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IMPLEMENTING ATAD GAAR: A CASE OF THE CZECH REPUBLIC

JIŘÍ KAPPEL

Abstract

The Czech Republic is obliged to implement the Anti-Tax Avoidance Directive of 12 July 2016 from 1 January 2019 on. This article discusses the general anti-abuse rule adopted in Art. 6 of the Directive and its transposition into the Czech law, proposed alternatives thereof and certain interpretation and application concerns.

Key words: ATAD; GAAR, tax law, transposition

JEL Classification: K22, K33, K34

1. Introduction

In the wake of current ethos in international taxation to assure that the taxes are paid where the value is generated and OECD's base erosion and profit shifting (BEPS) initiative, the European Union (EU) adopted in July 2016 the Anti-Tax Avoidance Directive [ATAD].

This article discusses implementation of the general anti-abuse rule (GAAR) contained in ATAD's Art. 6 in the Czech Republic. The main goal of the article is to find out whether the recently proposed transposition of the GAAR complies with the ATAD's requirements

and to assess both several practical and theoretical aspects of its interpretation and application.

The article is structured as follows: First, the GAAR of Art. 6 is examined to identify ATAD implementation requirements. Subsequently, the implementation alternatives proposed in the Czech Republic are set out. Finally, the implementation concerns are discussed based on the critical analysis.

2. GAAR contained in ATAD

From a historical perspective it should be pointed out that the transposition of BEPS measures into the EU law was initially drafted by the Presidency in December 2015 as a split from the [CCCTB] proposals. The initial Commission's ATAD draft of January 2016 [Proposal of 28th January 2016] differed considerably from the Presidency's transpositions proposals. Further, amendments were proposed by the European Parliament [Report of 27th May 2016] and acknowledged by the Commission without detailed comments [Commission's Position]. Eventually, the GAAR provision contained in the adopted version of the ATAD is practically verbatim adoption of the Presidency's proposal and is practically identical to the minimum anti-abuse clause contained in the Parent-Subsidiary Directive [PSD Directive, Art. 1 (2)]. Therefore, the relevance of preparatory materials is somewhat diminished.

The adopted ATAD is based on the minimum harmonization, Member States are therefore obliged to implement at least the minimum level of protection contained therein but are free to adopt higher level of protection [ATAD, Art. 3].

2.1. Scope and legal consequences

Starting with a scope of the GAAR, the Art. 6 merely obliges Member States to ignore qualifying arrangements for the purposes of calculating the corporate tax liability. Compared to opening anti-abuse clauses of other direct tax directives and minimum anti-abuse clause of the Parent Subsidiary Directive [Directive 2003/49/EC, Art. 5; Directive 2009/133/EC, Art. 15 (1)], the GAAR's scope is relatively broader. Conversely, domestic GAARs are frequently applicable to the entire area of tax law [Prebble QC 2018]. It was also discussed whether the Art. 6 should explicitly include withholding taxes. Due to differing views of the member states this was left to national transpositions [Docclo 2017: 377].

Once an arrangement qualifies as abusive the Member State shall ignore it and calculate the tax liability with accordance of the national law. This provision arguably allows Member States to re-characterize the wider fact pattern and calculate the tax liability in line with the object and purpose of the circumvented provision [De Broe, Beckers 2017: 143-144].

2.2. Qualifying arrangements

Arrangements or series thereof can be ignored only if three cumulative conditions are met [ATAD, Art. 6 (1)]. The first condition, i.e. the subjective test, examines taxpayer's motives for carrying out the arrangements by using the one of the main purposes criterion. The Commission preferred the essential purpose criterion stating in its explanatory memorandum that the proposed version reflects the Court of Justice EU (CJEU) case law. In the end, the GAAR provision was adopted in line with the Presidency's draft and brought in line with the PSD's minimum anti-abuse standard clause¹. Considering the historical development of anti-abuse clauses in the direct tax directives and one of the principal purposes test contained in the BEPS Action 6 and its transposition in the Multilateral Instrument [OECD Multilateral Convention 2016, Art. 7], it could be argued that the GAAR's subjective criterion reflects also a broader trend in international taxation.

Regardless, the subjective test of the Art. 6 has been heavily criticized as it considerably deviates, at least in a literal sense, from the sole or the essential purposes criteria used by in CJEU case law on national anti-abuse rules obstructing fundamental freedoms and sets rather low threshold for assessing taxpayer's abusive behaviour [De Broe, Beckers 2017: 141]. It has been also argued that the one of the main purposes criterion could endanger taxpayer's freedom to choose the most tax efficient yet legitimate structuring of its affairs [Bizioli 2017: 172-173]. Similar objections were raised in connection with adoption of the PSD's minimum anti-abuse clause when it was argued that this criterion is fundamentally unacceptable [Debelva, Luts 2015: 68-69].

As to the second condition, the objective test examines the object and purpose of the applicable tax law and whether obtaining the advantage defeats them. The term applicable tax law clearly refers to national legislations that the taxpayer potentially attempts to abuse. However, it has been argued that national corporate tax rules frequently do not have any noticeable purpose but raising revenue which renders the objective analysis senseless [Navarro, Parada, Schwarz 2015: 124-125].

Furthermore, determining the ultimate purpose of a national law could be difficult when the drafting history or travaux préparatoires are lacking, unclear or ambiguous. In that case the objective test cannot be considered met [De Broe, Beckers 2017: 142-143].

Continuing with the third cumulative condition, for an arrangement to qualify as abusive it has to be non-genuine with regard to all relevant facts and circumstances. The arrangement is non-genuine to the extent it is not carried out for valid commercial reasons that reflect economic reality. The rule could be interpreted as clarifying that the tax authority has to

¹ Notably, the Commission historically objected to one of the main purposes test in respect of the PSD's minimum anti as well. See Rigaut 2016: 499-502.

demonstrate taxpayer's subjective intention, i.e. lack of valid commercial reasons, from the actual facts and circumstances².

This wording also differs from the (wholly) artificiality tests of CJEU case law in the area of the direct taxation. As AG Kokott recently noted, CJEU case law distinguishes between wholly artificial arrangements that should be disregarded *prima facie* and arrangements existing in commercial life but circumvent the tax law that are now covered by the Art. 6 and necessitate more detailed analysis to be disregarded³. That could suggest that the Council meant to deviate from the wholly artificiality criterion to a broader concept⁴.

To conclude, there is a fair amount of uncertainty as the wording of the Art. 6 differs considerably from the settled CJEU case law since the former uses one of the main purposes and non-genuine criteria and the latter usually applies the essential purpose and wholly artificial criteria [Dourado 2015: 45-46]. The arguably lower threshold has been recognized by authors across several jurisdictions [Guttman et al. 2017: 10-11; Spindler-Simander, Wohrer 2018: 9].

3. The Czech approach to implementation

The first discussions regarding ATAD's implementation started in the Czech Republic in March 2017 when the Ministry of Finance released its discussion material. Therein it suggested that no transposition into statutory rule would be necessary since a principle of abuse of tax law is an implicit part of the Czech legal system [Implementation of Councils Directive against tax avoidance in the Czech legal system: 16].

Based on the Regulation Impact Assessment, the Ministry eventually decided for transposition into positive law and published in February 2018 the draft amendment for consultation purposes [Final Report - Regulatory Impacts Assessment].

The proposed amendment was to insert Art. 8 (4) into the Tax Procedural Code worded as follows: "Legal transactions and other facts whose main purpose or one of the main purposes is obtaining the tax or another advantage contrary to the goal and purpose of the applicable law shall be ignored for the purposes of tax administration" [Final Report - Regulatory Impacts Assessment].

The Czech Bar Association and the Tax Advisor's Chamber strongly objected to the wording of the February proposal as it applied to entire tax law and contained unclear terminology "other facts" and "another advantage" going likely beyond the requirements of

² Similar phrasing can be found in Art. 7 of the Multilateral Instrument. For detailed discussion regarding objectified intention see Dennis 2016: 113-114.

³ E.g. opinion of AG Kokott, case C-115/16, para. 64 and following.

⁴ Furthermore, the Presidency was of the opinion that the criterion was not limited to wholly artificial arrangements, see Docclo 2017: 378.

Art. 6. Furthermore, it was argued that the one of the main purposes criterion is contrary to the case-law developed Czech abuse of law principle which allows otherwise economically justified arrangements that aim to obtain a tax advantage [Consultation Report 2018].

Following discussions in the government's Legislative Council, the amendment was considerably modified. Most importantly, the one of the main purposes was changed to the prevailing purpose criterion. Apparently, the changes of subjective test were intended to reflect the observations made during the consultation process and to align the proposed rule with the Czech abuse of tax law principle [Hrdlička, Šmirausová 2018: 19-20].

The modified amendment was passed by the government and referred to the House of Representatives with following wording: "Legal transactions and other facts determining for the tax administration whose prevailing purpose is obtaining the tax advantage contrary to the goal and purpose of the applicable law shall be ignored for the purposes of tax administration." Furthermore, the amendment clarifies that the tax authorities would bear a burden of proof regarding the conditions under Art. 8 (4) of the Tax Procedural Code [House print no. 206/0, Sec. 6 Art. 12].

Since the transposition period elapses on 31 December 2018, the House of the Representatives and the Senate have rather limited amount of time to adopt the amendment let alone discuss it in detail. Therefore, it would be useful to critically analyse the amendment in the light of ATAD's implementation requirements.

4. Potential transposition concerns

Both the GAAR and by extension the proposed transpositions give cause for several concerns that will be analysed in this part of the article.

4.1. Potential transposition concerns

As noted above, the Ministry initially considered implementation by a mere reference to the abuse of law principle. This approach was previously used in the Czech Republic in regard to the other anti-abuse rules contained in direct tax directives [Kouba 2017] and is founded on settled CJEU case law allowing implementation without necessity to enact a statutory rule if the goal can be achieved through general legal context⁵.

The advantage of this approach is a legal certainty and continuity in applying a well-established domestic abuse of law principle. On the other hand the implementation by a mere reference to the national anti-abuse principle could defeat the ATAD's goal to introduce consistency and legal certainty across the internal market in relation to anti-

⁵ The CJEU reiterates this principle in *Kofoed*, C-321/05, para 44, *Commission v Italy*, C-456/03, para 51 and *Commission v Austria* 428/04, para 99.

abuse measures [Weber 2016: 103-104]. Furthermore, based on the Dzodzi case law the CJEU could conceivably assume jurisdiction over interpretation of such principle used for implementation purposes [Moreno 2016: 146]. Finally, this implementation would presume that the principle provides at least the minimum level of protection as the GAAR which is debatable as the GAAR's wording uses one of the main purposes criterion⁶, while the abuse of law principle operates usually with the essential purpose criterion⁷. Hence, although the implementation through a reference to abuse of law principle is arguably possible, it is rather unsuitable as it could defeat the ATAD's purpose, cause interpretation issues and disputably not safeguard the mandatory minimum level of protection.

4.2. Potentially lower threshold contained in GAAR

However, even the transposition into the statutory provision contained in the Tax Procedural Code could raise several implementation concerns. As noted above, there is a disparity between wording of the GAAR which contains one of the main purposes and non genuine criteria and CJEU case law on fundamental freedoms using the essential purpose and wholly artificial criteria. Since Czech the abuse of law principle has been considerably inspired by the CJEU case law, it should be assessed whether the more taxpayer friendly threshold transposed into the Czech law complies with the GAAR's minimum level of protection.

For the purposes of the following analysis it is presumed that the ATAD is a valid act of secondary law [Szudoczky 2016: 197 and following]. This presumption would likely hold under scrutiny since CJEU demonstrated in the past certain degree of tolerance when assessing compliance of secondary law with the fundamental freedoms [Dourado 2015: 57].

The most frequently suggested approach to reconcile the disparity between the one of the main purposes and the essential purpose criteria is the prospective CJEU's restrictive interpretation of the former in line with CJEU's case law developed notion of abuse in the area of direct taxation [Debelva, Luts 2015: 68-69; Bizoli 2017: 172; De Broe, Beckers 2017: 142]. In consequence, the GAAR would be interpreted as containing the essential purpose and the wholly artificial criteria.

It is however questionable whether the reconciliatory interpretation is viable as the result departs considerably from the explicit wording of ATAD's statutory provision that should function as a *lex specialis* inspiring the case law than vice versa [Szudoczky 2016: 432-433]. One could further argue that the case law on fundamental freedoms is of limited relevance since it is preconditioned on the divergent application of anti-abuse rule in domestic and cross-border situations while the recital 11 of the ATAD encourages that the GAAR should

⁶ See below.

⁷ E.g. Ruling of Supreme Administrative Court from 15 October 2015, no. 9 Afs 57/2015 - 120. For further details on abuse of law principle see Lang 2016: 222.

be applied uniformly in domestic, cross-border and third country situations [Rosenblatt, Tron 2018: sec. 3.1.4. Similarly also Szudoczky 2016: 425].

Absent the reconciliatory interpretation, the conclusion that the GAAR enacts a lower threshold can be reached not solely from the grammatical interpretation. Notably, the Council intentionally enacted one of the main purposes and non-genuine criteria despite Commission's objections based on CJEU case law. One could thus surmise that it was the Council's intention to introduce a stricter rule and therefore, the GAAR's purpose would be to target even arrangements that have a tax advantage only as one of its main purposes. Considering that the GAAR was inspired by the broader BEPS initiative strengthening the anti-abuse measures⁸, the contextual interpretation could arguably result in the similar conclusion.

Therefore, one could reasonably conclude that the GAAR introduces more stringent criteria compared to the CJEU case law and that these criteria represent minimum standard of protection that should be transposed.

4.3. Exhaustive harmonisation and interpretation solely in the light of the secondary law

Alternatively, when implementing ATAD the Member States have relatively narrow leeway (if any) between the mandatory minimum level of protection and the line drawn by the CJEU case law [Docclo 2017: 368].

Interestingly, the Commission opined that the Member States could adopt higher level protection only in cases which fall out of application of fundamental freedoms [Note on the Application of the 'Minimum Level of Protection' : 3]. It has been argued that at least in the area covered by fundamental freedoms and harmonized by the ATAD, i.e. cross-border corporate tax situations, the GAAR is de facto an exhaustive rule. Under these circumstances the CJEU would have to assess the national transpositions only in the light of the ATAD and not with regard to more favourable fundamental freedoms case law. Therefore, the CJEU could be forced to abandon the reconciliatory interpretation and to adopt the strict interpretation of one of the main purposes and non-genuine criteria [Szudoczky 2016: 205 and following, De Broe, Beckers 2017: 142].

4.4. Consequences, interpretation and application of the transposed GAAR

As demonstrated above, there is a fair amount of uncertainty concerning minimum level of protection safeguarded by the GAAR. It will be ultimately on the CJEU to decide whether it would reconcile differences between the GAAR and its case law by interpretation or

⁸ Compare principle purpose test, supra, no. 5.

whether it will interpret the GAAR as safeguarding relatively higher level of protection than was developed in the case law.

If the latter was the case, the Czech Republic could be found in infringement of its implementation obligations as it demonstrably implements only the essential purpose criterion. Arguably, the similar line of argumentation could be put forth in case of PSD's minimum anti-abuse rule implementation as the abuse of law principle also operates on the essential purpose criterion. Furthermore, the non-genuine criterion, i.e. the absence of valid economic reasons, was arguably incorrectly omitted from the Art. 8 (4) altogether as the Ministry considered it merely a consequence of arrangement having the prevailing purpose of obtaining the tax advantage [Hrdlička, Šmirausová 2018: 19].

Although the author puts forth that the stricter criteria of the ATAD's GAAR potentially represent a shift in the both international and European anti-abuse measure's approach, the risk of infringement procedure initiated against the Czech Republic could be relatively low. Regardless, the uncertainty is going to last likely until August 2020 when the Commission completes its review of the ATAD's implementation under Art. 10. It can be expected that the first CJEU ruling on ATAD rules would be handed down considerably later.

On the other hand, the uncertainty from the perspective of taxpayer is relatively limited as it is established in the CJEU case law that the Member States cannot rely on direct application of provisions of (potentially) incorrectly implemented directive. Therefore, only the prevailing purpose criterion could be applied against taxpayers in the Czech Republic.

Notably, the Czech courts and the tax authorities ought to interpret Art. 8 (4) autonomously, uniformly and in the light of used EU law terminology. Arguably, disparities in application of the anti-abuse measures could defeat ATAD's goal to introduce a common approach across the internal market.

Other modifications found in the Czech transposition, namely broader scope of the GAAR covering entire case and also explicit reference to the tax authorities burden of proof when applying Art. 8 (4) should be viewed favourably. The broader scope is a systematic solution preventing disparities and uncertainty in relation to other taxes.

5. Conclusion

This article focused on the implementation of the ATAD's GAAR into the Czech law and related implementation concerns that are caused mainly by the disparity between the GAAR's wording and CJEU case-law developed notion of abuse. Even though relatively unlikely, the CJEU could interpret the GAAR strictly as requiring higher level of protection

than transposed by the proposed Art. 8 (4) of the Tax Procedural Code. Consequently, the Czech Republic could find itself in breach of its implementation obligations and potentially face infringement proceedings.

Therefore, the legislative bodies should consider amending the draft Art. 8 (4) to reflect the GAAR's wording and avoid this possibility. This approach should also be in line with ATAD's broader goal to transpose the BEPS measure in common and coordinated manner. Finally, the transposed GAAR would be then closely aligned with one of the principle purposes criterion that would be applied by virtue of Multilateral Instrument in international tax context.

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