Fighting Artificial Transactions Under the Fundamental Freedoms

Edoardo Traversa and Fabrizio Pascucci

Abstract This chapter examines the application of the prohibition of abuse of rights under the EU fundamental freedoms in tax matters with a focus on artificial transactions. When analysing the case law of the Court of Justice the concept of artificiality represents one of the few firm points of the abuse test. However, although this principle appears somewhat self-evident, the methods by which it is enforced leave some doubt, as the Court's approach does not appear to be entirely consistent across the various areas of tax law (in particular harmonized and non-harmonized areas). In this respect, the lack of certainty is particularly evident when the Court attempts to assess the compatibility of a taxpayer's conduct with the objectives of the EU's fundamental freedoms in direct tax cases.

Keywords EU Law · Fundamental Freedoms · Prohibition of abuse · ECJ · Territoriality · Relationship to secondary law

1 Introduction

In EU tax law, the concept of abuse is closely linked to the concept of artificiality. In this respect, the analysis of the case law of the Court of Justice shows that this concept represents one of the few firm points of the abuse test, provided that—despite the heterogeneity of the situations brought before the Court of Justice over the years—the principle that tax advantages cannot arise from artificial transactions has been constantly reaffirmed since Halifax and does not seem to suffer from any significant exceptions.

However, although this prohibition is somewhat self-evident and should certainly be upheld, the methods by which it is enforced leave some doubt, as the Court's

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approach does not appear to be entirely consistent. The lack of certainty is particularly evident when the Court attempts to assess the compatibility of a taxpayer's conduct (and the tax benefits resulting from it) with the objectives of the EU's fundamental freedoms in direct tax cases.

There is an inherent paradox in the idea that what is the founding and guiding principle of the EU's internal market, i.e. free movement and cross-border mobility, could somehow be curtailed by considerations that are purely domestic and do not fall within any of the other objectives of EU integration. The protection of the financial interests of the Member States, as the Court of Justice has already stated on several occasions, cannot indeed be considered as a justification. However, it is also untenable to take the position that any kind of tax-driven arrangement should be protected by EU law. In this context, drawing a line between acceptable and unacceptable movements is a difficult exercise. It is therefore not surprising that over time the Court has more and more applied the prohibition of abuse in connection of a principle of territoriality governing the allocation of taxing rights between Member States.

A more consistent application of the concept of abuse in tax matters would require EU-harmonised direct tax legislation. The introduction of the ATAD GAAR, certainly a milestone in the process of EU integration, partly solves the problem—as it introduces the approach that the parameter is to be sought in the domestic legislation of the Member States. However, this method also has its limits and somehow jeopardises the uniform interpretation of EU law (and perhaps even denies the approach taken by the Court of Justice over the last twenty years or so). Such a conundrum is a further illustration of the lack of coherence in the EU tax framework, which seeks to attain full economic and legal integration in the internal market carving out direct taxation from the process.

The European Court of Justice has consistently emphasised that EU law cannot be invoked for abusive or fraudulent purposes and that its role includes the prevention of potential tax evasion, avoidance and abuse, which are objectives recognised by EU law itself.[1] According to the Court, the prohibition of abuse of rights is a general principle which applies to all areas covered by EU law. While this broad application underlines the importance of the concept of abuse, it can be difficult to grasp its precise function, as it is applied in different situations with different implications.

This chapter will examine the application of the prohibition of abuse of rights under the EU fundamental freedoms in tax matters, with a focus on artificial transactions.

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[1] Among others, see European Court of Justice, Case C-255/02 (*Halifax and Others*), para. 68; Case C-196/04 (*Cadbury Schweppes*), para. 35; Case C-321/05 (*Kofoed*), para. 38; Joined Cases C-131/13, C-163/13, C-164/13 (*Italmoda*), paras. 43,46 and 56; Case C-356/15 (*Commission v. Belgium*), para. 99; Case C-251/16 (*Cussens*), para. 27; Joined Cases C-116/16 and C-117/16 (*T-Danmark*), paras. 70 and 90; Joined Cases C-115/16, C-118/16, C-119/16, C-299/16 (*N Luxembourg 1*), para. 96. On the principle of abuse of rights in EU tax law, see O'Shea (2011) *Tax Avoidance and Abuse of EU Law*; de la Feria (2008); De Broe (2008) *International Tax Planning and Prevention of Abuse: A Study under Domestic Law, Tax Treaties and EC Law in Relation to Conduit and Base Companies*, pp. 755 et seq. For a critical comment, see Arnull, in: de la Feria/Vogenauer (2011) *Prohibition of Abuse of Law—A New General Principle of EU Law*, pp. 18–23, and Sørensen (2006).

2 The Prohibition of Abuse as a Transactional and Purposive Principle: What Are the Implications for the Application of the Fundamental Freedoms to Income Taxation?

The concept of abuse was first introduced in tax matters in the *Halifax* and *University of Huddersfield*[2] cases, which concerned the misuse of VAT deductions. Prior to that, the concept had been applied in the context of customs duties in *Emsland-Stärke*.[3] As stated in *Halifax*, the application of EU law cannot extend to abusive practices by economic operators. In this respect, the Court stated that two elements must be present in order to conclude that the transaction constitutes an abusive practice:

– notwithstanding the formal application of the conditions laid down in the relevant provisions of EU law (and in the national legislation transposing them), the transaction in question must result in the accrual of a tax advantage the grant of which would be contrary to the purpose of those provisions (objective element); and
– it must also be apparent from a number of objective factors that the essential (or principal) aim of the transaction in question is to obtain a tax advantage (subjective element).

The Court has also confirmed that the advantage conferred by EU secondary legislation (in this case, the right to deduct input tax under the Sixth EU VAT Directive, now Directive 2006/112/EC) should be disregarded if it derives from certain arrangements of the taxpayer which deviate from what could be considered as "normal commercial operations". According to the Court, "the transactions concerned must essentially seek to obtain a tax advantage, it must be borne in mind that it is the responsibility of the national court to determine the real substance and significance of the transactions concerned. In so doing, it may take account of the purely artificial nature of those transactions and the links of a legal, economic and/or personal nature between the operators involved in the scheme for reduction of the tax burden".[4]

In addition to the concept of abuse, there is also the concept of "artificiality",[5] which has the function of sorting out those taxpayers whose behaviour has no economic rationale and whose sole purpose is to exploit the rights granted by EU law in order to obtain a tax advantage. The concept of artificiality can be seen as a concept that somehow encompasses both the objective and subjective elements of the abuse test, provided that artificial behaviour would be contrary to the spirit of the rule in the first place (the second element of the objective part of the test) and would in some way be a confirmation that the primary intention of the taxpayer was to secure a tax advantage (the subjective test).

[2] European Court of Justice, Case C-223/03 (*University of Huddersfield*).

[3] European Court of Justice, Case C-110/99 (*Emsland-Stärke*).

[4] European Court of Justice, C-255/02 (*Halifax and Others*), para. 81.

[5] In this respect, *see also* European Court of Justice, C-653/11 (*Newey*), paras. 42–50.

Despite the various attempts to reduce this concept to an objective parameter, artificiality is a constantly evolving concept and a one-size-fits-all approach is by no means possible. For these reasons, the Court of Justice has wisely provided the test with an element that makes it possible to identify those situations where, despite the existence of a tax advantage, the transaction may still prove to be compatible with EU law. This element, represented by the existence of valid commercial reasons underlying the taxpayer's conduct, has the function of softening the somewhat harsh objectivity of the abuse test (in particular, when it comes to the question of the existence of an undue tax advantage) and excluding purely commercially motivated conduct, even if it is not standard business practice.

The abuse test first requires the identification of the transaction that could potentially be considered artificial. Once the transaction has been identified, it is necessary to identify the scope, or purpose, of the rule that is allegedly being circumvented. Such an exercise appears relatively straightforward in the context of a tax on individual transactions such as VAT, which is also systematically harmonised at EU level through secondary legislation. The existence of a common VAT system at EU level makes it possible for the interpreter (i.e. the Court of Justice) to determine the objectives of the various provisions contained in the secondary legislation and then to analyse whether the transactions carried out by the taxpayer were subject to the tax regime that should have been applicable according to the overarching principles of the VAT system (mainly neutrality in its various forms).[6]

However, this is not the case when the same concept is used to assess the compatibility of EU fundamental freedoms with a direct tax measure adopted by Member States.

First, "income" is indeed a concept that reflects an aggregation of positive (or negative) wealth that may or may not be linked to individual transactions. If it is possible to link the generation of business profits to the sale of goods or services, the same link cannot be established between individual transactions and other items of income, such as the accumulation of value independently of realisation, or the increase in the tax base due to the distribution of dividends. It is only in some specific circumstances that Member States' income tax legislation contains rules that apply to specific transactions, such as transfer pricing rules, withholding tax rules or anti-avoidance rules that target specific payments. It is not surprising that existing ECJ case law on abuse applies in such situations.

Second, an even more problematic dimension of the abuse prohibition in the context of the EU's fundamental freedoms and direct taxation relates to the purpose of the allegedly abused rule, which is not the domestic provision under the Court's scrutiny (which is not EU law and therefore could not serve as a benchmark for the

[6] For example, if a bank of an educational institution, whose ordinary business is to perform services which are ordinarily exempt from VAT (without a right to deduct), ends up being able to deduct, or at least not to support input VAT as regards taxable transactions, it appears quite clear that this situation is not in line with the general objective of the system, which links the possibility to perform exempt services in the field of finance and education with the obligation to support economically input VAT.

application of the EU abuse concept), but the freedom at stake. What is the purpose of an EU fundamental freedom, especially when it comes to specific transactions?

The case law of the Court of Justice offers relatively little guidance in this respect.

With regard to the free movement of persons, the Court has held that the application of Article 21(1) TFEU requires genuine residence in order to enable the citizen to establish or strengthen family life in an EU Member State.[7] Regarding the free movement of workers, the Court has referred to a "real and genuine employment relationship", or the fact of seeking employment "with a genuine chance of being engaged" (the latter expression is also used in Directive 2004/38[8]). In various cases concerning freedom of establishment, the Court has referred to "the actual pursuit of an economic activity through a fixed establishment in that State for an indefinite period,"[9] which presupposes "the actual establishment of the company concerned in the host Member State and the pursuit of a genuine economic activity there".[10]

A similar reference to the genuine nature of the economic activity is found in the case law on the freedom to provide services ("provide and receive [genuine] services in return for [actual] remuneration") and the free movement of capital, where the Court of Justice considers as not genuine "any scheme which has as its primary objective or one of its primary objectives the artificial transfer of the profits made by way of activities carried out in the territory of a Member State to third countries with a low tax rate".[11]

Interestingly, and contrary to the jurisprudence dealing with VAT situations (where the purpose of the legislation is determined by reference to a system), the Court goes on to look for the objective of the abused rule only by reference to the notion of abuse itself, using the term "not genuine" as a synonym for "abusive", which is a rather circular reasoning. This can also be explained by the fact that in areas harmonised by secondary EU law, the focus is on the purpose of the harmonised legislation, whereas when applying the prohibition of abuse in relation to fundamental freedoms, the Court has to take into account the purpose of a set of norms over which it has no direct power of interpretation, i.e. the domestic (tax) legislation of the EU Member States.[12]

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[7] European Court of Justice, C-456/12, para. 51.

[8] European Court of Justice, C-344/95. *See also*, Article 14(1), (2) and (4) of Directive 2004/38.

[9] European Court of Justice, C-221/89, para. 20, and C-246/89, para. 21.

[10] European Court of Justice, C-196/04 (*Cadbury Schweppes and Cadbury Schweppes Overseas*), para. 54.

[11] European Court of Justice, C-135/17 (*X*), para. 84.

[12] However, in some (non-tax) cases, the Court discussed the possibility that freedom of movement could be used to try to circumvent obligations imposed by Member States. *See for example*, European Court of Justice, 7 February 1979, *Knoors v Staatssecretaris van Economische Zaken,* 115/78; para. 25; 3 December 1974, Case 33/74 Van Binsbergen v Bestuur van de Bedriifsvereniging VOOT de Metaalnijverheid, para. 13; 10 January 1985, Case 229/83 *Association des Centres distributeurs Edouard Leclerc* et al. *v SARL «au Blé Vert»'* et al., para. 27 ECR 1. On this issue, Weatherill, in: de la Feria/Vogenauer (2011) *Prohibition of Abuse of Law—A New General Principle of EU Law*.

3 Analysis of the Interaction Between Fundamental Freedoms and the General Principle of Abuse in Selected ECJ Cases

EU Member States often justify their discriminatory or restrictive provisions in national tax legislation by referring to the need to combat cross-border tax abuse (or avoidance). In its case law, the Court of Justice, while rejecting purely fiscal justifications (loss of tax revenue), has consistently recognised the legitimate public (fiscal) interest of EU Member States in combating tax-motivated "artificial arrangements" which lack economic substance or a genuine commercial purpose.

However, according to Wolfgang Schön, it remains unclear whether this issue is primarily about interpreting the scope and content of the fundamental freedoms themselves—which, as shown above, is not an easy task—or it is rather a distinct principle that serves as a "justification basis" for coercive measures implemented by national governments.[13]

The implications of such a distinction are methodological and may have practical consequences. When approaching the potentially abusive nature of a transaction from the perspective of the scope of the fundamental freedoms, the focus inevitably shifts to examining the objective features of the economic activity concerned and whether it is consistent with a more or less restrictive definition of the relevant scope of freedom as defined in the Treaties (e.g. establishment, services, capital movements or employed labour). On the other hand, when the issue of abuse is approached from the point of view of justification, it is necessary not only to clarify the extent to which the taxpayers' intention is to minimise their tax liability, but also to make an overall assessment on whether the measures taken by the national legislator are appropriate, necessary and proportionate to combat the transaction at hand. This analysis is crucial as it involves striking a balance between the taxpayer's interest in exercising his freedom and the EU Member State's interest in combating abusive arrangements.

An analysis of some key judgments in this area shows that the Court of Justice is more concerned with the proportionality of the domestic tax measure than whether the taxpayer's behaviour is consistent with the hypothetical scope of the fundamental freedom.

3.1 Cadbury-Schweppes: Abuse, CFC Rules and Freedom of Establishment

Halifax is the paradigm of the abuse test, but the landmark decision on the interaction between abuse and EU primary law is *Cadbury-Schweppes*.[14] In that case, the main

[13] Schön (2019) *The Concept of Abuse of Law in European Taxation.*

[14] European Court of Justice, C-196/04.

question referred to the Court was whether and to what extent the Controlled Foreign Corporation legislation of an EU Member State was compatible with EU primary law, in particular the freedom of establishment. More specifically, the question was whether the (additional) taxation resulting from the application of the domestic CFC legislation in the United Kingdom constituted an unjustified restriction on the freedom of EU taxpayers to establish a legally separate company in another EU Member State.

In the *Cadbury-Schweppes* case, the tax advantage examined by the Court of Justice was that resulting from the lower overall taxation of the economic unit (i.e. the group of companies consisting of legal entities established in two or more EU Member States) where part of the group's income is derived in another EU Member State (in this case, Ireland) compared with the (hypothetical) case where all the income had been derived in the EU Member State of the parent company (in this case, the United Kingdom). In this respect, the existence of a tax advantage was not disputed in the *Cadbury-Schweppes* case, as it was clear that the profits generated by the Irish CFC were taxed at a significantly lower rate than in the UK. Rather, the main issue in *Cadbury-Schweppes* was whether the advantage is compatible with the objective of freedom of establishment.

According to the Court's judgment in paras. 53 and 54, the purpose of freedom of establishment is to ensure that a national of an EU Member State, whether a natural or a legal person, can carry out his own (commercial) activities in another EU Member State and thus participate in the economic life of that EU Member State.[15]

For legal persons, this possibility is expressed in the right to establish a fixed place of business in an EU Member State by setting up a separate legal entity (i.e. a subsidiary). In general terms, therefore, the function of freedom of establishment is to promote full integration into the EU internal market.

The consequence is that an abuse of the law exists as long as the taxpayer (also intended as an economic entity; e.g. a multinational company) establishes a subsidiary in another EU Member State with the sole aim of obtaining a tax advantage (e.g. lower overall corporate taxation) and without any intention of participating fruitfully in the economic life of that country. Put simply, according to the Court, as in the *Cadbury-Schweppes* case, abuse occurs whenever the structure—and not necessarily the transactions between that structure and the parent company—is "wholly artificial".[16]

The assessment made by the Court essentially reflects the paradigm introduced in *Halifax,*[17] but the normative parameter is different in *Cadbury-Schweppes*, since the allegedly abused norm is not a specific tax rule but a fundamental freedom. In

[15] European Court of Justice, C-212/97 (*Centros*), para. 25.

[16] Another aspect, much debated indeed, is represented by the approach adopted by the ECJ when it comes to evaluating the artificiality of the arrangement, given that according to the ECJ the artificiality of the transaction must be asserted only if the conduct, or the arrangement (to use the terminology of para. 55), does not reflect economic reality. In this respect, *see also* De Broe (2022), p. 443.

[17] The elements taken into consideration are the tax effects due to the re-localization of commercial activities, i.e. the lower effective tax burden of the economic entity, compared to the theoretical

other words, it is not a tax rule that provides for a particular tax effect if certain conditions are met (e.g. a favourable tax regime), but a general principle that has no tax consequences of its own. The beneficial tax effect (i.e. a lower overall tax burden at group level) is in fact due to the lack of harmonisation between the two domestic tax systems (England and Ireland); more specifically, the lack of harmonisation of tax rates between the two EU Member States concerned.

Moreover, benefiting from a lower tax burden in another EU Member State may constitute a valid reason for taking advantage of the application of the fundamental freedoms. The Court thus resorted to escamotage in order to establish a link between the principles and rules in question. Indeed, in *Halifax*, the taxpayer obtained the tax advantage by virtue of a specific rule contained in the Sixth Directive, whereas in *Cadbury-Schweppes*, the tax advantage resulted from the interaction of the domestic tax rules of the EU Member States concerned.

Accordingly, the Court's analysis in *Cadbury-Schweppes* is not directly aimed at understanding whether the tax advantage (which does not depend on EU law) is ultimately compatible with the spirit of the freedom of establishment, but rather at assessing whether the domestic (CFC) legislation denying such an advantage is compatible with that freedom. It follows from the above that, *stricto* sensu, the test is not directly aimed at the taxpayer's conduct *in concreto*, but aims at verifying in the abstract whether the internal rule is compatible with EU primary law. Specifically, whether the internal tax rule is designed to target only abusive conduct, or whether it is otherwise possible for the rule to affect genuine situations (i.e. not wholly artificial arrangements).

This implies that whenever the normative parameter of the abuse test (i.e. the objective part of the test) is an EU fundamental freedom, the test is threefold, as it involves the taxpayer's conduct, the applicable domestic tax rule(s) and EU primary law. In this sense, therefore, one could say that the abstract nature of the normative parameter and its purpose is to be scrutinised together with the purpose of the internal rules, whose interaction is key to the tax advantage.

Unsurprisingly, the factor that allows these three elements to be linked is the very notion of artificiality, since *Cadbury-Schweppes* reaffirms the principle that it is not possible to benefit from EU law in any way if the conduct is abusive, or rather artificial. In this sense, the function of "wholly artificial arrangement" is such as to encompass several elements of the abuse test, since it involves not only an examination of the real intentions of the taxpayer (i.e. the subjective element),[18] but also constitutes the parameter by which to measure the compatibility of the tax advantage obtained with the objectives of the principles and rules at stake.

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tax burden in the absence of re-localization (the comparison between the current situation and the hypothetical one).

[18] As it is clear-cut that whenever the arrangement is wholly artificial, then it can be said that the taxpayer's intentions are quite obviously to take advantage of a beneficial tax regime, and not to participate fruitfully in the economic life of the hosting EU Member State.

3.2 X: Abuse, CFC Rules and Free Movement of Capital

The factual and normative elements of the situation dealt with by the Court in *X*[19] are similar to those in *Cadbury-Schweppes* (in particular, as regards the applicable domestic tax rules), since both cases concerned the compatibility of a CFC-type domestic legislation with EU primary law.

Case *X* concerns a German company with a 30% shareholding in a non-EU company (i.e. a company established in Switzerland) and the domestic CFC legislation requires a German resident parent company to include the passive income in its taxable income (as a deemed dividend) whenever a foreign subsidiary is taxed below 25%. The circumstances are therefore comparable but, given the different EU fundamental right at stake,[20] the Court of Justice in *X* developed a concept of artificiality that can be seen as somewhat broader than that in *Cadbury*-Schweppes.

As the Court stated, "the free movement of capital between EU Member States and third countries is intended not to frame the conditions under which companies can establish themselves within the internal market, but to liberalize cross-border movements of capital" (para. 83), with the consequence that "[…] in the context of the free movement of capital, the concept of 'wholly artificial arrangement' cannot necessarily be limited to merely the indications, referred to in [*Cadbury-Schweppes*]" (para. 84).

This means that, according to the Court's reasoning, the artificial creation of the conditions from which the tax advantage arises (i.e. also in *X*, the lower overall taxation compared to a purely domestic situation) may take different forms, with the consequence that "the "concept is also capable of covering, in the context of the free movement of capital, any scheme which has as its primary objective or one of its primary objectives the artificial transfer of the profits made by way of activities carried out in the territory of an EU Member State to third countries with a low tax rate" (para. 84).

It follows that the Court implicitly recognises that a situation may be considered abusive from a tax point of view even if the transaction is not 100% artificial. This is confirmed by the fact that, as has become standard in its case law, the Court accepts in addition to the prevention of abuse other justifications such as "the need to safeguard the balanced allocation between the EU Member States of the power to impose taxes" and "the need to guarantee the effectiveness of fiscal supervision", which are considered to be "closely linked".[21]".

Moreover, the Court's approach in *X* seems to imply that a situation should be regarded as abusive whenever the taxpayer's objective is to transfer profits to a low-tax jurisdiction and it is established that at least one of his main intentions is to obtain

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[19] European Court of Justice, C-135/17.

[20] In *Cadbury-Schweppes*, the ECJ's analysis concerned the freedom of establishment, with the consequence that the other EU fundamental rights potentially relevant were absorbed (i.e. the analysis regarding the compatibility of the CFC legislation applicable in the UK with the freedom of establishment absorbed *inter alia* the free movement of capital).

[21] European Court of Justice, C-135/17, para. 70–75.

a tax advantage. This terminology, as discussed in the dedicated section, is similar to the wording of the general anti-abuse rule contained in the now applicable Article 6 of the ATAD.

3.3 Thin Cap (and SGI): Abuse and Transfer Pricing

The *Thin Cap*[22] decision concerns a group of cases selected by the UK national court as test cases for the purposes of the so-called thin cap rules and involves a UK resident company which is at least 75% owned, directly or indirectly, by a non-resident company and which has received a loan either from that non-resident parent company or from another non-resident company (itself at least 75% owned, directly or indirectly, by that parent company).

By way of a brief background, the purpose of the thin cap rules is essentially to convert part of an intra-group loan into equity, and thus to recharacterise part of the interest payments as a distribution (a dividend) in the event that the interest on the loan is higher than a normal commercial return on that loan, thereby preventing the borrowing company from deducting the excess portion of the interest payments from its taxable income.

These cases are varied and relatively complex, particularly given the interrelated nature of the questions referred for a preliminary ruling. However, the main question referred to the Court can be summarised as follows: are thin capitalisation rules compatible with EU primary law (and in particular with the freedom of establishment) where those national rules do not allow the deduction of interest on a loan granted by a direct or indirect parent company resident in another EU Member State, where that resident company would not have been subject to such a restriction if the interest had been paid on loan finance granted by a parent company resident in the first EU Member State?

Among the various aspects affected by the application of those rules, the Court's judgment addresses the relationship between the deductibility of certain expenses, in this case interest payments, and artificiality, in particular where those expenses exceed the normal return on a loan and therefore do not comply with the arm's length principle.[23]

Indeed, in *Thin Cap*, the amount of interest paid on an intra-group loan (if it exceeds certain parameters) can be considered a symptom of artificiality. That is to say, whenever the amount of interest paid is higher than the amount that would have been paid in a transaction between unrelated parties, it means that the part exceeding the normal return can be considered as the effect of an artificial agreement between related parties whose sole aim is to erode the tax base of the State in which the borrower company is located and to shift profits to another jurisdiction.

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[22] European Court of Justice, C-524/04.

[23] For a comprehensive analysis, *see also* Helminen (2023).

What appears to be more complex in the Court's reasoning, however, is the reconciliation of the purpose of the allegedly abused rule, the freedom of establishment, with the behaviour of a taxpayer aiming at artificially creating the conditions to erode the tax base of an EU Member State. Given that the Court of Justice has held on several occasions that the purpose of the freedom of establishment is incompatible with a wholly artificial structure set up by a taxpayer whose intention is not to integrate a given entity into the economic and social life of the host EU Member States, in the *Thin Cap* case it seems that the Court of Justice is focusing only on the financing and, presumably, a full investigation would have shown that the financing agreement alone is artificial, since the company is nonetheless integrated into the EU Member State's market.

It therefore seems that the conduct should not be tested against the prohibition of abuse and thus the purpose of the freedom of establishment, but rather in relation to another justification, the balanced allocation of taxing rights between EU Member States, which is in fact briefly mentioned in para. 75, which reads: "the type of conduct described in the preceding paragraph is such as to undermine the right of the Member States to exercise their tax jurisdiction in relation to the activities carried out in their territory and thus to jeopardise a balanced allocation between Member States of the power to impose taxes".

Conversely, in the *Thin Cap* case, the Court seems to invoke the normative parameter of the abuse test in EU primary law in order to avoid ending up in a situation where it would have to discuss and ultimately define what the "correct allocation of tax rights" could be, the existence of which would be difficult to justify in the absence of uniform tax rules.

Similarly, this argument is repeated to some extent in *SGI*, where the Court seems to use this principle to strengthen the fight against abusive practices as a justification for an internal anti-avoidance measure: it stated indeed that "In that context, national legislation which is not specifically designed to exclude from the tax advantage it confers such purely artificial arrangements—devoid of economic reality, created with the aim of escaping the tax normally due on the profits generated by activities carried out on national territory—may nevertheless be regarded as 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".[24]

3.4 Lexel: Abuse and Cross-Border Deduction of Interest Expenses

A broadly similar approach is confirmed by the Court in the *Lexel*[25] case, which also concerns cross-border interest payments. In brief, *Lexel* concerns the case of a Swedish company making interest payments to a company established in France.

[24] European Court of Justice, C-311/08, para. 66.
[25] European Court of Justice, C-484/19.

Under Swedish law, interest paid by a resident company to another company in the group resident in another country is not deductible if the debt to which the interest relates was incurred in order to obtain a tax advantage. This rule does not apply to payments between resident companies, as interest payments would have been covered by certain domestic rules on intra-group financial transfers. The main issue was therefore the compatibility of this rule with the freedom of establishment.

The peculiarity of this decision is that the Court emphasises the existing link between abuse and the correct allocation of powers between EU Member States, explicitly stating in para. 74 that "the objectives of safeguarding the balanced allocation of the power to impose taxes between EU Member States and the prevention of tax avoidance are linked. 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, is such as to undermine the right of the EU Member States to exercise their tax jurisdiction in relation to those activities and to jeopardize a balanced allocation between EU Member States of the power to impose taxes".

Furthermore, the Court confirms the approach according to which the arm's length principle can be regarded as an appropriate element for identifying the existence of artificiality, at least to some extent, since the payment of interest in amounts consistent with the application of that principle is in some way an element capable of demonstrating that the transaction is not artificial.[26]

For the sake of completeness, in the *Lexel* case, the Court confirmed the incompatibility of the national measure with the freedom of establishment, since neither the justifications based on the fight against tax avoidance, evasion nor the principle of the correct allocation of taxing powers between EU Member States, nor the combination of the two elements, were acceptable.

In a way, this confirms that the artificiality of the taxpayer's behaviour is essential and that national measures which do not include this parameter cannot constitute a restriction on the exercise of fundamental freedoms.

3.5 SIAT: Abuse and Cross-Border Payments

The *SIAT*[27] case concerns a company established in Belgium which made payments to an unrelated company established in Luxembourg for services provided by the latter. The deductibility of these payments was disputed by the Belgian tax authorities

[26] According to paras. 55–56 "However, the fact alone that a company wishes to make a deduction of interest payments in a cross-border situation, in the absence of any artificial transfer, cannot justify a measure which undermines the freedom of establishment provided under Article 49 TFEU. It must be held that the exception may include within its scope transactions which are carried out at arm's length and which, consequently, are not purely artificial or fictitious arrangements created with a view to escaping the tax normally due on the profits generated by activities carried out on national territory.

[27] European Court of Justice, C-318/10.

on the grounds that the payments were not included in the taxable income of the Luxembourg company because the latter could benefit from the so-called "1929 holding tax regime" (and the company receiving the payments was therefore not liable to pay taxes analogous to the corporate tax applicable in Belgium).

More specifically, the special Belgian legislation in force pro tempore required the Belgian taxpayer—whenever the foreign service provider was subject to a domestic tax regime that was significantly more favourable than that applicable in Belgium—to prove that such payments related to a genuine transaction.[28]

In this case, the Court was therefore asked to assess the compatibility of that rule with the freedom to provide services, which is intended to enable a taxpayer established in one Member State to provide services to a taxpayer from another Member State under the same conditions as if the recipient of the services were also established in the first state[29] State.

In *SIAT*, the Court of Justice does not provide any analytical reasoning regarding the existence of a tax advantage[30]; or rather, the Court of Justice does not develop any comparative reasoning between the situation considered to be abusive (i.e. the concrete situation that has led to a tax advantage in the form of a deduction/non-inclusion) and the situation considered to be genuine.[31]

In this respect, in the SIAT, it appears that the only tax advantage that could arise when comparing the genuine situation and the abusive one is related to the fact that in the first case the income would be fully taxed in the hands of the domestic recipient (i.e. a fully taxable entity in Belgium), whereas in the second case it would not be taxed due to the exemption granted to the recipient in the foreign State (i.e. a fully exempt entity in Luxembourg).

In fact, the concern of *SIAT* is that the taxpayer does not appropriate the tax advantage. In other words, even if a tax advantage were to be deemed to exist when comparing the two situations, such an advantage would not necessarily be attributable to the Belgian entity, as the payer and the recipient are not required to be related entities (i.e. the tax advantage is not obtained within the same group, nor can it be argued that the parties are related according to the reconstruction of the facts contained in the decision).[32,33]

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[28] And do not exceed certain limits.

[29] In other words, the Court of Justice was called upon to verify the compatibility of an internal regulation which, like the one in question, entails the application of more severe conditions in case the payment for the provision of services was made for the benefit of a foreign provider (which benefits from a more advantageous tax regime than that of the country of residence of the taxpayer who uses the service).

[30] Precisely, when it comes to discussing and identifying the presence of a tax advantage the Court of Justice does not perform any comparison and simply states that the tax advantage lies in "the possibility of deducting as business expenses those payments made to a service provider" (para. 31).

[31] This is probably because the comparison would not lead to the identification of a tax advantage for the Belgian taxpayer deriving from the transaction thus structured.

[32] *See* para. 26 of the Conclusions of the Advocate General in *SIAT*.

[33] It rather seems in *SIAT* that the law introduced an anti-hybrid rule which is activated whenever the income recipient is not taxed adequately (compared to the theoretical situation in which he

Even if the domestic provision was ultimately declared incompatible with the freedoms on grounds of proportionality (lack of legal certainty), the fact that the Court *prima facie* accepted a possible justification based on the prevention of abuse[34] raises an issue of compatibility with the abuse doctrine in its traditional "building blocks". Indeed, the approach adopted by the Court in *SIAT* seems to remove the subjective element of the abuse test (i.e. the taxpayer's intentions), as the taxpayer would probably have no interest in adopting such a scheme (unless collateral benefits in the hands of an associated recipient are proven). This means that no one could argue that the taxpayer intended to structure the transaction in such a way, as the only (tax) consequence would be to jeopardise the tax benefit of deducting a payment that has actually been made.[35]

3.6 The Danish Cases: Abuse and Conduit Structures

The well-known *Danish cases*[36] concern the source taxation of dividends and interest paid by companies established (and tax resident) in Denmark to parent companies established in other EU Member States. More precisely, all (six) decisions deal with the applicability of withholding taxes on cross-border payments in cases where the recipient is not considered to be the beneficial owner of such payments, but rather a company that has been interposed between the EU resident entity and the non-EU resident beneficiary in order to benefit from the exemption granted by the Parent-Subsidiary Directive and the Interest and Royalties Directive ("PSD" and "IRD", respectively[37]).

As a normative circumstance, it should be mentioned at the outset that the internal tax rules applicable pro tempore did not contain any references to abuse or artificiality; nor did the PSD contain any references to the concept of beneficial ownership (which, however, was included in the IRD[38]). In addition, it is worth noting that the PSD did

had been taxable in Belgium), with the possibility, however, of proving that the payment was in effect linked to an existing, genuine transaction and "do not exceed the normal limits" (i.e., by a reasonable amount compared to other comparable genuine situations).

[34] European Court of Justice, C-318/10, para. 40–42.

[35] Except these concerns regarding the comparative analysis of the tax advantage and its effects on the subjective element of the abuse test, when it comes to the other elements the reasoning appears to be the usual one.

[36] European Court of Justice, C-116/16 and C-117/16 (*T-Danmark*); C-115/16, C-118/16, C-119/16, C-299/16 (*N Luxembourg 1*).

[37] Directive 2011/96/EU on taxation applicable in the case of parent companies and subsidiaries of different Member States and Directive 2003/49/EC of 3 June 2003 on a common system of taxation applicable to interest and royalty payments made between associated companies of different Member States, whose objective is to facilitate cross-border investments across the EU by *inter alia* exempting such payments from withholding taxes (i.e. at source).

[38] According to Article 1, para. 4, of the IRD: "A company of a Member State shall be treated as the beneficial owner of interest or royalties only if it receives those payments for its own benefit and not as an intermediary, such as an agent, trustee or authorised signatory, for some other person."

not contain the general anti-abuse rule that is now contained in Article 1(2) (i.e. the PSD GAAR), which was only introduced in 2015.[39]

However, leaving aside the (additional) factual and normative aspects (which are quite complex), we will focus on the most important passages of the Court's reasoning to highlight the main elements of the abuse test applied in the *Danish cases*.

A first comment concerns the Court's reasoning on the objective part of the abuse test. In this respect, when examining paras. 107–110 (*T-Danmark*, on dividends) and 134–137 (*N Luxembourg 1*, on interest payments), the ECJ seems to argue that somehow the absence of a tax advantage does not in itself exclude the abusive nature of the conduct. Indeed, the Court states: "The referring court is also unsure, in essence, whether there can be an abuse of rights where the beneficial owner of dividends transferred by conduit companies is ultimately a company whose seat is in a third State with which the source Member State has concluded a tax convention under which no tax would have been withheld on the dividends if they had been paid directly to the company having its seat in that third State"; i.e. if the beneficial owner is established outside the EU and yet the payments are fully exempt from withholding tax on the basis of a tax treaty, abuse of the law cannot be ruled out per se.

This statement undoubtedly leaves us with some confusion, as it seems that the Court of Justice (once again) does not consider the tax advantage to be a *condicio sine qua non* when it comes to assessing the abusive nature of a practice. That is to say, this reasoning seems to imply that the tax advantage is not an essential element of the test, but rather a kind of symptomatic element which is somehow accessory to the artificiality of the taxpayer's conduct.

Moreover, this approach may also lead to unintended consequences if one considers that the abuse test requires an examination of the taxpayer's intentions (i.e. the subjective part of the abuse test), as it would not seem possible to prove that the taxpayer artificially created the conditions to benefit from legislation (e.g. the exemption provided for by the PSD or the IRD) which ultimately does not confer a tax advantage (since the outbound payment would have been exempt from withholding tax anyway under the applicable bilateral tax treaty).[40]

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[39] According to Article 1 of The Directive 2015/121 of 27 January 2015, "In Directive 2011/96/EU, Article 1(2) is replaced by the following paragraphs: '2. Member States shall not grant the benefits of this Directive to an arrangement or a series of arrangements which, having been put into place for the main purpose or one of the main purposes of obtaining a tax advantage that defeats the object or purpose of this Directive, are not genuine having regard to all relevant facts and circumstances. An arrangement may comprise more than one step or part. 3. For the purposes of paragraph 2, an arrangement or a series of arrangements shall be regarded as not genuine to the extent that they are not put into place for valid commercial reasons which reflect economic reality. 4. This Directive shall not preclude the application of domestic or agreement-based provisions required for the prevention of tax evasion, tax fraud or abuse'.".

[40] For this reason, it could be argued that the European Court of Justice simply wanted to reiterate that those rights granted by EU law are intrinsically incompatible with artificial conducts (i.e. irrespective of any practical consequences) and that the abuse test is somewhat autonomous with respect to domestic and conventional rules which may have been implemented in the concerned countries (including non-EU Member States, too).

Another observation relates to the fact that the Court seems to take the view that, irrespective of the normative parameter and, consequently, the analysis of the purpose of the presumed abuse rule, there is an overarching prohibition of abusive conduct in EU law, which is something of a super-parameter (or, rather, an inherent objective of the EU legislation) that must always be taken into account.

This is made clear in paragraph 83 of the Court's judgment on dividends, where it is stated that "in the light of the general principle of EU law that abusive practices are prohibited and of the need to ensure observance of that principle when EU law is implemented, the absence of domestic or agreement-based anti-abuse provisions does not affect the national authorities' obligation to refuse to grant entitlement to rights provided for by Directive 90/435 where they are invoked for fraudulent or abusive ends".[41]

Leaving aside specific considerations on this immanent principle of EU law (and the legal basis of this argument, which has been much debated in the literature[42]), the aspect of primary interest here is that the Court's reasoning implies a change of perspective with respect to previous decisions, since this approach implies that—irrespective of the "spirit" of the abused rule (or even in the absence of an abused rule *stricto* sensu)—there is always a "hidden EU principle" affirming that tax advantages resulting from abusive conduct should not be granted. This amounts to affirming that, according to this approach, the objective part of the abuse test is deprived of any meaning, since it would no longer be necessary to find and analyse the purpose of the abused rule, since it would be sufficient that the taxpayer's conduct is nevertheless artificial (due to the presence of certain indicators, *see infra*).

It follows that, according to the Court's approach in the *Danish cases*, it could be argued that the only analysis that actually needs to be carried out in order to label a certain conduct as "tax abusive" is the artificiality test, which implies that whenever there is a sufficient degree of evidence that the conditions have been artificially created by the taxpayer in order to obtain a certain tax advantage, the conduct is abusive and the right cannot be granted.

To this end, the Court sets out a number of "factors" that should be considered as symptoms of an artificial or fraudulent situation. In the specific case of conduit structures, such symptoms are those which are capable of demonstrating the absence of "real economic activity" at the level of the intermediate entity, such as "factors relating, in particular, to the management of the company, to its balance sheet, to the structure of its costs and the expenses actually incurred, to the staff it employs and to the premises and equipment it has" (para. 104), or, for example, the existence of various agreements between the companies of the group which give rise to intra-group flows of funds.

In other words, this decision seems to mark the supremacy of the artificiality factor over the other elements of the abuse test, which, according to this approach, boils down to a relatively simple question: are the indicators sufficient to prove that

[41] European Court of Justice, C-115/16, C-118/16, C-119/16, C-299/16 (*N Luxembourg 1*) at paras. 96 and 97, concerning interest payments.

[42] Among others, *see* de la Feria (2020), pp. 142–146; and Baerentzen (2020), pp. 9–10.

the conduct is artificial? If so, the benefit should not be granted (irrespective of the other elements of the abuse test, such as the analysis of the intention of the abused standard).

In conclusion, by maintaining a strict definition of abuse based on the artificiality of the transactions and/or entities in question, the Court has somewhat lowered the threshold for accepting the EU compatibility of EU Member States' anti-avoidance measures aimed at mitigating the risk of loss of tax base due to the shifting of profits or the transfer of persons or activities outside the State concerned. It is indeed noteworthy that in many cases the Court has analysed the prevention of abuse in the context of the principle of territoriality, coherence and/or the preservation of the (balanced) allocation of taxing powers between EU Member States. The reference to abuse does not make the Court's reasoning clearer, because it mixes two very different lines of argument. On the one hand, "objective" reasons linked to the allocation of taxing powers between EU Member States and, on the other hand, "subjective" reasons based on the (allegedly) abusive behaviour of taxpayers seeking to minimise their tax burden by shifting income (but not real economic activities) abroad.[43]

4 The Impact of the Adoption of the ATAD GAAR on the Previous ECJ Case Law on Abuse and Fundamental Freedoms

The introduction of the ATAD GAAR, as well as all the other provisions contained in the EU Commission's anti-avoidance package, is closely linked to the need to protect the EU internal market, as aggressive tax planning practices constitute an obstacle to economic integration between EU Member States. Specifically, Article 6 of the EU Council's Anti-Tax Avoidance Directive 2016/1164 (commonly referred to as "ATAD"[44]) introduces a general anti-abuse rule, which is not intended to address predetermined abusive practices (such as CFCs or conduit structures), but residual situations that are in principle not affected by these ad hoc rules (or specific anti-abuse rules).

The objective of this section is to analyse the normative elements of this provision, in order to facilitate conclusive observations as to whether (and to what extent) the approach adopted by the Court of Justice over time may still be relevant in a post-ATAD scenario (i.e. a scenario in which tax abusive structures are to be addressed pursuant to Article 6 of ATAD).

However, Article 6 of ATAD consists of three distinct paragraphs, of which only the first two are strictly relevant for our purposes, as the function of the last paragraph

[43] Traversa, in: Panayi/Haslehner/Traversa (2020) *Research Handbook on European Union Taxation Law*.

[44] Council Directive (EU) 2016/1164 of 12 July 2016, laying down rules against tax avoidance practices that directly affect the functioning of the internal market.

is simply to establish that whenever one or more arrangements are deemed to be "non-genuine" in light of the parameters contained in the first two paragraphs of Article 6, the tax liability shall be calculated disregarding such arrangements and in accordance with the applicable domestic tax rules. In essence, this means that any deductions and exemptions—or, more generally, any possible reduction in the corporate tax base resulting from such arrangements—must be excluded when calculating the effective tax burden.

In general terms, therefore, the function of the EU GAAR is to exclude any favourable tax effects for the taxpayer resulting from non-genuine behaviours.

The non-genuineness of a taxpayer's conduct (or "arrangement", according to the specific terminology of the GAAR) is assessed by examining two interrelated factors, which to a large extent reflect the two-pronged (abuse) test developed by the Court of Justice. More specifically, Article 6(1) of the ATAD contains the two constitutive elements of the EU GAAR, which may be illustrated as follows:

– the objective of the taxpayer; and
– the existence of a tax advantage contrary to the objective of the applicable tax rule.

In other words, "having regard to all the facts and circumstances", an arrangement is to be regarded as non-genuine from a tax point of view if it has "been put into place for the main purpose or one of the main purposes of obtaining a tax advantage that defeats the object or purpose of the applicable tax law".

The first element, therefore, deals with the taxpayer's intentions and seems to resonate with the subjective element of the abuse test developed by the Court of Justice. However, as Luc De Broe[45] points out, the terminology used by the Court of Justice seems to be relatively flexible and therefore different approaches can coexist when it comes to assessing this factor according to the case law of the Court of Justice, as the wording varies from "sole (objective)" to "principal or one of the principal objectives". On the other hand, the approach taken in Article 6 seems to be that every time the taxpayer intends to adopt a certain course of action with a view to obtaining a tax benefit (i.e. an advantageous tax treatment resulting from the agreement), the subjective condition is to some extent fulfilled.

Notably, the wording of Article 6 of the ATAD is almost identical to the so-called "principal purpose test" (or "PPT") included in the final report of the OECD's BEPS Action 6 (and now largely implemented through the OECD Multilateral Instrument[46]), where the (model) treaty rule recommended by the OECD to avoid the application of treaty benefits in inappropriate circumstances provides that the tax treaty benefit should not be granted if "it is reasonable to conclude, having regard

[45] *See* De Broe (2022), p. 444.

[46] The full text of the Multilateral Convention To Implement Tax Treaty Related Measures To Prevent Base Erosion And Profit Shifting is available at: https://www.oecd.org/tax/treaties/multilateral-convention-to-implement-tax-treaty-related-measures-to-prevent-BEPS.pdf.

to all relevant facts and circumstances, that obtaining that benefit was one of the principal purposes […]".[47]

Moreover, the wording of Article 6 of the ATAD appears to be fully compatible with that of the GAAR as incorporated in the PSD.[48]

The approach adopted in Article 6—in particular, the terminology used in the first part of paragraph 1—seems to exclude any conduct that cannot be considered to be "principally" motivated by tax reasons as compared to the existence of non-tax reasons, with the consequence that the interpreter will be asked to assess the tax and non-tax results of the arrangement as a whole and to rule out the fulfilment of the subjective requirement in those cases where the tax results are conspicuously marginal, as it seems unlikely that the taxpayer's main intention (or one of the taxpayer's main intentions) was to obtain a tax advantage.

Leaving aside all these problems regarding the ability of a tax administration or a tax court to adequately investigate the "real intentions" of a taxpayer, it therefore appears that the approach adopted in the ATAD's GAAR is essentially a result-oriented approach, which leaves a wide margin of appreciation to the EU Member States in considering which type of transactions should be neutralised from a tax perspective.

Furthermore, the subjective condition of paragraph 1 seems to interact with paragraph 2 to a relevant extent, as the existence of "valid commercial reasons reflecting economic reality" excludes the non-genuineness of the arrangement tout court. In other words, it seems reasonable to argue that even if one of the taxpayer's main intentions was to obtain the tax benefit (i.e. the subjective test is met), the soundness of the commercial reasons underlying the conduct will preclude the artificiality of the transaction tout court, with the result that the arrangement cannot be considered abusive in any event.

It follows that: A) whenever the tax reasons are marginal, the wording of Article 6(1) is sufficient to exclude the tax abuse of the arrangement (since paragraph 1 requires for the fulfilment of the subjective condition that the intention to obtain a tax advantage is either the main objective or one of the main objectives); B) whenever the tax reasons are not marginal, it is therefore necessary, in order to exclude tax abuse, that the "valid commercial reasons reflecting economic reality" are strong enough to outweigh the non-marginal tax reasons.

However, meeting the subjective condition is not sufficient, as the ATAD abuse test also requires the existence of a tax advantage that is contrary to the spirit of the allegedly abused (domestic) rule. This essentially means that the existence of reasons aimed at obtaining a (non-marginal) tax advantage is a necessary but not sufficient condition for passing the abuse test, as the interpreter is called upon to verify that the

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[47] OECD (2015) *Preventing the Granting of Treaty Benefits in Inappropriate Circumstances, Action 6–2015 Final Report*, p. 55 available at: https://doi.org/10.1787/9789264241695-en.

[48] According to Article 1, para. 2, PSD: "Member States shall not grant the benefits of this Directive to an arrangement or a series of arrangements which, having been put into place for the main purpose or one of the main purposes of obtaining a tax advantage that defeats the object or purpose of this Directive, are not genuine having regard to all relevant facts and circumstances". In this respect, *see also* Öner (2020).

tax advantage obtained by the taxpayer is intrinsically incompatible with the purpose of the rule granting the advantage.

Again, the approach taken by the ATAD is broadly similar to that of the Court of Justice, but Article 6 introduces a new (and much welcomed) element in that paragraph 1 specifies that the rule to be considered for the compatibility test (the objective leg) is the domestic tax rule of the EU Member State that is considered to be abusive. However, it is very different as regards the type of objective to be considered, also because the scope of Article 6 ATAD, which is contrary to the fundamental freedoms, is not limited to cross-border transactions.

This clarification resolves a number of problems that have arisen over the years because, as discussed in the previous section, the Court has applied a similar approach to very different situations where the normative parameter was either a provision contained in secondary EU law (and implemented in the EU Member States concerned) or an EU fundamental freedom, or even situations (as in the Danish cases when ruling on the dividend case) in which the normative parameter was not clearly identifiable (provided that, as noted above, the internal tax rules applicable pro tempore did not contain any references to abuse or artificiality; nor did the PSD contain any reference to the concept of beneficial ownership).

Overall, therefore, it would seem that the approach to be followed in a post-ATAD scenario would involve, in the first instance, an analysis of the tax advantage, the existence of which would be determined by comparing the (presumably) abusive situation with the genuine one. The assessment should then focus on the spirit of the domestic legislation in order to determine whether it was intended to provide such an advantage in this particular situation or whether the tax advantage was simply unintended (e.g. where the tax advantage arose as a result of the lack of harmonisation between the domestic tax systems concerned).

Once the existence of the tax advantage is confirmed, it will be necessary to assess whether or not the tax reasons are marginal compared to the non-tax reasons. The last resort is represented by Article 6(2), which seems to prioritise the existence of valid commercial reasons reflecting the economic reality of the arrangement, meaning that whenever such reasons are found to exist, the behaviour should not be considered abusive *ab origine.*

5 The Consequences for EU Member States of Applying the Abuse Principle to Domestic Anti-Avoidance Measures

As mentioned above, the introduction of the concept of abuse in EU tax law is essentially due to the case law of the Court of Justice, which for the first time established the paradigm to be followed in order to assess the genuineness of a given taxpayer's conduct.

In this context, the prohibition of abuse in EU tax law reveals its function as a parameter to validate the compatibility of domestic tax rules implemented by EU Member States with EU primary and secondary law. This function reflects, inter alia, the need to reconcile the EU fundamental freedoms with the potential restrictions that EU Member States may introduce to counter abusive cross-border practices. That is, the need to ensure the proper functioning of the EU internal market while effectively tackling abusive tax practices through national anti-avoidance legislation.

In other words, the prohibition of abuse in the pre-ATAD context acts as a justification for EU Member States' domestic tax rules that restrict free movement within the EU, with the consequence that the protection afforded by EU primary law is overridden when taxpayers engage in artificial arrangements (the implication being that EU Member States can introduce measures to combat abusive practices without being in breach of EU law).

In a pre-ATAD scenario, therefore, the prohibition of abuse of tax laws can be understood as a limit for EU Member States to introduce domestic anti-abuse measures; within the limits set by this prohibition, EU Member States are free to exercise their fiscal sovereignty.

It is worth noting that the ability of EU Member States to introduce domestic anti-abuse rules is based (almost) exclusively on the jurisprudence of the Court of Justice, as the area of direct taxation is not harmonised and, prior to the ATAD, there were few anti-abuse rules in EU law (e.g. the PSD GAAR). This meant that EU Member States were free to introduce domestic anti-abuse rules as long as these rules were compatible with the Court's approach as derived from the relevant case law. However, the exercise of this power by EU Member States can sometimes prove problematic, as there has been no systematic framework for addressing tax abuse.

A first element fuelling uncertainty is the fact that the abuse test developed by the Court of Justice over the years depends on an examination of the objective (or intention) of the rule deemed to be abused, and in a context of non-harmonised law (such as that of direct taxation) the rules whose intention is to be examined are not tax rules granting a rather specific right (e.g. the right to deduct a certain expense or the right to exempt a certain income), but rather abstract rules that have no tax objective per se.

This is particularly true in cases where the normative parameter used by the Court to assess the abusive nature of the conduct is an EU fundamental freedom, since the purpose of such rules is by nature abstract. In the context of those decisions of the Court of Justice where EU fundamental freedoms are at stake, there is not an assessment of the compatibility between the taxpayer's conduct and the intention of the (domestic) rule triggering the tax benefit, but rather a trilateral assessment involving the tax benefit, the relevant domestic tax legislation and the EU fundamental freedom at stake. In fact, in this type of case law, the tax advantage does not necessarily derive from a specific tax rule, but rather from the interaction between non-harmonised tax rules, for example in cases where the taxpayer tries to exploit the loopholes between two or more domestic tax systems or, for example, the difference in the applicable tax rates of the different EU Member States concerned.

Another element of uncertainty is the fact that the Court of Justice has, in several decisions, applied the abuse test on a transaction-by-transaction basis. Although this approach is acceptable from a practical point of view (i.e. the effect of the artificial transaction on the taxpayer's liability is not taken into account), from a theoretical point of view it leaves some uncertainties, since income tax is a synthetic tax that takes into account the taxpayer's overall situation and not a tax on a single transaction such as VAT.

After the introduction of the ATAD, the perspective changes as the general prohibition of abuse in EU tax law takes shape through the GAAR contained in Article 6, which means that the implementation of measures to combat tax abuse is no longer a faculty left to EU Member States, but rather a specific obligation arising from EU secondary law. It follows that, in a post-ATAD scenario, EU Member States are obliged to implement a residual application rule, which acts as a general principle of law and whose purpose is to neutralise the tax effects of practices considered abusive on the basis of a test that prima facie reflects the abuse doctrine developed by the Court of Justice.

In theoretical terms, the introduction of the GAAR also marks the transition from the abuse of tax law as a justification for the introduction of domestic anti-abuse measures to the prohibition of abuse as an autonomous principle with which EU Member States must comply under penalty of non-compliance.

This change of perspective, from an option to an obligation, also has important consequences when it comes to assessing the abuse of a taxpayer's conduct, since in a post-ATAD context the interpreter will no longer have to assess the compatibility of the taxpayer's conduct (and the tax advantage resulting from such conduct) with the purpose of the EU fundamental freedom at stake (i.e. the normative parameter of the abuse test developed by the Court of Justice), but rather with the purpose of the internal rule concretely granting the tax advantage.

As a result, some problems, such as the complexity of assessing the compatibility of a tax advantage with an abstract EU freedom, are resolved, but new ones arise. For example, an important observation concerns the uniform application of this principle across the EU, given that a breach of the Directive would likely require identifying the purpose of the (presumably) abused domestic tax rule. Against this background, the question arises whether the EU institutions called upon to verify compliance between the EU GAAR contained in the ATAD and the domestic anti-abuse rule will have to rely exclusively on domestic sources or whether they will be able to interpret the domestic rules themselves to identify its objective[49]in order to determine their purpose.

A further observation concerns the significance that EU Member States' tax courts and tax authorities may attach to the existing jurisprudence of the Court of Justice, given that—as explained above—the approach developed by the Court of Justice in the absence of a GAAR was primarily aimed at assessing the compatibility of internal rules with EU fundamental freedoms, whereas in a post-ATAD scenario the interpreter will either have to assess the compatibility of the taxpayer's conduct

[49] In this respect, *see also*, Traversa (2019).

with the internal rule granting the tax benefits (e.g. EU Member States' tax courts and tax authorities) or, in the case of the Court of Justice, to assess the conformity between the domestically implemented GAAR and the one contained in the ATAD. It therefore appears that the previous case law on abuse will lose much of its relevance in situations falling within the scope of the ATAD GAAR (i.e. corporate taxation).

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