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GAAR, Abuse of law and Tax Treaties: the Italian perspective

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Framework: preliminary issues

- GAARs represent a new trend in the tax “landscape” and in the political/social recent debate of many European Countries (e.g. the Finance Act 2013, for the first time, introduce a General Anti-Abuse into UK Law).
- GAAR can be studied by:
 - ✓ European tax law perspective;
 - ✓ international tax law perspective;
 - ✓ domestic tax law perspective;
- Distinguishing between “tax fraud”, “tax evasion”, “tax avoidance”, “abuse of law”, “aggressive Tax planning” and “tax planning” It’s not easy.

Framework: preliminary issues

European Law:

- - Art. 325, “**Treaty of the functioning of the European Union**” - “**Combatting Fraud**”: “The Union and the Member States shall counter fraud and any other illegal activities affecting the financial interests of the Union through measures to be taken in accordance with this Article, which shall act as a deterrent and be such as to afford effective protection in the Member States, and in all the Union's institutions, bodies, offices and agencies”.
- Art. 1: “Convention on the protection of European Communities’ financial interest” (1995): Fraud is “the use or presentation of false, incorrect or incomplete statements or document, which has its effects the illegal diminution of the resources of the general budget of the European Communities”.
- ECJ (C-617/10, 26/02/2013) puts “tax fraud” and “tax evasion” at the same level .

Framework: preliminary issues

- Also the fight to abuse of law represents a common European principle:
- Art. 54, *EU Charter of fundamental rights*, "**Prohibition of abuse of rights**": "*Nothing in this Charter shall be interpreted as implying any right to engage in any activity or to perform any act aimed at the destruction of any of the rights and freedoms recognised in this Charter or at their limitation to a greater extent than is provided for herein*".
- Recent judgments of the Italian Supreme Court (e.g., Cass. 07/02/2013, n. 2869) state the fight to abuse of tax law is a **general European principle relevant in direct taxation** (and not only in the VAT system).

Framework: preliminary issues

- What does abuse of tax law mean?
- The European tax law, but also the international guidelines, identify the abuse with “**artificial arrangements** which has been put into place for the essential purpose of avoiding taxation” (Rec. EU 8806/2012).
- An arrangement is artificial where it lacks “**commercial substance**” and leads to a tax benefit.
- BEPS: “*fundamental changes are needed to effectively prevent double non-taxation, as well as cases of no or low taxation associated with practices that **artificially segregate taxable** income from the activities that generate it*”.

Framework: preliminary issues

- An artificial transaction is not a sham transaction: sham transactions identify a case of tax fraud (or tax evasion).
- The “fulcrum” of abuse (but also of tax avoidance) is the lack of “commercial substance”: in other words, the lack of valid economic reasons in accordance with the “prevalence of substance over form” principle.

Framework: preliminary issues

- What does aggressive tax planning mean?
- Tax planning is a legitimate practice but “aggressive tax planning” is a notion really closed to tax avoidance and abuse of law.

“Aggressive tax planning consists in taking advantage of the technicalities of a tax system or of mismatches between two or more tax systems for the purpose of reducing tax liability” (Rec. EU 8806/2012). In the perspective of international taxation, aggressive tax planning requires double deductions or double non-taxation.

Framework: preliminary issues

- A key characteristic of aggressive tax planning practices is *“that they reduce tax liability through strictly arrangements which however **contradict** the **intent** of the law”* (Rec. EU 8806/2012).
- The fight to aggressive tax planning is strictly linked to *Corporate social Responsibility: “Aggressive tax planning could thus be considered contrary to the principles of Corporate Social Responsibility”* (COM(2012) 722, EU).

In conclusion, the abuse of law (but also aggressive tax planning) identify an artificial but legal arrangement, which contradict the spirit (or the “intent”) of the law: in this context, could be interesting to apprise **subjective elements** and, consequently, the intention of the taxpayer.

Framework: preliminary issues

- Recent draft of UK Finance Bill 2013, 13 March 2013, House of Lords Economic Affairs Committee:
 - ✓ - **Tax Planning**: *“What we mean by legitimate tax planning is tax planning that is very much in line with Parliament’s intentions when it passed the rules”.*
 - ✓ **Tax Avoidance**, *“on the other hand, is behaviour that seeks to bend the tax rules in a way that Parliament did not intend. It is accompanied by artificial transactions—trying to seek a result that was not intended”.*

Framework: preliminary issues

Tax Treaties: European soft law (Rec 8806/2012) encourage Member States to introduce in their double taxation conventions the following clause: *“Where this convention provides that an item of income shall be taxable only in one of the contracting States or that it may be taxed in one of the contracting States, the other contracting States shall be preclude from taxing such item only if this item is subject to tax in the first contracting State”*.

OECD Commentary (post 2003): *“The principal purpose of double taxation conventions is to promote, by eliminating international double taxation, exchanges of good and services and the movement of capital and persons. It is also a purpose of tax conventions to prevent tax avoidance and tax evasion”* .

Framework: preliminary issues

- Against this backdrop it's possible to conclude as follows:
 - ✓ The difference between tax avoidance, abuse of law and aggressive tax planning are vague at the level of European law: European Commission puts, substantially, the international aggressive tax planning and the international abuse at the same level.
 - ✓ “Aggressive” but genuine (not artificial) transactions shall be considered a form of legitimate tax planning.
 - ✓ At the same time, OECD guidelines encourage to fight only wholly artificial arrangements:
 - aimed at obtain double non-taxation, double deductions or **significant** lower taxation;
 - which contradict the **spirit (intent) of tax treaties**.

Framework: preliminary issues

The Beps is clear: “***No or low taxation IS NOT PER SE A CAUSE OF CONCERN, but it becomes so when it is associated with practices that artificially segregate taxable income from the activities that generate it”.***

In other words, OECD guidelines seem to be less rigorous than European soft law and aimed to balance different needs.

The Italian perspective

- Italian tax Law doesn't provides a GAAR and a general concept of “Abuse of Law” but the Italian Supreme Court introduced a general “anti – abuse of tax law” principle, also applied in international taxation.

- The Italian Supreme Court, in the following case law (e.g. Cass. 19234/2012; 21782/2011), applied the anti abuse principle in many types of transactions and created the notion of “*distorted use of legal arrangements*” or of “*anomalous transaction*” (Cass. 31290/2012).

Framework: Italian perspective

- In other words, the Supreme Court introduced in Italian tax System a **broad** notion of abuse, really closed to “*aggressive tax planning*”.

This broad notion of abuse has been criticized by a lot of scholars because it is in contrast with the general principle of **LEGAL CERTAINTY**.

However, recent case law use the notion of “*artificial arrangement*” and not of “*anomalous transaction*”, in agreement with European and international tax law;

- Domestic tax Law provides also special anti-avoidance rules (e.g. CFC, Transfer pricing rules, ecc..)

The Italian perspective

- Domestic tax Law provides a *quasi* GAAR (art. art. 37-*bis* Italian Tax code) also applied to some international transactions.
 - It's not easy to understand which rules are passed to fight tax avoidance (or “abusive behaviours”), and which to tackle aggressive tax planning: the wide notion of “aggressive tax planning” enforce to analyze national rules in the light of the new European and international framework.

The Italian perspective

- Most of Italian tax treaties provides specific anti avoidance rules (e.g, the beneficial owner clause, ecc).
- Most of Italian tax treaties include rules implicitly aimed to fight abusive behaviours (e.g. Convention Italy – Mexico, 1995: *“The provisions of this Article shall not apply where the debt-claim in respect of which the interest is paid was agreed upon or assigned with the sole objective of taking advantage of this Article”*);
- Most of recent Italian Tax treaties (e.g. Convention between Italy and Qatar, 2002) contain GAAR.
- Some tax treaties encourage the exchange of information *“to the prevention of fiscal avoidance, evasion and fraud”* (Convention Italy – Republic of Venezuela; Italy – Republic of South Africa).

The Italian perspective

Most of old treaties does not provide GARR and specific anti avoidance rules (e.g. Italy – Brasil, 1978) and impede the exchange of information.

But the 1978 tax landscape is not the 2014 landscape: so, tax treaties must be interpreted on the present political and social landscape.

The Italian perspective

- ✓ What is the link between the national anti-abuse principle, the special anti-avoidance rules and the tax treaties?
- ✓ Is it possible to apply GAARs (or the principle of abuse of law) at the tax treaty level?
- 1) Tax treaties prevail over the national anti-abuse rules and domestic principles: this is a consequence of Italian constitutional system.

The Italian perspective

In the light of the Italian Constitutional Court case law, tax treaties have a “*quasi* constitutional” value.

The Supreme Court identifies the source of the Abuse of Tax Law on the basis of “***ability to pay principle***” and of “***progressive taxation***” (rules contained in Article 53 of the Italian Constitution): but the abuse of law **is not a constitutional principle**.

Consequently, when the same situation is regulated by a national rule (or non constitutional principle) and by a tax treaties rule, international convention **must prevails**.

- But, what if the treaty is silent about GAAR or specific “abusive” or “aggressive” behaviour of tax payer?

The Italian perspective

Some scholars consider that the international *pacta sunt servanda* principle impedes the implementation of GAARs .

I do not agree: indeed, the fight to the “double non - taxation” must be a fundamental interpretative canon and a common value (in European and international tax law).

The Italian perspective

In other words, the lack of specific anti avoidance rules in the single treaty does not mean that contracting states allow artificial arrangement to obtain “double - non taxation”: indeed, tax treaties system has a purpose, on the one hand, to fight “double taxation” but, on the other hand, to prevent “double non-taxation”.

- This is the main issue: tax treaties must be interpreted in accordance of international principles and not only of domestic law and principles.

The tax treaties interpretation must balance the fight to “double - non taxation” with the target of eliminating double taxation and with the respect of contracting States sovereignty.

The Italian perspective

- Italian Case Law on the links between abuse of law and tax treaties is rather scarce.
- The problem is that Italian Supreme Court interprets tax treaties on domestic principles and not on tax treaties principles.

Cass. 29455/2008: in this case the Supreme Court interpreted the Convention between Italian and Switzerland on the domestic ability to pay principles and not on tax treaties principle and categories. In this case **there was not a wholly artificial arrangement**, but the tax payer took advantage of tax treaty.

But the Beps says: “***No or low taxation IS NOT PER SE A CAUSE OF CONCERN***”.

The Italian perspective

Cass. 20/02/2013, n. 4165: The Italian Supreme Court applied domestic anti abuse rules to interpret the Convention between Italy and UK.

The Court stated that the notion of “*received dividends by beneficial owner*” (the UK corporate controlled 100% the Italian Corporate) needs dividends **be effectively paid.**

Indeed, in this case the Italian Corporate extinguished the “dividends debt” entering in a new contractualing agreement (profitable loan) with the Uk corporate.

The Court denied the tax credit (and the tax refund) asked by the Uk Company on the domestic abuse of law principle and on the national notion of “*dividend payment*”.

But OECD Commentary: “*the term <<paid>> has a **very wide meaning,** since the concept of payments means the fulfillment of the obligation to put funds at the disposal of the shareholder **in the manner required by contract or by custom**”.*

The jurisprudence can not distort tax treaties categories in the light of domestic principle of abuse of tax law where the transaction is genuine and, consequently, not artificial.

The Italian perspective

-What if the treaty is silent about the relationship between tax treaty and domestic special anti-avoidance rules?

- Some Italian tax treaties provide that the convention “*will not limit the application of the domestic provisions for the prevention of fiscal evasion and tax avoidance*” (Italy – United Arab Emirates, 1995; Italy - Ukraine);
- Also Oecd Commentary (post 2003) is very clear that the treaties do not preclude the application of domestic anti avoidance rules.

Against this backdrop, tax treaties do not impede the implementation of domestic special anti-avoidance rule but domestic **rules cannot contrast with tax treaties.**

The Italian perspective

Italian tax Court (Comm. Trib. Prov. Bergamo, 12/11/2009, n. 170) stated that Italian CFC rules contrast with the notion of residence included in the treaty between Italy and Cyprus. Indeed, this tax treaty provides that the control of a corporate resident in one of contracting State is not enough to consider this corporate as a resident in the other contracting State. So, the Italian CFC rules were not applied.

Conclusions

- Today distinguishing between tax avoidance, aggressive tax planning and abuse of law it's not easy: the "fulcrum" of these categories is the lack of commercial substance;
- Italian tax system is advanced (perhaps, "too much") to fight tax avoidance, abuse of law and aggressive tax planning;
- Italian treaties system is in agreement with OECD guidelines;
- Italian jurisprudence is too much rigorous but essentially in agreement with European soft law with the political/social recent debate of many European Countries;
- Italian case law is not fully sharable about the relationships between domestic principle and tax treaties system.