law of the Court a Member State is entitled to take measures designed to prevent certain of its nationals from attempting, under cover of the rights created by the Treaty, improperly to circumvent their national legislation or to prevent individuals from improperly or fraudulently taking advantage of provisions of Community law ...

25. However, although, in such circumstances, the national courts may, case by case, take account – on the basis of objective evidence – of abuse or fraudulent conduct on the part of the persons concerned in order, where appropriate, to deny them the benefit of the provisions of Community law on which they seek to rely, *they must nevertheless assess such conduct in the light of the objectives pursued by those provisions* (Paletta II, paragraph 25).[12]

26. In the present case, the provisions of national law, application of which the parties concerned have sought to avoid, are rules governing the formation of companies and not rules concerning the carrying on of certain trades, professions or businesses. The provisions of the Treaty on freedom of establishment are intended specifically to enable companies formed in accordance with the law of a Member State and having their registered office, central administration or principal place of business within the Community, to pursue activities in other Member States through an agency, branch or subsidiary.

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12 Italics supplied.

> 27. That being so, 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 is inherent in the exercise, in a single market, of the freedom of establishment guaranteed by the Treaty."

8.5 *Kefalas*

Alexandros Kefalas and Others v Elliniko Dimosio (Greek State) and Organismos Oikonomikis Anasygkrotisis Epicheiriseon AE (OAE) [1998] ECR I-2843 is to similar effect. It concerned the Second Company Law Directive, which gives shareholders in a company a right of pre-emption in respect of the issue of further shares. Administration of a company in financial difficulties was taken over by an organ of the State, which implemented a rescue plan involving the issue of fresh share capital to third parties who were prepared to bail out the company. When the company's affairs were turned round, the original shareholders complained.

See in particular the Opinion of Mr Advocate General Tesauro in that case, from paragraph 21 onwards, and especially at paragraph 25:

> "So, essentially, the Court recognises that a national court may sanction an excessive or distorted use of Community law only where this is not prejudicial to the objectives pursued by the relevant provision, in particular in cases where the provision relied upon is only 'apparently' the one governing the circumstances concerned, or when the situation of the person relying upon the right concerned only 'apparently' meets what is laid down by the provision at issue. *This really means that the Court reserves itself the right, as is appropriate, to define the substantive scope of the Community right at issue, that is to say, to define the intrinsic limits of the subjective legal position concerned.* So, reliance on a right may be refused only where it is proved that those limits have been exceeded."

Kefalas decided merely that, while Community law does not preclude the application by national courts of a provision of national law in order to assess whether a right arising from a provision of Community law is being exercised abusively, the application of such a national rule must not prejudice the full effect and uniform application of Community law in the Member States. In particular, it is not open to national courts, when assessing the exercise of a right arising from a provision of Community law, to alter the scope of that provision or to compromise the

objectives pursued by it.

The ECJ said:

> "20. According to the case-law of the Court, Community law cannot be relied on for abusive or fraudulent ends ...
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> 21. Consequently,[13] the application by national courts of domestic rules such as Article 281 of the Greek Civil Code for the purposes of assessing whether the exercise of a right arising from a provision of Community law is abusive cannot be regarded as contrary to the Community legal order.
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> 22. Although the Court cannot substitute its assessment for that of a national court, which is the only forum competent to establish the facts of the case before it, it must be pointed out that the application of such a national rule must not prejudice the full effect and uniform application of Community law in the Member States (Case C-441/93 *Pafitis and Others*, cited above, paragraph 68). In particular, it is not open to national courts, when assessing the exercise of a right arising from a provision of Community law, to alter the scope of that provision or to compromise the objectives pursued by it.
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> 23. In the present case, the uniform application and full effect of Community law would be prejudiced if a shareholder relying on Article 25(1) of the Second Directive were deemed to be abusing his right on the ground that the increase in capital contested by him resolved the financial difficulties threatening the existence of the company concerned and clearly enured to his economic benefit.
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> 24. It is settled case-law that the decision-making power of the general meeting provided for in Article 25(1) applies even where the company in question is experiencing serious financial difficulties ... Since an increase in capital is, by its very nature, designed to improve the economic situation of the company, to characterise an action based on Article 25(1) as abusive on the ground mentioned in paragraph 23 of this judgment would be tantamount to a declaration that the mere exercise of the right arising from that provision is improper.
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> 25. It would mean that, in the event that the company found itself in a financial crisis, a shareholder could never rely on Article 25(1) of the Second Directive. Consequently, the scope of that provision would be

[13] Is not this a non-sequitur?

altered, whereas, according to the case-law cited above, the provision must remain applicable in such a situation.

26. Similarly, the uniform application and full effect of Community law would be prejudiced if a shareholder relying on Article 25(1) of the Second Directive were deemed to be abusing the right conferred on him by that provision because he did not exercise his preferential right under Article 29(1) of the Second Directive to acquire new shares issued on the increase of capital at issue.

27. By exercising his preferential right, the shareholder would have shown his willingness to assist in the implementation of the decision to increase the capital without the approval of the general meeting, whereas he is in fact contesting that very decision on the basis of Article 25(1) of the Second Directive. Consequently, to require a shareholder, as a condition of his being able to rely on that provision, to participate in an increase in capital adopted without the approval of the general meeting would be to alter the scope of Article 25(1)."

So far, so good. The ECJ continued:

"28. However, Community law does not preclude a national court, on the basis of sufficient telling evidence, from examining whether, by bringing an action under Article 25(1) of the Second Directive for a declaration that an increase in capital is invalid, a shareholder is seeking to derive, to the detriment of the company, an improper advantage, manifestly contrary to the objective of that provision, which is to ensure, for the benefit of shareholders, that a decision increasing the capital of the company and, consequently, affecting the share of equity held by them, is not taken without their participation in the exercise of the decision-making powers of the company.

29. In the light of the foregoing, the reply to the questions referred must be that Community law does not preclude national courts from applying a provision of national law in order to assess whether a right arising from a provision of Community law is being exercised abusively. However, where such an assessment is made, a shareholder relying on Article 25(1) of the Second Directive cannot be deemed to be abusing the right arising from that provision merely because the increase in capital contested by him has resolved the financial difficulties threatening the existence of the company concerned and has clearly enured to his economic benefit, or because he has not exercised his preferential right under Article 29(1) of the Second

Directive to acquire new shares issued on the increase in capital at issue."

The position was clarified further in *Diamantis*.

8.6 *Diamantis*

In *Dionysios Diamantis v Elliniko Dimosio and Others* Case C-373/97 (23rd March 2000), the European Court of Justice reasserted what it had said in *Kefalas*:

> "The preliminary point must be made that, as the Court has already held in Case C-367/96 *Kefalas and Others v Greek State and Others* [1998] ECR I-2843, paragraph 28, the objective of Article 25(1) of the Second [Company Law] Directive is to ensure, for the benefit of shareholders, that a decision increasing the capital of the company and, consequently, affecting the share of equity held by them, is not taken without their participation in the exercise of the decision-making powers of the company. According to the case-law, that objective would be seriously frustrated if the Member States were entitled to derogate from the provisions of the directive by maintaining in force rules – even rules categorised as special or exceptional – under which it was possible to decide by administrative measure, outside any decision by the general meeting of shareholders, to effect an increase in the company's capital."

The issue arose in a similar context: whether a shareholder could be precluded from complaining that shares in a company had been issued to others in breach of the EC Second Company Law Directive.

The Court then went on:

> "33. However, Community law cannot be relied on for abusive or fraudulent ends (see *Kefalas and Others,* cited above, paragraph 20, and the case-law cited there). That would be the case if a shareholder, in reliance on Article 25(1) of the Second Directive, brought an action for the purpose of deriving, to the detriment of the company, an improper advantage, manifestly contrary to the objective of that provision (*Kefalas and Others*, cited above, paragraph 28)."

I note the ambiguity in "abusive or fraudulent end" and in "an improper advantage". In my view they are all controlled by the final words "manifestly contrary to the objective of that provision".

> "34. Although national courts may, therefore, take account – on the basis of objective evidence – of abuse on the part of the person concerned in order, where appropriate, to deny him the benefit of the provisions of Community law on which he seeks to rely, they must nevertheless assess such conduct in the light of the objectives pursued by those provisions (Case C-206/94 *Paletta* [1996] ECR I-2357, paragraph 25). The application of a national rule such as Article 281 of the Civil Code must not, therefore, detract from the full effect and uniform application of Community law in the Member States (*Pafitis and Others*, cited above, paragraph 68).
>
> 35. It is for the national court to determine whether, in the case before it, application of Article 281 of the Civil Code is compatible with that requirement. However, the Court has jurisdiction to provide the national court with guidance on interpretation to enable it to assess that issue of compatibility.
>
> 36. In that connection, it is clear from the above judgments in *Pafitis and Others*, paragraph 70, and *Kefalas and Others*, paragraph 29, that a shareholder relying on Article 25(1) of the Second Directive cannot be deemed to be abusing his rights merely because he is a minority shareholder of a company subject to reorganisation measures, or has benefited from the reorganisation of the company, or has not exercised his right of pre-emption. Similarly, the fact that the plaintiff in the main proceedings asked that Plastika Kavalas be made subject to the scheme under Law No 1386/1983 does not indicate an abuse of rights."

So far, so good.

> "37. As the Advocate General observed in point 29 of his Opinion, once a company is placed under the scheme provided for under Law No 1386/1983, a wide range of solutions regarding the treatment to be applied to it is available, so that a request for that Law to be applied cannot be treated as agreement to the power to take decisions with regard to increases in capital being transferred to a body external to the general meeting. A shareholder relying on Article 25(1) of the Second Directive cannot, therefore, be said to be abusing his rights under that provision on the ground that he was one of the shareholders who asked that the company be placed under the scheme of Law No 1386/1983.
>
> 38. It must next be determined whether Community law precludes the national court from verifying whether, in choosing to bring an action for a declaration that the alterations in capital were invalid, *after periods of five*

years and four years had elapsed, the plaintiff in the main proceedings was seeking to derive, to the detriment of Plastika Kavalas, an improper advantage manifestly contrary to the objective of Article 25(1) of the Second Directive, thus constituting an abuse of his rights under that provision.

39. On that point it must be observed that the fact of having instituted proceedings, even after a certain lapse of time, within the limitation period provided for under national law for such actions cannot, as such, be described as sufficient telling evidence of abuse of rights.

40. However, it appears from the order for reference that if the action brought by the plaintiff in the main proceedings for a declaration of invalidity in respect of the alterations in the capital of Plastika Kavalas when it was under provisional administration were upheld, several operations that took place during that period could be affected, in particular purchases, sales, enforcement measures, acquisitions of businesses and the merger of Plastika Kavalas with another company. Moreover, it is indisputable that the invalidity of those alterations would inevitably affect the rights of *bona fide* third parties.

41. In this connection it must be borne in mind that the Second Directive does not provide for any specific penalty for breach of any of its provisions, so that the normal penalties under private law could be applicable. When he instituted proceedings, the plaintiff in the main proceedings was thus entitled to elect, as he did, from among the remedies in national law available for penalising a breach of Article 25 of the Second Directive, an action for a declaration that the alterations in the capital of the company that took place were invalid.

42. It must therefore be ascertained whether Community law precludes the national court from verifying whether, in view of all that has taken place, in law and in fact, since the alterations in the capital of the company, the type of reparation sought constitutes sufficient telling evidence, in the sense indicated above, of abuse of the shareholder's rights under Article 25(1) of the Second Directive.

43. In this case it would not appear that the uniform application and full effect of Community law would be compromised if it were to be held an abuse of rights for a shareholder to rely on Article 25(1) of the Second Directive on the ground that, of the remedies available for a situation that has arisen in breach of that provision, he has chosen a remedy that will cause such serious damage to the legitimate interests of others that it

> appears manifestly disproportionate. Such a determination would not alter the scope of that provision and would not compromise its objectives."

What is odd about the case is how it got off the ground in the first place. Diamantis was in effect claiming that the Second Directive should have horizontal effect in Greek law and bind persons pother than the Greek State, even though it had clearly not been fully implemented into Greek law.

Now what this case decides is not that there is an EC principle of abuse of rights but that in some cases the application of a rule of abuse of rights in the municipal law of a Member State may not be inconsistent with EC law.

Moreover, it decides merely that a right can be lost by "abuse", not, as Customs are contending, that it never arises in the first place. We in the British Isles should find nothing unusual in that. We have limitation periods. We also have the equitable doctrine of laches, under which rights may be lost by the lapse of time, particularly where others would be prejudiced by their exercise. We have the doctrine of fraudulent silence or standing by, a species of estoppel. We have even common law bars to recission of a transaction where third parties, or sometimes even a wrongdoer, has acted to his detriment on the faith of the validity of the transaction.

8.7 *Zunis*

Another case on loss of a right by lapse of time coupled with "abuse of right" is *Zunis Holding SA, Finan Srl and Massinvest SA v Commission of the European Communities* Case C-480/1993 P [1996] ECR I-1. Advocate-General Lenz stated at paragraph 23 of his Opinion:

> "The basis for that is, however, not a time-limit applied by analogy, but the general legal principle that rights may not be exercised if to do so would constitute an abuse. In my view there is such an abuse if the person who has discovered a relevant new fact fails to act within a reasonable period.
>
> The longer the persons affected wait in such a case before approaching the Commission, the more important the requirements of legal certainty become. However, so long as the legislature has not laid down any rules in that area, the question whether the persons affected have acted within a reasonable period will have to be answered not by reference to an abstract, overall time-limit, but only by taking into account all the circumstances of the case itself."

8.8 *Emsland-Stärke*

Customs have relied heavily on *Emsland-Stärke GmbH v Hauptzollamt Hamburg-Jonas* European Court of Justice Case C-110/99, 14th December 2000, as laying down a general principle of abuse of rights in EC law. It turned on the interpretation of Commission Regulation (EEC) No 2730/79 of 29th November 1979 laying down common detailed rules for the application of the system of export refunds on agricultural products. The case thus concerned a right granted by EC law.

Emsland-Stärke exported to Switzerland several consignments of a product based on potato starch under the description 'Emes E'. The recipients of the goods were declared to be the undertakings Fuga AG (hereinafter 'Fuga') and Lukowa AG (hereinafter 'Lukowa'), both established at the same address in Lucerne, Switzerland, and managed and represented by the same group of persons. The invoice was addressed in each case to Lukowa. On an application by Emsland-Stärke, and in the light *inter alia* of Swiss customs clearance certificates and freight papers, the HZA granted the company an export refund. Immediately after their release for home use in Switzerland, the exported consignments marked 'Emes E' were transported back to Germany unaltered and by the same means of transport under an external Community transit procedure recently set up by Lukowa and were released for home use in that Member State on payment of the relevant import duties.

There appears to have been no real argument that abuse of rights was not in point, the main argument being that Germany could no longer claw back the refund. The real reason that the Court found against Emsland was that the Regulation gave no right to an export refund if there was no intention to put the goods exported into free circulation outside the EC. This was a purposive construction. See the Opinion of A-G Alber at paragraphs 71 onwards. It is in this light that the judgement of the Court must be read:

> "50. However, in the light of the specific circumstances of the operation at issue in the main proceedings, which might suggest an abuse, that is to say, a purely formal dispatch from Community territory with the sole purpose of benefiting from export refunds, it must be examined whether Regulation No 2730/79 precludes an obligation to repay a refund once granted.
>
> 51. The Court has also held that the fact that importation and re-exportation operations were not realised as *bona fide* commercial transactions but only in order wrongfully to benefit from the grant of

> monetary compensatory amounts, may preclude the application of positive monetary compensatory amounts (*General Milk Products*, cited above, paragraph 21).
>
> 52. A finding of an abuse requires, first, a combination of objective circumstances in which, despite formal observance of the conditions laid down by the Community rules, the purpose of those rules has not been achieved.
>
> 53. It requires, second, a subjective element consisting in the intention to obtain an advantage from the Community 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 Community exporter receiving the refunds and the importer of the goods in the non-member country."

As we would put it in the United Kingdom, an exportation with a view to re-importation and with the motive simply of exploiting the arbitrage between export subsidies and import duties is not such an exportation as is, on its true construction, within the purview of the Regulation. Put that way, the point is rather obvious. Indeed, the only argument on the case appears to be whether, *Emsland-Stärke* having received the export subsidy, it could be compelled to repay it.

Hence, in my view, the case lays down no general principle. Indeed, the principle it lays down is not new either. The following cases are similarly explicable.

8.9 *General Milk Products*

General Milk Products GmbH v Hauptzollamt Hamburg-Jonas ECJ Case C-8/1992 concerned "positive monetary compensatory amounts" payable under EC law for exports of New Zealand cheddar cheese from one Member State to another. The ECJ agreed, at paragraph 13 of the Judgment, that, "in the light of the applicable Community provisions, the re-exportation of cheese in such circumstances may continue to give rise to the application of monetary compensatory amounts, unless there is evidence of fictitious transactions effected solely for the purpose of wrongfully obtaining monetary compensatory amounts".

It added later:

> "21. As stated by the plaintiff company in the main proceedings and the Commission, the position would be different only if it could be shown that the importation and re-exportation of that cheese were not realised as *bona*

> *fide* commercial transactions but only in order wrongfully to benefit from the grant of monetary compensatory amounts (see, by analogy, the judgment in Case 250/80 *Anklagemyndigheden v Toepfer* [1981] ECR 2465). The *bona fide* nature of those transactions is a question of fact to be decided by the national court."

8.10 *Leclerc*

Association des Centres Distributeurs Édouard Leclerc and Others V Sarl "Au Blé Vert" and Others (Case 229/83) [1985] ECR 11, concerned the field of the free movement of goods. The Court held that legislation on fixed prices for books which was applicable without restriction constituted a prohibited measure having effect equivalent to a quantitative restriction on imports. However, this was not applicable "where it is established that the books in question were exported for the sole purpose of re-importation in order to circumvent legislation of the type at issue".

8.11 *Lair*

In the field of the free movement of workers, the Court held in a judgment on student assistance that abuses established on the basis of objective evidence such that a worker entered a Member State for the sole purpose of enjoying, after a very short period of occupational activity, the benefit of the student assistance system in that State was not covered by the relevant Community provisions. *Lair v Unveristät Hannover* [1988] ECR 3161.

8.12 *Knoors*

Knoors v Secretary of State for Economic Affairs Case 155/78 [1979] ECR 399 concerned freedom of establishment and freedom to provide services. The ECJ held:

> "However, it is not possible to disregard the legitimate interest which a Member State may have in preventing certain of its nationals, by means of facilities created under the Treaty, from attempting wrongly to evade the application of their national legislation as regards training for a trade."

8.13 *Van Binsbergen*

In a string of cases, such as *Van Binsbergen* [1974] ECR 1299 Case 33/74, the ECJ held that a Member State cannot be denied the right to take measures to prevent the exercise by a person providing services whose activity is entirely or principally directed towards its territory of the freedom guaranteed by Article 59 for the purpose of avoiding the professional rules of conduct which would be applicable to

him if he were established within that State.[14]

8.14 *TV10*

In *TV10 SA v Commissariaat voor de Media* (Case C-23/93), a cable TV operator, had established itself in Luxembourg in order to escape Netherlands legislation applying to domestic associations. The ECJ held:

> "21. It follows that a Member State may regard as a domestic broadcaster a radio and television organization which establishes itself in another Member State in order to provide services there which are intended for the first State's territory, since the aim of that measure is to prevent organizations which establish themselves in another Member State from being able, by exercising the freedoms guaranteed by the Treaty, wrongfully to avoid obligations under national law, in this case those designed to ensure the pluralist and non-commercial content of programmes.
>
> 22. In those circumstances it cannot be regarded as incompatible with the provisions of Articles 59 and 60 of the Treaty to treat such organizations as domestic organizations."

8.15 General Comment

All the above are cases where an individual attempts to rely on an EC right to override national law. See *R* v *HM Treasury* and *Inland Revenue Commissioners, ex parte Daily Mail* and *General Trust plc* (Case 81/87) [1988] STC 787 per A-G Darmon paragraph 9: "Community Law offers no assistance where 'objective factors' show that a particular activity was carried out 'in order to circumvent' national legislation".

9 The BUPA Decision

In *BUPA Hospitals Ltd v Commissioners of Customs and Excise*, the London Value Added Tax and Duties Tribunal (chairman Stephen Oliver QC) were faced with, *inter alia,* a Customs argument based on abuse of rights. The appellant provided healthcare services to the paying public which the Court of Appeal had held were

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[14] See also *Van de Bijl* [1989] ECR 3039 Case 130/88 and *Veronica Emroep Organisatie* [1993] ECR I-487.

zero-rated.[15] The House of Lords refused the Commissioners of Customs and Excise leave to appeal. The appellant realised that a wise government would welcome the decision. It meant that the United Kingdom did not have to exempt the supplies; the cost of private healthcare would remain lower than if it did; the over-strained National Health Service would be strained that much less and the health of the nation would not suffer. The appellant also appreciated that there was a chance that New Labour would disregard the health of the nation and throw a sop to the envy and malice of Old Labour supporters to whom the very concept of private healthcare was anathema. It also appreciated that there was a chance that the Commissioners of Customs and Excise would, in pique at having lost the litigation, seek to persuade ministers to change the law and that ministers in question would in their ignorance accede to their demands.

The appellant therefore bought in £100,000,000 of supplies from a company in the same commercial group (but not value added tax group) by contracting to acquire them, paying for them and receiving a value added tax invoice at a time before any change in the law had been announced, with actual delivery to be made in future. The appellant claimed deduction of the input tax on the grounds that it intended to use the inputs to make supplies which under the then current law were characterised as zero-rated.

The Tribunal accepted, at paragraph 125 of the Decision, that there is a general principle in Community law of "abuse of rights". It held, however, as the claim to deduct input tax was made under section 26 of the Value Added Tax Act 1994, then "so far as concerns the relationship between the Appellants on the one hand and the Commissioners on the other, the rights and obligations are matters of domestic and not of Community law. The question therefore is whether a United Kingdom tribunal is required by the abuse of rights principle contained in Community law to dismiss an appeal based on what must be assumed for these purposes to be a good claim for input tax relief under UK law. We see no reason why the abuse of rights principle should operate here to strike down the Appellants' claims simply because they are perceived to be abuses of 'the right to deduct' contained in Article 17. No relevant rights have, in our view, been abused".

The Tribunal thus did not need to consider any further the true scope of what it alleged was "a general principle in Community law of 'abuse of rights'".

The Tribunal found against *BUPA Hospitals Ltd* on a different point, concerned with the decision of the same Tribunal in *Halifax PLC v Commissioners of Customs &*

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15 Zero-rating is a United Kingdom term for "exemption with refund" of input tax suffered by the person making the supply. It is preferable to exemption *simpliciter*, where there is no right to a refund.

Excise, on 1st March 2001 (2001) VAT Decision 17124. *BUPA Hospitals Ltd* appealed to the High Court on the Halifax point and the Commissioners of Customs and Excise cross-appealed on the abuse of rights point.

10 Conclusion

In so far as there is an EC doctrine of abuse of rights, it is concerned merely with the identification of the true scope of the right in question.

Cases concerning loss of rights through conduct and/or lapse of time are in a special category.

There is not any general doctrine preventing a person from enjoying an undoubted right. Nor is it competent for the European Court of Justice to invent such a doctrine to defeat rights lawfully conferred through democratic and constitutional processes.

Whatever the scope of abuse of rights in EC law, it can have no application to rights subsisting under United Kingdom law, even if such rights are granted to give effect to an obligation of the United Kingdom under EC law.