

# Cadbury Schweppes' *Line of Case Law* from the Member States' Perspective

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## I. INTRODUCTION

ONE OF THE most difficult and controversial legal questions is how to deal with the attempt to circumvent the law. Within Europe, completely different legal traditions and concepts exist in this respect. Not surprisingly, these issues play an important role in European law as well. The Court of Justice has had to deal with attempts to circumvent European law on several occasions. In recent years, these issues have become increasingly relevant in tax cases. One important judgment in this respect is *Cadbury Schweppes*,<sup>1</sup> to which a lot of attention has been paid by academics. Several authors consider the reasoning the ECJ developed in *Cadbury Schweppes* as a separate line of case law. It is my task to analyse whether this line of case law has impact on anti-abuse doctrines of the Member States. I will deal with this question in Part III of this chapter. Before dealing with that question, one has to clarify what the approach of the Court concerning abuse of law is and whether there is a specific line of *Cadbury Schweppes* case law at all. These issues will be dealt with in Part II of this chapter.

## II. CADBURY SCHWEPPE CASE LAW

### A. 'Wholly Artificial Arrangements' and the Court's Case Law

In *Cadbury Schweppes* the ECJ referred to 'wholly artificial arrangements' to describe situations in which a less favourable treatment for intra-Community cross-border situations could be justified in order to reduce the risk of tax avoidance.<sup>2</sup> It is not the first time the

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<sup>1</sup> Case C-196/04 *Cadbury Schweppes plc, Cadbury Schweppes Overseas Ltd v Commissioners of Inland Revenue* [2006] ECR I-7995.

<sup>2</sup> See for example, Case C-264/96 *Imperial Chemical Industries plc (ICI) v Kenneth Hall Colmer (Her Majesty's Inspector of Taxes)* [1998] ECR I-4695, para [26]; Case C-324/00 *Lankhorst-Hohorst GmbH v Finanzamt Steinfurt* [2002] ECR I-11770, para [37]; Case C-446/03 *Marks & Spencer plc v David Halsey (Her Majesty's Inspector of Taxes)* [2005] ECR I-10837, para [57]; *Cadbury Schweppes* (n 1 above), para [51]; Case C-524/04 *Test Claimants in the Thin Cap Group Litigation v Commissioners of Inland Revenue* [2007] ECR I-2107, paras [71, 72]. See also the Opinion of AG Mengozzi in Case C-298/05 *Columbus Container Services BVBA & Co v Finanzamt Bielefeld-Innenstadt* [2007] ECR I-10451, paras [169–84].

Court used this phrase.<sup>3</sup> But *Cadbury Schweppes* is special, as for the first time, the ECJ defined what it understood by this phrase. In its previous case law, the ECJ saw no need for that because the domestic measures which had been examined by the Court had such a broad scope that it was clear that they would not merely cover ‘wholly artificial arrangements’ and were therefore not proportionate. However, in order to understand the *Cadbury Schweppes* judgment, one has to include the predecessors of this judgment in one’s analysis.

*ICI*<sup>4</sup> was the first judgment where the phrase ‘wholly artificial arrangement’ was used. *ICI* was about a UK tax provision denying tax relief with respect to losses incurred by a resident subsidiary. The majority of the subsidiaries controlled by the holding company had their seat outside the United Kingdom, while tax relief was granted where the majority had their subsidiaries within the UK. The ECJ found it necessary to determine whether there was a justification for such an inequality of treatment and concluded that there was none:<sup>5</sup>

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

*Lankhorst-Hohorst* was about German thin capitalisation rules. Under German law, interest paid by a resident subsidiary on loan capital provided by a non-resident parent company was taxed as a hidden dividend at a rate of thirty per cent, whereas, in the case of a resident subsidiary whose parent company is also resident and receives a tax credit, interest paid was treated as expenditure and not as a hidden dividend. The ECJ held that this unequal treatment infringed the freedom of establishment:<sup>6</sup>

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

*X and Y* was about Swedish rules that allowed for a transfer of shares from one legal entity to another legal entity at less than market value if the transferor had a holding in the other legal entity, except when the other legal entity was either a foreign legal entity or a Swedish legal entity under foreign control. The ECJ held this distinction to be in conflict with the freedom of establishment and the free movement of capital:<sup>7</sup>

<sup>3</sup> For a description of the Court’s case law on wholly artificial arrangements and for the following deliberations see already, M Lang and S Heidenbauer, ‘Wholly Artificial Arrangements’ in L Hinnekens and P Hinnekens (eds), *A Vision of Taxes Within and Outside European Borders: Festschrift in honor of Frans Vanistendael* (The Hague, Kluwer Law International 2008) 597.

<sup>4</sup> *ICI* (n 2 above).

<sup>5</sup> *ICI* (n 2 above), para [26]. See also M Lang, ‘CFC Legislation and Community Law’ (2002) 42 *European Taxation* 374, 375.

<sup>6</sup> *Lankhorst-Hohorst* (n 2 above), para [37].

<sup>7</sup> Case C-436/00 *X and Y v Riksskatteverket* [2002] ECR I-10829, paras [61, 62].

The provision at issue here is not specifically designed to exclude from a tax advantage purely artificial schemes designed to circumvent Swedish tax law, but concerns, generally, any situation in which, for whatever reason, the transfer at undervalue is to a company established under the legislation of another Member State or a branch set up in the Kingdom of Sweden by such a company. [. . .] However, tax evasion or tax fraud cannot be inferred generally from the fact that the transferee company or its parent company is established in another Member State and cannot justify a fiscal measure which compromises the exercise of a fundamental freedom guaranteed by the Treaty.

In *Lasteyrie du Saillant*, the Court dealt with a French exit tax provision:<sup>8</sup>

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

*Marks & Spencer* was about cross-border group relief. The ECJ accepted that the UK may distinguish between cross-border situations and domestic situations. The Court referred to three different grounds of justifications that—‘taken together’—allowed for different treatment.<sup>9</sup> One of them was the ‘risk of tax avoidance’.<sup>10</sup> However, the ECJ mentioned this justification again, this time without having been asked:<sup>11</sup>

It is also important, in that context, to make clear that Member States are free to adopt or to maintain in force rules having the specific purpose of precluding from a tax benefit wholly artificial arrangements whose purpose is to circumvent or escape national tax law.

In *Cadbury Schweppes*, which was about the UK Controlled Foreign Companies (CFC) tax rules, the Court explained its concept of ‘wholly artificial arrangements’ in more detail; we will take a closer look at this concept below. However, it is worth mentioning at this point that the Court considered itself to be in line with previous case law:<sup>12</sup>

It is also apparent from case-law that the mere fact that a resident company establishes a secondary establishment, such as a subsidiary, in another Member State cannot set up a general presumption of tax evasion and justify a measure which compromises the exercise of a fundamental freedom guaranteed by the Treaty. [. . .] On the other hand, a national measure restricting freedom of establishment may be justified where it specifically relates to wholly artificial arrangements aimed at circumventing the application of the legislation of the Member State concerned.

<sup>8</sup> Case C-9/02 *Hughes de Lasteyrie du Saillant v Ministère de l'Économie, des Finances et de l'Industrie* [2004] ECR I-2409, para [50].

<sup>9</sup> See also F Vanistendael, ‘The ECJ at the Crossroads: Balancing Tax Sovereignty against the Imperatives of the Single Market’ (2006) 46 *European Taxation* 413, 415.

<sup>10</sup> *Marks & Spencer* (n 2 above), paras [49, 50].

<sup>11</sup> *Marks & Spencer* (n 2 above), para [57]; critical M Lang, ‘The *Marks & Spencer* Case—The Open Issues Following the ECJ’s Final Word’ (2006) 46 *European Taxation* 54, 58; M Lang, ‘Direct Taxation: Is the ECJ Heading in a New Direction?’ (2006) 46 *European Taxation* 421, 427.

<sup>12</sup> *Cadbury Schweppes* (n 1 above), paras [50, 51]. See also F Vanistendael, ‘*Halifax* and *Cadbury Schweppes*: One Single European Theory of Abuse in Tax Law?’ (2006) 15 *EC Tax Review* 192, 193; and J Kokott and T Henze, ‘Ist der EuGH—noch—ein Motor für die Konvergenz der Steuersysteme?’ (2007) 62 *Betriebs-Berater* 913, 916. For the difficulty in drawing the borderline between the use and abuse of a fundamental freedom, also see N Vinther and E Werlauff, ‘Tax Motives Are Legal Motives—The Borderline between the Use and Abuse of the Freedom of Establishment with Reference to the *Cadbury Schweppes* Case’ (2006) 46 *European Taxation* 383, 384.

In *Test Claimants in the Thin Cap Group Litigation* the Court confirmed what it had previously held and further developed its ideas. As a starting point, the ECJ referred to its previous judgments:<sup>13</sup>

It must be pointed out that, according to established case-law, a national measure restricting freedom of establishment may be justified where it specifically targets wholly artificial arrangements designed to circumvent the legislation of the Member State concerned [ . . . ]. The mere fact that a resident company is granted a loan by a related company which is established in another Member State cannot be the basis of a general presumption of abusive practices and justify a measure which compromises the exercise of a fundamental freedom guaranteed by the Treaty.

This case law has been confirmed in *NV Lammers & Van Cleeff*:<sup>14</sup>

In this respect, it must be pointed out that, according to established case-law, a national measure restricting freedom of establishment may be justified where it specifically targets wholly artificial arrangements designed to circumvent the legislation of the Member State concerned (*Test Claimants in the Thin Cap Group Litigation*, paragraph 72 and the case-law cited). [ . . . ]

The mere fact that a resident company is granted a loan by a related company which is established in another Member State cannot be the basis of a general presumption of abusive practices and justify a measure which compromises the exercise of a fundamental freedom guaranteed by the Treaty (*Test Claimants in the Thin Cap Group Litigation*, paragraph 73 and the case-law cited). [ . . . ]

In order for a restriction on the freedom of establishment to be justified on the ground of prevention of abusive practices, the specific objective of such a restriction must be to prevent conduct involving the creation of wholly artificial arrangements which do not reflect economic reality, with a view to escaping the tax normally due on the profits generated by activities carried out on national territory (*Test Claimants in the Thin Cap Group Litigation*, paragraph 74 and the case-law cited). [ . . . ]

At paragraph 80 of its judgment in *Test Claimants in the Thin Cap Group Litigation*, the Court held that legislation of a Member State may be justified by the need to combat abusive practices where it provides that interest paid by a resident subsidiary to a non-resident parent company is to be treated as a distribution only if, and in so far as, it exceeds what those companies would have agreed upon on an arm's-length basis, that is to say, the commercial terms which those parties would have accepted if they had not formed part of the same group of companies. [ . . . ]

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

In the present case, it is apparent from the order for reference that the interest payments made by the Belgian subsidiary on a loan granted by a non-resident company which is a director were reclassified as dividends because the limit laid down in the second indent of Article 18 (1), point 3, of the ITC 1992 had been exceeded, that is to say, at the beginning of the taxable period the total of the interest-bearing loans was higher than the paid-up capital plus taxed reserves. [ . . . ]

<sup>13</sup> *Thin Cap* (n 2 above), paras [72, 73].

<sup>14</sup> Case C-105/07 *NV Lammers & Van Cleeff v Belgische Staat* [2008] ECR I-0173, paras [26–34].

It is clear that, even if the application of such a limit seeks to combat abusive practices, it goes in any event beyond what is necessary to attain that objective. [ . . . ]

As the Commission of the European Communities stated in its submissions, the limit laid down in the second indent of Article 18 (1), point 3, of the ITC 1992 also affects situations in which the transaction concerned cannot be regarded as a purely artificial arrangement. If interest payments made to non-resident companies are reclassified as dividends as soon as they exceed such a limit, it cannot be ruled out that that reclassification will also apply to interest paid on loans granted on an arm's length basis. [ . . . ]

Consequently, the answer to the question submitted must be that Articles 43 EC and 48 EC [now Articles 49 and 54 TFEU] must be interpreted as precluding national legislation, such as that at issue in the main proceedings, under which interest payments made by a company resident in a Member State to a director which is a company established in another Member State are reclassified as dividends and are, on that basis, taxable, where, at the beginning of the taxable period, the total of the interest-bearing loans is higher than the paid-up capital plus taxed reserves, whereas, in the same circumstances, where those interest payments are made to a director which is a company established in the same Member State, those payments are not reclassified as dividends and are, on that basis, not taxable.

In its Order in *The Test Claimants in the CFC and Dividend Group Litigation* the ECJ summarised its case law:<sup>15</sup>

[A] national measure restricting freedom of establishment may be justified where it specifically targets wholly artificial arrangements designed to circumvent the legislation of the Member State concerned (*Cadbury Schweppes and Cadbury Schweppes Overseas*, paragraph 51 and the case-law cited). [ . . . ]

It follows that, for a restriction on the freedom of establishment to be justified on the ground of prevention of abusive practices, the specific objective of such a restriction must be to prevent conduct involving the creation of wholly artificial arrangements, which do not reflect economic reality, with a view to escaping the tax normally due on the profits generated by activities carried out on national territory (*Cadbury Schweppes and Cadbury Schweppes Overseas*, paragraph 55). [ . . . ]

In order to find that there is such an arrangement there must be, in addition to a subjective element consisting in the intention to obtain a tax advantage, objective circumstances showing that, despite formal observance of the conditions laid down by Community law, the objective pursued by freedom of establishment has not been achieved (*Cadbury Schweppes and Cadbury Schweppes Overseas*, paragraph 64 and the case-law cited). [ . . . ]

In those circumstances, in order for the legislation on CFCs to comply with Community law, the taxation provided for by that legislation must be excluded where, despite the existence of tax motives, the incorporation of a CFC reflects economic reality. That finding must be based on objective factors which are ascertainable by third parties with regard, in particular, to the extent to which the CFC physically exists in terms of premises, staff and equipment (*Cadbury Schweppes and Cadbury Schweppes Overseas*, paragraphs 65 and 67). [ . . . ]

In this case, it is for the national court to determine whether, as maintained by the United Kingdom Government, the motive test, as defined by the legislation on CFCs, lends itself to an interpretation which enables the taxation provided for by that legislation to be restricted to wholly artificial arrangements or whether, on the contrary, the criteria on which that test is based mean that, where none of the exceptions laid down by that legislation applies and the intention to obtain a reduction in United Kingdom tax is central to the reasons for incorporating the CFC, the resident parent company comes within the scope of application of that legislation,

<sup>15</sup> Case C-201/05 *The Test Claimants in the CFC and Dividend Group Litigation v Commissioners of Inland Revenue* [2008] ECR I-2875, paras [76–82], [84].

despite the absence of objective evidence which could indicate the existence of an arrangement of that nature. In the first case, the legislation on CFCs should be regarded as being compatible with Articles 43 EC and 48 EC. In the second case, on the other hand, the view should be taken that that legislation is contrary to Articles 43 EC and 48 EC (*Cadbury Schweppes and Cadbury Schweppes Overseas*, paragraphs 72 to 74). [ . . . ]

In the light of the preceding considerations, Articles 43 EC and 48 EC must be interpreted as precluding the inclusion in the tax base of a resident company established in a Member State of profits made by a CFC in another Member State, where those profits are subject in that State to a lower level of taxation than that applicable in the first State, unless such inclusion relates only to wholly artificial arrangements intended to escape the national tax normally payable. Accordingly, such a tax measure must not be applied where it is proven, on the basis of objective factors which are ascertainable by third parties, that despite the existence of tax motives, that CFC is actually established in the host Member State and carries on genuine economic activities there (*Cadbury Schweppes and Cadbury Schweppes Overseas*, paragraph 75). [ . . . ]

As regards, secondly, compliance requirements to which the exemption for a CFC's profits in the hands of a resident company is subject, it is appropriate to point out, first, that in *Cadbury Schweppes and Cadbury Schweppes Overseas*, the Court held that the resident company is best placed to establish that it has not entered into 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 and that it must be given an opportunity to produce evidence that the CFC is actually established and that its activities are genuine (*Cadbury Schweppes and Cadbury Schweppes Overseas*, paragraph 70). [ . . . ]

Secondly, in *Test Claimants in the Thin Cap Group Litigation*, the Court held that national legislation which provides for a consideration of objective and verifiable elements in order to determine whether a transaction represents a purely artificial arrangement, entered into for tax reasons alone, is to be considered as not going beyond what is necessary to prevent abusive practices where, on each occasion on which the existence of such an arrangement cannot be ruled out, the taxpayer is given an opportunity, without being subject to undue administrative constraints, to provide evidence of any commercial justification that there may have been for that arrangement (*Test Claimants in the Thin Cap Group Litigation*, paragraph 82).

In *Jobra Vermögensverwaltungs-Gesellschaft mbH* the ECJ referred to its case law on wholly artificial arrangements as well.<sup>16</sup> Under Austrian law, a special tax incentive ('investment growth premium') was only granted for goods used in Austria. The Austrian Government also invoked the need to prevent abuse:

The legislation at issue in the main proceedings aims to prevent wholly artificial arrangements involving transfers for remuneration. If it were not for that provision, an asset allocated to a lessor would be eligible for an investment premium irrespective of where the lessee took that asset. A concern would be that the lessor could hand over all or part of that premium to the lessee which, for its part, could use that asset to generate profits in other Member States. Thus, it would be possible to circumvent the fact that that advantage is limited to Austria.

The ECJ did not accept that justification:<sup>17</sup>

As regards the justification alleging that there is a need to prevent abuse, it must be held that a national measure restricting the freedom to provide services can be justified where it specifically targets wholly artificial arrangements which do not reflect economic reality and whose only

<sup>16</sup> Case C-330/07 *Jobra Vermögensverwaltungs-Gesellschaft mbH v Finanzamt Amstetten Melk Scheibbs* [2008] ECR I-9099, paras [29], [35–39].

<sup>17</sup> *Jobra* (n 16 above).

purpose is to obtain a tax advantage (see, to that effect, Case C-196/04 *Cadbury Schweppes and Cadbury Schweppes Overseas* [2006] ECR I-7995, paragraphs 51 and 55, and Case C-524/04 *Test Claimants in the Thin Cap Group Litigation* [2007] ECR I-2107, paragraph 74). [ . . . ]

In the present case, it cannot be claimed that it actually constitutes abuse for an undertaking that can claim the investment premium to hire out assets for remuneration to another undertaking which uses them primarily in other Member States. [ . . . ]

Such hiring out cannot be the basis of a general presumption of abusive practice and justify a measure which compromises the exercise of a fundamental freedom guaranteed by the Treaty (see, to that effect, *Test Claimants in the Thin Cap Group Litigation*, paragraph 73, and Case C-105/07 *Lammers & Van Cleef* [2008] ECR I-0000, paragraph 27). [ . . . ]

In that context, it must be noted that the legislation at issue in the main proceedings affects every lessor eligible for the investment premium which hires out assets for remuneration to undertakings carrying out cross-border activities, and does so even where nothing points towards the existence of such an artificial arrangement. Furthermore, the legislation does not allow lessors to adduce evidence that no abuse is taking place. [ . . . ]

Therefore, it must be held that the legislation at issue in the main proceedings does not make it possible to limit the refusal to grant the investment premium to cases involving wholly artificial arrangements. Moreover, it has not been claimed before the Court of Justice that such an arrangement exists in the case in the main proceedings.

## B. Other Case Law on Abuse

In order to develop the criteria under which it considers an arrangement to be wholly artificial, the Court referred to its judgments in *Emsland-Stärke* and *Halifax*.<sup>18</sup> Neither judgment concerned direct taxation or the application of the fundamental freedoms. However, in *Emsland-Stärke* and *Halifax*, the Court carefully summarised its then-existing case law and developed it further. By referring to these judgments in *Cadbury Schweppes*, the Court gives the impression that it is willing to apply a uniform abuse concept in different areas of law.

*Emsland-Stärke GmbH* exported several consignments of a product based on potato starch to Switzerland. The recipients of the goods were established in Switzerland. On an application by *Emsland-Stärke*, and in the light, inter alia, of Swiss customs clearance certificates and freight papers, the German customs authorities granted the company an export refund. Subsequent inquiries conducted by the German customs investigation service revealed that, immediately after their release for home use in Switzerland, the exported consignments were transported back to Germany unaltered and, by the same means of transport under an external Community transit procedure, were released for home use in that Member State on payment of the relevant import duties. In respect of those consignments, the German customs authorities revoked the decisions granting an export refund and demanded repayment.<sup>19</sup>

The ECJ held that:

[I]t is clear from the case-law of the Court that the scope of Community regulations must in no case be extended to cover abuses on the part of a trader. [ . . . ] The Court has also held that the fact that importation and re-exportation operations were not realised as bona fide commercial

<sup>18</sup> *Cadbury Schweppes* (n 1 above), para [64]; see already, Lang and Heidenbauer (n 3 above) 597.

<sup>19</sup> See Case C-110/99 *Emsland-Stärke GmbH v Hauptzollamt Hamburg-Jonas* [2000] ECR I-11569, paras [7–12].

transactions but only in order wrongfully to benefit from the grant of monetary compensatory amounts, may preclude the application of positive monetary compensatory amounts. [ . . . ]

A finding of an abuse requires, first, a combination of objective circumstances in which, despite formal observance of the conditions laid down by the Community rules, the purpose of those rules has not been achieved. [ . . . ]

It requires, second, a subjective element consisting in the intention to obtain an advantage from the Community rules by creating artificially the conditions laid down for obtaining it. The existence of that subjective element can be established, *inter alia*, by evidence of collusion between the Community exporter receiving the refunds and the importer of the goods in the non-member country.<sup>20</sup>

*Halifax* is a more recent decision than *Emsland-Stärke*. The judgment concerned the application of the Sixth VAT Directive.<sup>21</sup> The ECJ held that:

[I]t must be borne in mind that, according to settled case-law, Community law cannot be relied on for abusive or fraudulent ends. [ . . . ]

The application of Community legislation cannot be extended to cover abusive practices by economic operators, that is to say transactions carried out not in the context of normal commercial operations, but solely for the purpose of wrongfully obtaining advantages provided for by Community law.<sup>22</sup>

The Court continued by acknowledging that the:

[P]rinciple of prohibiting abusive practices also applies to the sphere of VAT. [ . . . ]

Preventing possible tax evasion, avoidance and abuse is an objective recognised and encouraged by the Sixth Directive. [ . . . ]

However, as the Court has held on numerous occasions, Community legislation must be certain and its application foreseeable by those subject to it. [ . . . ] That requirement of legal certainty must be observed all the more strictly in the case of rules liable to entail financial consequences, in order that those concerned may know precisely the extent of the obligations which they impose on them. [ . . . ]

Moreover, it is clear from the case-law that a trader's choice between exempt transactions and taxable transactions may be based on a range of factors, including tax considerations relating to the VAT system. [ . . . ] Where the taxable person chooses one of two transactions, the Sixth Directive does not require him to choose the one which involves paying the highest amount of VAT. On the contrary, as the Advocate General observed in point 85 of his Opinion, taxpayers may choose to structure their business so as to limit their tax liability.<sup>23</sup>

The Court concluded by holding that:

In view of the foregoing considerations, it would appear that, in the sphere of VAT, an abusive practice can be found to exist only if, first, the transactions concerned, notwithstanding formal application of the conditions laid down by the relevant provisions of the Sixth Directive and the

<sup>20</sup> *Emsland-Stärke* (n 19 above), paras [51–53]. See also C Böing, *Steuerlicher Gestaltungsmissbrauch in Europa—Eine rechtsvergleichende und gemeinschaftsrechtliche Untersuchung von Konzeptionen zur Bekämpfung des Gestaltungsmissbrauchs* (Hamburg, Verlag Dr Kovač 2006) 299.

<sup>21</sup> Sixth Council Directive 77/388/EEC of 17 May 1977 on the harmonisation of the laws of the Member States relating to turnover taxes—Common system of value-added tax: uniform basis of assessment (Sixth VAT Directive) [1977] OJ L145/1, *as amended*.

<sup>22</sup> Case C-255/02 *Halifax plc, Leeds Permanent Development Services Ltd, County Wide Property Investments Ltd v Commissioners of Customs & Excise* [2006] ECR I-1609, paras [68, 69]. See also Vanistendael (n 12 above) 192; and O Rousselle and H Liebman, 'The Doctrine of the Abuse of Community Law: The Sword of Damocles Hanging over the Head of EC Corporate Tax Law?' (2006) 12 *European Taxation* 559, 561.

<sup>23</sup> *Halifax* (n 22 above), paras [70–73].

national legislation transposing it, result in the accrual of a tax advantage the grant of which would be contrary to the purpose of those provisions. [ . . . ]

Second, it must also be apparent from a number of objective factors that the essential aim of the transactions concerned is to obtain a tax advantage. As the Advocate General observed in point 89 of his Opinion, the prohibition of abuse is not relevant where the economic activity carried out may have some explanation other than the mere attainment of tax advantages.

The Court added that:

[I]t 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.<sup>24</sup>

In *Part Service* the ECJ was forced to explain its *Halifax* judgment in more detail. The Italian court referred the following question to the ECJ:<sup>25</sup> ‘Does the concept of abuse of rights defined in the judgment of the Court of Justice in [*Halifax and Others*] as *transactions, the essential aim of which is to obtain a tax advantage*, correspond to the definition transactions carried out for no commercial reasons other than a tax advantage, or is it broader or more restrictive than that definition?’ The ECJ provided the following explanation:<sup>26</sup>

In paragraphs 74 and 75 of *Halifax and Others*, the Court first held that, in the context of interpreting the Sixth Directive, an abusive practice can be held to exist where:

- the transactions concerned, notwithstanding formal application of the conditions laid down by the relevant provisions of the Sixth Directive and the national legislation transposing it, result in the accrual of a tax advantage the grant of which would be contrary to the purpose of those provisions;
- it is apparent from a number of objective factors that the essential aim of the transactions concerned is to obtain a tax advantage.

When, subsequently, it provided the referring court with details for guidance in interpreting the transactions in the case in the main proceedings, the Court once again referred, at paragraph 81, to transactions essentially seeking to obtain a tax advantage. [ . . . ]

Therefore, when it stated, in paragraph 82 of that judgment, that in any event, the transactions at issue had the sole purpose of obtaining a tax advantage, it was not establishing that circumstance as a condition for the existence of an abusive practice, but simply pointing out that, in the matter before the referring court in that case, the minimum threshold for classifying a practice as abusive had been passed. [ . . . ]

The reply to the first question therefore is that the Sixth Directive must be interpreted as meaning that there can be a finding of an abusive practice when the accrual of a tax advantage constitutes the principal aim of the transaction or transactions at issue.

### C. Objective and Subjective Criteria

In *Cadbury Schweppes*, the ECJ referred to *Emsland-Stärke* and *Halifax* and held that—in order to describe the notion ‘wholly artificial arrangement’—‘there must be,

<sup>24</sup> *Halifax* (n 22 above), paras [74, 75, 81].

<sup>25</sup> Case C-425/06 *Ministero dell'Economia e delle Finanze v Part Service Srl* [2008] ECR I-897, para [32].

<sup>26</sup> *Part Service* (n 25 above), paras [42–45].

in addition to a subjective element consisting in the intention to obtain a tax advantage, objective circumstances showing that, despite formal observance of the conditions laid down by Community law, the objective pursued by freedom of establishment, as set out in paragraphs 54 and 55 of this judgment, has not been achieved'.<sup>27</sup>

The Court went on to explain in more detail:<sup>28</sup>

In those circumstances, in order for the legislation on CFCs to comply with Community law, the taxation provided for by that legislation must be excluded where, despite the existence of tax motives, the incorporation of a CFC reflects economic reality. [ . . . ]

That incorporation must correspond with an actual establishment intended to carry on genuine economic activities in the host Member State. [ . . . ]

[T]hat finding must be based on objective factors which are ascertainable by third parties with regard, in particular, to the extent to which the CFC physically exists in terms of premises, staff and equipment.

The key words seem to be 'economic reality', 'actual establishment', 'genuine economic activities', and 'the extent to which the CFC physically exists'. The Court seems to require that the complete facts have to be established. If an arrangement turns out not to reflect economic reality, not to correspond to an actual establishment, or not to exist physically, it may be ignored. This does not come as a surprise: tax authorities are well advised to establish the actual fact pattern—not only when applying the fundamental freedoms. In most Member States, the principle of legality requires the tax authorities to put much effort into carefully establishing the facts. It is rather obvious that they are not prevented from fulfilling their obligations when operating within the scope of EU law.

It is remarkable that in *Cadbury Schweppes* the Court refers to the term 'letter-box'.<sup>29</sup> If checking the objective factors 'leads to the finding that the CFC is a fictitious establishment not carrying out any genuine economic activity in the territory of the host Member State, the creation of that CFC must be regarded as having the characteristics of a wholly artificial arrangement. That could be so in particular in the case of a "letter-box" or "front" subsidiary (see Case C-341/04 *Eurofood IFSC* [2006] ECR I-0000, paragraphs 34 and 35).'

On the one hand, the use of the term 'letter-box' can be misleading.<sup>30</sup> One might get the impression that a legal entity that has no premises, staff, or equipment may be described as a letter-box company and thus may, in a cross-border situation, be treated less favourably.<sup>31</sup> However, the requirement imposed by the Court that the legal entity 'physically exists in terms of premises, staff and equipment' does not necessarily mean that legal entities without premises, staff or equipment can be completely ignored. The size of premises and the amount of staff and equipment that is required cannot be determined without taking into account the type of business a corporation operates. There does not seem to be a need for an intermediate holding company or a group financing company to have a large office space or lots of full-time employees. In a mere domestic

<sup>27</sup> *Cadbury Schweppes* (n 1 above), para [64]; see Lang and Heidenbauer (n 3 above).

<sup>28</sup> *Cadbury Schweppes* (n 1 above), paras [65–67]. See also Vanistendael (n 12 above) 194; and F Wassermeyer and J Schönfeld, 'Die EuGH-Entscheidung in der Rechtssache *Cadbury Schweppes* und deren Auswirkungen auf die deutsche Hinzurechnungsbesteuerung' [2006] *GmbHRundschau* 1065, 1066.

<sup>29</sup> *Cadbury Schweppes* (n 1 above), para [68].

<sup>30</sup> See Lang and Heidenbauer (n 3 above) 597.

<sup>31</sup> See H Loukota, 'Das erste Treaty-Shopping-Urteil des VwGH' [1998] *Steuer und Wirtschaft International* 105; H Loukota, 'Einschaltung ausländischer Basisgesellschaften' [2005] *Steuer und Wirtschaft International* 205, 209.

context there is no doubt that such legal entities without office space or staff are not ignored for tax purposes. On the contrary, in many tax jurisdictions, such companies are liable to minimum corporate income tax, even if they only receive tax-exempt dividends. Therefore, one cannot assume that the creation of such legal entities should be considered as wholly artificial arrangements in general.<sup>32</sup>

A closer look at *Eurofood IFSC*,<sup>33</sup> which the ECJ referred to when mentioning the example of letter-box companies,<sup>34</sup> confirms this result. In *Eurofood IFSC*, the ECJ had to interpret Article 3(1) of Regulation 1346/2000.<sup>35</sup> This provision is relevant to determine the Member State where insolvency proceedings may be opened (international jurisdiction). According to this provision, in 'the case of a company or legal person, the place of the registered office shall be presumed to be the centre of its main interests in the absence of proof to the contrary'. The Court arrived at the following conclusions:<sup>36</sup>

It follows that, in determining the centre of the main interests of a debtor company, the simple presumption laid down by the Community legislature in favour of the registered office of that company can be rebutted only if factors which are both objective and ascertainable by third parties enable it to be established that an actual situation exists which is different from that which locating it at that registered office is deemed to reflect. [ . . . ]

That could be so in particular in the case of a 'letterbox' company not carrying out any business in the territory of the Member State in which its registered office is situated. [ . . . ]

By contrast, where a company carries on its business in the territory of the Member State where its registered office is situated, the mere fact that its economic choices are or can be controlled by a parent company in another Member State is not enough to rebut the presumption laid down by the Regulation.

From this reasoning, one could derive that a letter-box company is not a company lacking office space or staff but a company 'not carrying out any business in the territory of the Member State in which its registered office is situated'. A company that fulfils holding or finance functions, even exclusively within a group of companies, cannot be considered a letter-box company. 'The mere fact that its economic choices are or can be controlled by a parent company in another Member State' is not enough to ignore the legal existence of this company as a resident of the other Member State. Thus, whenever the facts establish that the legal entity concerned carries out whatever type of business in another Member State, its activities cannot be considered a 'wholly artificial arrangement'.

A careful finding of the facts quite often proves that the conditions for applying a specific beneficial rule are not met. The Court has already dealt with cases of fraud, of the manipulation of a product to obtain export restitutions, of false declarations, or sham transactions.<sup>37</sup> However, there are cases where the Court applies a substance-over-form approach and where it is not completely clear whether the real facts are established or

<sup>32</sup> See the Opinion of AG Mengozzi in *Columbus Container* (n 2 above), paras [181–184].

<sup>33</sup> Case C-341/04 *Eurofood IFSC Ltd* [2006] ECR I-3813.

<sup>34</sup> *Cadbury Schweppes* (n 1 above), para [68].

<sup>35</sup> Council Regulation (EC) No 1346/2000 of 29 May 2000 on insolvency proceedings [2000] OJ L160/1, as amended.

<sup>36</sup> *Eurofood* (n 33 above), paras [34–36].

<sup>37</sup> See L De Broe, 'International Tax Planning and Prevention of Abuse under Domestic Law—Tax Treaties and EC Law: A Study of the Use of Conduit and Base Companies' (Doctoral Thesis, Katholieke Universiteit Leuven 2007) 567.

whether the facts are recharacterised in order not to be covered by the rule which would be applied otherwise. *Test Claimants in the Thin Cap Group Litigation* seems to be such a borderline case. For the Court, the arm's-length character of the transaction seems to be crucial and it remains unclear whether the Court permits the Member State to recharacterise the facts under its domestic law:<sup>38</sup>

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

As the Advocate General stated at point 67 of his Opinion, national legislation which provides for a consideration of objective and verifiable elements in order to determine whether a transaction represents a purely artificial arrangement, entered into for tax reasons alone, is to be considered as not going beyond what is necessary to prevent abusive practices where, in the first place, on each occasion on which the existence of such an arrangement cannot be ruled out, the taxpayer is given an opportunity, without being subject to undue administrative constraints, to provide evidence of any commercial justification that there may have been for that arrangement. [ . . . ]

In order for such legislation to remain compatible with the principle of proportionality, it is necessary, in the second place, that, where the consideration of those elements leads to the conclusion that the transaction in question represents a purely artificial arrangement without any underlying commercial justification, the re-characterisation of interest paid as a distribution is limited to the proportion of that interest which exceeds what would have been agreed had the relationship between the parties or between those parties and a third party been one at arm's length.

Other parts of the Court's reasoning in *Cadbury Schweppes* put emphasis on the object and purpose of the provisions at stake:<sup>39</sup>

It is necessary, in assessing the conduct of the taxable person, to take particular account of the objective pursued by the freedom of establishment. [ . . . ]

That objective is to allow a national of a Member State to set up a secondary establishment in another Member State to carry on his activities there and thus assist economic and social interpenetration within the Community in the sphere of activities as self-employed persons. [ . . . ] To that end, freedom of establishment is intended to allow a Community national to participate, on a stable and continuing basis, in the economic life of a Member State other than his State of origin and to profit therefrom. [ . . . ]

Having regard to that objective of integration in the host Member State, the concept of establishment within the meaning of the Treaty provisions on freedom of establishment involves the actual pursuit of an economic activity through a fixed establishment in that State for an indefinite period.

Since the ECJ had to apply the freedom of establishment, it examined the object and purpose of this freedom. One might wonder whether the Court would have arrived at different results had it had to apply other fundamental freedoms, such as the free movement of capital. It would probably refer to the object of assisting 'economic and social

<sup>38</sup> *Thin Cap* (n 2 above), paras [81–83].

<sup>39</sup> *Cadbury Schweppes* (n 1 above), paras [52–54].

interpenetration within the Community' as well. However, the free movement of capital is not necessarily intended to allow someone to participate 'on a stable and continuing basis' in the economic life of another Member State. Furthermore, this does not necessarily involve the actual pursuit of an economic activity 'through a fixed establishment in that State for an indefinite period'. One can therefore speculate whether the Court would define the phrase 'wholly artificial arrangement' in an even more restrictive way if it ever had to apply such deliberations under the free movement of capital and payments. In intra-group situations, the freedom of establishment prevails.<sup>40</sup> However, one cannot exclude that situations occur in which the free movement of capital is still applicable.

Overall, the approach followed by the ECJ is convincing. The Court identified the applicable provision—not only did it look at the letter of Article 43 EC [now Article 49 TFEU] but also at its object and purpose. In order to comprehensively determine the scope of the freedom of establishment, the Court actually took into account considerations inferred from the object and purpose of the provision. This corresponds to traditional legal methodology and is in line with general means of interpretation. The wording of a provision is only the starting point of its interpretation. One has to look at other aspects—like its object and purpose, its history, or its context—as well.<sup>41</sup>

However, in the light of these deliberations, it is remarkable that the Court has dealt with the artificiality of the arrangement at the level of justifications and proportionality and not when applying the freedom as such.<sup>42</sup> On the contrary, the Court even found it necessary to emphasise that:

[T]he fact that a Community national, whether a natural or a legal person, sought to profit from tax advantages in force in a Member State other than his State of residence cannot in itself deprive him of the right to rely on the provisions of the Treaty. [ . . . ]

As to freedom of establishment, the Court has already held that the fact that the company was established in a Member State for the purpose of benefiting from more favourable legislation does not in itself suffice to constitute abuse of that freedom (see, to that effect, *Centros*, paragraph 27, and Case C-167/01 *Inspire Art* [2003] ECR I-10155, paragraph 96). [ . . . ]

As noted by the applicants in the main proceedings and the Belgian Government, and by the Cypriot Government at the hearing, it follows that the fact that in this case CS [= Cadbury Schweppes] decided to establish CSTS and CSTI in the IFSC for the avowed purpose of benefiting from the favourable tax regime which that establishment enjoys does not in itself constitute abuse. That fact does not therefore preclude reliance by CS on Articles 43 EC and 48 EC (see, to that effect, *Centros*, paragraph 18, and *Inspire Art*, paragraph 98).<sup>43</sup>

It is not entirely clear why the ECJ did not consider the setting up of a wholly artificial arrangement an abuse of the fundamental freedoms, although in its own view, the object and

<sup>40</sup> See for example, *Cadbury Schweppes* (n 1 above), para [33], where the ECJ refers to Case C-36/02 *Omega Spielhallen- und Automatenaufstellungs-GmbH v Oberbürgermeisterin der Bundesstadt Bonn* [2004] ECR I-9609, para [27] (freedom to provide services vs free movement of goods); *Thin Cap* (n 2 above), para [34]. See also Case C-452/04 *Fidium Finanz AG v Bundesanstalt für Finanzdienstleistungsaufsicht* [2006] ECR I-9521, para [48] (freedom to provide services vs free movement of capital); Case C-492/04 *Lasertec Gesellschaft für Stanzformen mbH v Finanzamt Emmendingen* [2007] ECR I-3775, paras [18–26] (freedom of establishment vs free movement of capital).

<sup>41</sup> See for example, W Gassner, *Interpretation und Anwendung der Steuergesetze* (Vienna, Wirtschaftsverlag Orac 1972) 13; M Lang, 'Der Normgehalt des § 22 BAO' (2001) 4 *Österreichische Steuer-Zeitung* 65, 68.

<sup>42</sup> In favour of distinguishing between the level of the application of the freedoms and the level of justification and proportionality, D Weber, *Tax Avoidance and the EC Treaty Freedoms: A Study of the Limitations under European Law to the Prevention of Tax Avoidance* (The Hague, Kluwer Law International 2005) 76.

<sup>43</sup> *Cadbury Schweppes* (n 1 above), paras [36–38].

purpose of the freedom were relevant in this respect. In any case, because of this reasoning, the Court saw no need to distinguish its *Cadbury Schweppes* case law from judgments like *Centros* and *Inspire Art*. Although the level of analysis should not play a crucial role—the issues regarding the scope of the freedom, the search for a comparable situation and for an appropriate justification, and the proportionality test are closely interrelated<sup>44</sup>—examination of this issue at the justification level<sup>45</sup> seems to have made it easier for the Court to actually look at the least restrictive measure. Had the ECJ prevented taxpayers having set up ‘wholly artificial arrangements’ from benefiting from Community law at all, it might have had difficulties including the proportionality test in its deliberations. However, there is a big difference between *Centros* and *Inspire Art*, on the one hand, and *Cadbury Schweppes* and *Test Claimants in the Thin Cap Group Litigation*, on the other hand. In *Centros*, ‘the provisions of national law, application of which the parties concerned have sought to avoid, [were] rules governing the formation of companies and not rules concerning the carrying on of certain trades, professions or businesses’.<sup>46</sup> Denying a corporation access to the Internal Market by already considering the formation of a corporation a wholly artificial arrangement would have been more severe than examining the specific economic performance of the corporation. There is not necessarily a contradiction between these judgments. Accepting the formation of a legal entity under EU law does not prevent the Court from considering it a wholly artificial arrangement if specific activities are conducted through this entity. On the contrary, if the Court did not accept the validity of the formation of a legal entity that merely has its registered office in a Member State and that pursues its activities in another Member State, this would have prevented the Court from applying a differentiating approach when looking at these activities. Therefore, the assessment of the same arrangement could differ under tax law and under other areas of law. Considering an arrangement wholly artificial for tax purposes, and thus allowing CFC or thin capitalisation rules to apply, does not necessarily mean that the arrangement may as well be ignored for labour law or consumer protection law purposes.<sup>47</sup>

While the ECJ’s reasoning in *Cadbury Schweppes* with respect to the objective circumstances is convincing, it is less convincing that the Court asks for a subjective element as well.<sup>48</sup> Although the Court in *Cadbury Schweppes* does not spend much effort in explaining what is meant by the subjective criterion, it nevertheless mentions this additional requirement for considering an arrangement ‘wholly artificial’. Accounting for intentions is in line with *Emsland-Stärke* and *Halifax* as well.<sup>49</sup>

<sup>44</sup> See also M Lang, ‘Eine Wende in der Rechtsprechung des EuGH zu den direkten Steuern?’ in M Hebig, K Kaiser, K-D Koschmieder and M Oblau (eds), *Aktuelle Entwicklungsaspekte der Unternehmensbesteuerung: Festschrift für Wilhelm H Wacker* (Berlin, Erich Schmidt Verlag 2006) 365; M Lang, *Die Rechtsprechung des EuGH zu den direkten Steuern* (Frankfurt, Verlag Peter Lang GmbH 2007) 19; M Lang, ‘Die Rechtsprechung des EuGH zu den direkten Steuern—Planungssicherheit für den nationalen Gesetzgeber?’ in A Wagner and V Wedl (eds) *Bilanz und Perspektiven zum europäischen Recht—Eine Nachdenkschrift anlässlich 50 Jahre Römische Verträge* (Vienna, OGB Verlag 2007) 113, 123.

<sup>45</sup> For a discussion of the level at which the Court scrutinises the issue of tax avoidance, see also C Böing, ‘Der Begriff des steuerlichen Gestaltungsmissbrauchs im Gemeinschaftsrecht’ (2007) 18 *Europäisches Wirtschafts- und Steuerrecht*, 55, 58.

<sup>46</sup> Case C-212/97 *Centros Ltd v Erhvervs- og Selskabsstyrelsen* [1999] ECR I-1459, para [26].

<sup>47</sup> In *Cartesio*, AG Poiares Maduro had difficulty bringing the ECJ’s reasoning in *Cadbury Schweppes*, on the one hand, and *Centros* and *Inspire Art*, on the other hand, in line with each other. See the Opinion of AG Poiares Maduro in Case C-210/06 *Cartesio Oktató és Szolgáltató bt* [2008] ECR I-9641, para [26].

<sup>48</sup> See M Lang, ‘Rechtsmissbrauch und Gemeinschaftsrecht im Lichte von *Halifax* und *Cadbury Schweppes*’ [2006] *Steuer und Wirtschaft International* 273, 283.

<sup>49</sup> For a careful analysis of the Court’s case law on the subjective criterion, see Weber (n 42 above) 190.

In academic writing it had been observed that there has been a shift in emphasis in the Court's case law from a subjective application of the doctrine of abuse towards a more objective approach.<sup>50</sup> In *Halifax*, both the Advocate-General and the ECJ restricted the subjective test in *Emsland-Stärke* by elaborating the objective nature of the second limb: the state of mind of the taxpayer was no longer considered relevant. Instead, the 'essential aim' of the transactions must be apparent from a number of objective factors.

I have difficulty seeing a shift in case law. It is never possible to find out what the *real* intention of a human being is. One always has to look at the factual situation and try to discern why a human being acted in the way he or she did, but in the end, there is always a certain amount of guesswork involved. The well-advised taxpayer is always in a better situation, since he is able to structure his affairs in a way that establishes additional objective factors from which tax authorities or courts may draw different explanations.

However, it is doubtful whether intentions should indeed play a role as an additional requirement in order to assume that an arrangement is 'wholly artificial'. Taking into consideration the object and purpose of a law should be a regular part of any interpretation process. The relevance of this teleological factor should not depend on an additional subjective requirement. Irrespective of possible intentions, attention should be paid to the object and purpose of the law under consideration. The underlying assumption of the Court's judgment seems to be that the letter of the law should prevail over its object and purpose. From *Halifax*, one gets the impression that—in the Court's view—teleological interpretation and legal certainty contradict each other. The Court emphasised that the 'requirement of legal certainty must be observed [ . . . ] in order that those concerned may know precisely the extent of the obligations which they impose on them'<sup>51</sup> and thus defined abusive situations rather narrowly. However, focusing on the mere letter of the law does not provide ultimate legal certainty. On the contrary, the wording of a provision, if analysed carefully enough, usually leaves much room for heterogeneous results of interpretation. Taking into account the object and purpose of a provision, together with other means of interpretation, leads to a limitation of the number of possible different meanings. Therefore, the object and purpose of a provision should not only be taken into account if the subjective criterion is met but also in all other cases. Consequently, intention should not play a role as a separate criterion when determining the artificiality of an arrangement. It is not at all convincing to rely on the subjective element. If an arrangement is considered to be artificial, either because its real substance is different from what the taxpayer pretends it to be, or because—according to the object and purpose of the fundamental freedom—the situation should not be covered, it is difficult to understand why the legal consequence should depend on the taxpayer's intention. Again, this would mean that in other situations that would not be covered by the fundamental freedom concerned—according to the object and purpose of the EU law provision—that the benefit had to be granted, despite its artificiality, simply because no intention of the taxpayer to escape from the tax that is normally due was on hand or could be proven.

However, it should be taken into account that one does not necessarily have to conclude from cases like *Emsland-Stärke* that the intention of the economic operator is an independent criterion in order to determine an abusive situation. The Court expressed

<sup>50</sup> HL McCarthy, 'Abuse of Rights: The Effect of the Doctrine on VAT Planning' (2007) 2 *British Tax Review* 160, 163.

<sup>51</sup> *Halifax* (n 22 above), para [72].

the view that ‘the existence of that subjective element can be established, inter alia, by evidence of collusion between the Community exporter receiving the refunds and the importer of the goods in the non-member country’.<sup>52</sup> In the context of this judgment, determining the intention of the taxpayer was part of the necessary exercise of properly establishing the facts. In the case of evidence of collusion between the exporter and the importer, the whole transaction can be considered a sham transaction. Thus, one could conclude from carefully analysing the facts that there was neither an export nor an import of goods. The conditions necessary to be granted an export refund had not been met at all.

Since the relevance of the subjective criterion is controversial and, in my view, one cannot infer more from the remaining ‘objective’ criterion than that the fact pattern of a case has to be determined carefully and that the relevant provisions have to be interpreted in line with their object and purpose, it seems to be doubtful whether there is a specific *Cadbury Schweppes* line of case law. It is more convincing to take the position that ‘wholly artificial arrangements’ have to be ignored since they are not covered under the relevant provisions of EU law, either because a thoroughful characterisation of the facts shows that the factual situation is different than originally assumed, or the provisions, interpreted in the light of their object and purpose, are not applicable. This leads to the result that there is no specific abuse concept in European law. Attempts to circumvent the law have to be caught in exactly the same way as has been done for centuries in other areas of law: by means of proper interpretation. However, if one, contrary to the position taken here, assumes that there is something like a specific abuse concept in EU law, then one has to deal with the question of its impact on the domestic law of the Member States. This will be done, as a mere thought experiment, in Part III below.

### III. IMPACT OF *CADBURY SCHWEPPE*S CASE LAW ON THE MEMBER STATES

#### A. *EU Law and Domestic Law*

The answer to both the question whether the *Cadbury Schweppes* line of case law has impact on the domestic law of the Member States and the question whether EU law has impact on the domestic law of the Member States is identical: ‘that depends’. It is clear that domestic law has to be in accordance with EU law. However, not all domestic rules are predetermined by European law. As far as EU law precisely describes what the context of domestic law has to be, there is no leeway for the domestic legislator to make its own policy decisions. In some areas, directives are so precise that they do not leave any room for domestic policy decisions. As far as EU law does not contain precise rules which have to be implemented by the domestic legislator, the domestic legislator is free to make its policy decision, as long as it pays attention to EU law requirements. These EU law requirements might stem from directives as well as from primary European law, eg the freedoms or the state aid provisions.

Where the Court’s case law on ‘wholly artificial arrangements’ is relevant to the application of a precise EU law rule which has to be implemented by the domestic

<sup>52</sup> *Emsland-Stärke* (n 19 above), para [53]. See also Case C-279/05 *Vonk Dairy Products BV v Productschap Zuivel* [2007] ECR I-0239, para [33], a case that also concerns the abuse of rights under secondary Community legislation in the field of agriculture.

legislator and does not leave room for the domestic legislator to make a policy decision of its own, this case law—whatever its content really is—has to be implemented into domestic law as well. On the other hand, if the case law on ‘wholly artificial arrangements’ has the effect of an exception to the principal EU law requirements that have to be met by domestic law, it is up to the domestic legislator to decide what to do. If the domestic legislator refuses to grant a certain benefit to a foreign taxpayer, or grant a benefit for foreign income which is usually granted to domestic taxpayers or domestic income, such a treatment does not constitute any infringement of the freedoms in the case of a ‘wholly artificial arrangement’. However, if the domestic legislator is generous enough to grant these benefits even in cases of ‘wholly artificial arrangements’, this does not constitute any infringement of EU law either. Therefore the domestic legislator is free to exclude ‘wholly artificial arrangements’ when granting these benefits but is not forced to do so.

The same is true when courts, in finally deciding the case they had referred to the Court, are forced to implement a judgment of the Court on the basis of its preliminary ruling.<sup>53</sup> Whenever a judgment of the Court leaves room for more than one solution, it is up to the domestic court to decide on one of the solutions to create domestic law that is in line with the Union requirement. Of course, the domestic legislator may decide for another solution, equally in line with EU law, for the future. However, for the case which was the reason for the referral, and for all other cases which are not yet covered by an explicit rule of the legislator, the domestic court has room to decide on the solution that is in line with the constitutional and other requirements of the domestic system of the Member State and which fits best with other rules of that State. In *Gebrüder Lück* the ECJ repeated the request of the domestic court and provided immediately the answer:<sup>54</sup>

The third question seeks a clarification of the consequences of the precedence of Community law, that is to say, in the present case, Article 95 of the [EEC] Treaty [later Article 90 EC and now Article 110TFEU], with regard to the provisions of national law incompatible with it. The point of the question is in particular whether the national court must hold such provisions inapplicable to the extent to which they are incompatible with Community law or whether it must declare them void as from the expiry of the period prescribed by the third paragraph of Article 95. [. . .]

Although Article 95 of the Treaty has the effect of excluding the application of any national measure incompatible with it, the article does not restrict the powers of the competent national courts to apply, from among the various procedures available under national law, those which are appropriate for the purpose of protecting the individual rights conferred by Community law. Particularly when an internal tax is incompatible with the first paragraph of Article 95 only beyond a certain amount, it is for the national court to decide, according to the rules of its national law, whether the illegality affects the whole tax or only so much of it as exceeds that amount. Accordingly, it is for the court making the reference to choose a solution from among those suggested in the question and, indeed, any others.

This had been confirmed in *Iannelli & Volpi*:<sup>55</sup>

It is nevertheless for the national court within the framework of its own legal system to decide whether the whole of any internal taxation which is discriminatory within the meaning of Article 95 or only that part of it which exceeds the tax assessed on the domestic product is to be regarded as not payable.

<sup>53</sup> See also S Douma, ‘Doorwerking van rechtspraak van het HvJ EG in de nationale rechtsorde’ (2008) 137 *Weekblad Fiscaal Recht* 1178 and oral presentation at PwC-WU Seminar on 4 December 2008 in Vienna.

<sup>54</sup> Case 34/67 *Firma Gebrüder Lück v Hauptzollamt Köln-Rheinau* [1968] ECR 245, 251.

<sup>55</sup> Case 74/76 *Iannelli & Volpi SpA v Ditta Paolo Meroni* [1977] ECR 557.

In *IN.CO.GE* the ECJ developed this line of reasoning further:<sup>56</sup>

It cannot therefore, contrary to the Commission's contention, be inferred from the judgment in *Simmenthal* that the incompatibility with Community law of a subsequently adopted rule of national law has the effect of rendering that rule of national law non-existent. Faced with such a situation, the national court is, however, obliged to disapply that rule, provided always that this obligation does not restrict the power of the competent national courts to apply, from among the various procedures available under national law, those which are appropriate for protecting the individual rights conferred by Community law (see Case 34/67 *Lück v Hauptzollamt Köln-Rheinau* [1968] ECR 245).<sup>57</sup>

### *B. Obligation to Implement the Court's Abuse Concept*

Although the Court in *Halifax* mentions the phrase 'abusive practice' and not 'wholly artificial arrangements', this judgment may serve as an example for a situation where Member States are obliged to implement an abuse concept the Court developed. In *Halifax*, the referring court wanted to ascertain under what conditions VAT may be recovered where an abusive practice has been found to exist. The ECJ noted at the outset that no provision of the Sixth Directive deals with the recovery of VAT:

That directive merely defines, in Article 20, the conditions which must be complied with in order that deduction of input taxes may be adjusted at the level of the person to whom goods or services have been provided (see the order of 3 March 2004 in Case C-395/02 *TransportService* [2004] ECR I-1991, paragraph 27). [ . . . ]

It is therefore, as a rule, for the Member States to lay down the conditions under which the tax authorities may recover VAT after the event, while remaining within the limits imposed by Community law (*TransportService*, paragraph 28). [ . . . ]

It is important, however, to note in that respect that the measures which the Member States may adopt under Article 22(8) of the Sixth Directive in order to ensure the correct levying and collection of the tax and for the prevention of fraud must not go further than is necessary to attain such objectives (see *Gabalfrisa and Others*, paragraph 52, and the order in *Transport Service*, paragraph 29). They may not therefore be used in such a way that they would have the effect of undermining the neutrality of VAT, which is a fundamental principle of the common system of VAT established by the relevant Community legislation (see Case C-454/98 *Schmeink & Cofreth and Strobel* [2000] ECR I-6973, paragraph 59). [ . . . ]

It must also be borne in mind that a finding of abusive practice must not lead to a penalty, for which a clear and unambiguous legal basis would be necessary, but rather to an obligation to repay, simply as a consequence of that finding, which rendered undue all or part of the deductions of input VAT (see, to that effect, *Emsland-Stärke*, paragraph 56). [ . . . ]

It follows that transactions involved in an abusive practice must be redefined so as to re-establish the situation that would have prevailed in the absence of the transactions constituting that abusive practice. [ . . . ]

In that regard, the tax authorities are entitled to demand, with retroactive effect, repayment of the amounts deducted in relation to each transaction whenever they find that the right to deduct has been exercised abusively (*Fini H*, paragraph 33). [ . . . ]

<sup>56</sup> Joined Cases C-10/97 to C-22/97 *Ministero delle Finanze v IN.CO.GE. '90 Srl et al* [1998] ECR I-6307, para [21].

<sup>57</sup> See Case C-309/06 *Marks & Spencer plc v Her Majesty's Commissioners of Customs and Excise* [2008] ECR I-2283, para [64].

However, they must also subtract therefrom any tax charged on an output transaction for which the taxable person was artificially liable under a scheme for reduction of the tax burden and, if appropriate, they must reimburse any excess. [ . . . ]

Similarly, it must allow a taxable person who, in the absence of transactions constituting an abusive practice, would have benefited from the first transaction not constituting such a practice, to deduct, under the deduction rules of the Sixth Directive, the VAT on that input transaction. [ . . . ]

It follows that the answer [ . . . ] must be that, where an abusive practice has been found to exist, the transactions involved must be redefined so as to re-establish the situation that would have prevailed in the absence of the transactions constituting that abusive practice.<sup>58</sup>

In essence, the Court requires the domestic authorities to apply the abuse concept developed by it, since the rules of the VAT Directives do not give any room to the domestic legislator to decide the question itself who should benefit or suffer from VAT rules.

As far as the case is concerned, in which the referring court had to deal with the issue, the court complies with EU law if it applies this concept directly. However, as the Court's case law requires the concept to be expressly implemented into domestic law, it is necessary to create a legal basis for the application of this concept in these cases. In countries where the concept developed by the Court is identical with unwritten interpretation principles, an explicit provision will not be needed. However, in countries where such principles do not exist, it might be necessary to introduce an explicit statutory provision.

It has been submitted in academic writing that it should make a difference whether the Court decides a case at the level of justification or at the level of proportionality. If the ECJ had concluded that the UK CFC provisions were not fit for their avowed purpose and therefore could not be objectively justified, the provisions would be precluded from being applied. Since the Court held it was not disproportionate to apply these provisions in the case of 'wholly artificial arrangements', domestic courts seem to be free to apply these provisions to 'wholly artificial arrangements'.<sup>59</sup> However, in my view, this does not make a difference. The level of justification and the level of proportionality are exchangeable. The Court could either hold that there are two different cross-border situations: A (no wholly artificial arrangement) and B (wholly artificial arrangement), and in situation B there is a justification for a worse treatment, while in situation A there is none, or the Court could hold that a worse treatment is justified insofar as the arrangement is wholly artificial. There is no difference in substance between presenting the issue at the justification or the proportionality level. In both examples, EU law neither prevents the domestic legislator from treating wholly artificial arrangements in cross-border situations as worse than other domestic transactions, nor forces the domestic legislator to do so. From a *domestic* point of view there could be valid reasons to reduce the scope of a provision which provides worse treatment for cross-border situations to wholly artificial arrangements. There is no need to go beyond what EU law requires. However, some courts seem to take the view that there are valid reasons not to apply such a provision at all and let the legislator make the law. One could never be sure whether reducing the scope of such a provision to wholly artificial arrangements would really have been the second best solution in the eyes of the legislator, had he anticipated that CFC regulations may only cover wholly artificial arrangements. The legislator could also have chosen to limit

<sup>58</sup> *Halifax* (n 22 above), paras [90–98].

<sup>59</sup> S Whitehead, 'Practical Implications Arising from the European Court's Recent Decisions Concerning CFC Legislation and Dividend Taxation' (2007) 16 *EC Tax Review* 176, 182.

its CFC legislation even further or not to apply any such CFC provision or to combat aggressive tax planning by other means. Thus, it could be seen as ‘judicial self-restraint’ not to apply the CFC rules at all, in order to avoid the implication that the law is designed by judges. Instead, it may force the legislator to take action himself. In any case, how a domestic judge implements a judgment of the Court is not a question of EU law but of domestic law.

The England and Wales High Court (Chancery Division) was obviously guided by the idea of judicial self-restraint when it decided that the UK CFC rules, as an immediate consequence of ECJ’s judgment in *Cadbury Schweppes*, may not be applied at all in *Vodafone 2*.<sup>60</sup> Judge Evans-Lombe gave the following explanation:

It seems to me that all UK taxpayers, including Vodafone, were and are entitled to be told by legislation, of which the meaning is plain, what the tax consequences for them will be if they decide to incorporate a CFC in a Member State. As it stands, unamended, Section 748(3), although its meaning, on the basis of conventional methods of construction, is plain, when viewed against the background of Article 43, is wholly misleading as to its actual effect brought about by the operation of Section 2 of the European Communities Act 1972. The CFC legislation and the motive test are of potentially wide application throughout the UK business world. To adapt the speech of Lord Hope in that case, the nature of the defect [in Section 748(3)] is such that a single solution is required that can reasonably be applied to all taxpayers. That can only be done by Parliament, or possibly by appropriate executive steps as was suggested by the House of Lords in the *Fleming* case. [ . . . ] In my judgment the CFC legislation, which depends on Section 747 and Section 748 for its effectiveness, must be disapplied so that, pending such amending legislation or executive action, no charge can be imposed on a company such as Vodafone under the CFC legislation. It follows that HMRC’s enquiry into Vodafone’s tax return for the Accounting Period has no legitimate purpose and should be closed.

However, there is also case law which illustrates that the Court sometimes is concerned with how an EU law obligation is implemented into domestic law and considers this to be a question of EU law as well.<sup>61</sup> The Court seems to demand that the domestic legislator create a proper legal basis in order to implement the requirements which it has imposed. This could be seen as contradictory if one assumes that the mode of implementation is up to domestic law. However, the Court’s judgment in *Biehl II* has to be understood to be exceptional. In this case, the ECJ seemed to be concerned that the domestic legislator ignored its judgment. Therefore, the Court did not accept the explanation provided by the domestic legislator that equity measures were applied in order to ensure the application of the freedoms.

In practice, if a domestic legislator is required to draft a provision which implements the Court’s case law, this exercise can be quite difficult since the content of the rules developed by Court are by no means clear. There are other examples, such as the implementation of the *Scorpio*<sup>62</sup> judgment, which illustrate that the legislator might be tempted to simplify this task by copying the phrases of the relevant judgment.<sup>63</sup> However, such a technique does not necessarily simplify life for the taxpayer, since all the ambiguity of the judgment has to be borne directly by him. Furthermore, by deliberately using a phrase stemming

<sup>60</sup> *Vodafone 2 v Her Majesty’s Revenue and Customs Commissioners* [2008] EWHC 1569 (Ch).

<sup>61</sup> Case C-151/94 *Commission v Luxembourg (Biehl II)* [1995] ECR I-3699, para [18].

<sup>62</sup> Case C-290/04 *KP Scorpio Konzertproduktionen GmbH v Finanzamt Hamburg-Eimsbüttel* [2006] ECR I-9461.

<sup>63</sup> See Sec 99 par 2 number 2 of the Austrian Income Tax Act (‘mitteilen’).

from a judgment of the Court, the interpretation of this phrase might become a question of interpretation of EU law as well. Thus, domestic courts might become enabled or even obliged to refer such an issue to the Court of Justice.

A closer look at the Sixth VAT Directive, which had to be interpreted in *Halifax*, illustrates that the question whether there is an EU law obligation to implement certain rules is even more complex than indicated before. The VAT Directive contains some provisions which give room for domestic tax policy decisions. For example, Article 28(2)(a) of the Directive allows pre-existing exemptions to be maintained. In such a situation, as long as the EU law requirements are not in question, the interpretation of the relevant domestic provisions is in the exclusive competence of the domestic court and is not influenced by EU law. Therefore, there is no need to apply the abuse concept of the Court's case law.<sup>64</sup>

### C. No Obligation to Implement the Court's Abuse Concept

There are, however, other legal situations where there is no obligation for Member States to implement anti-abuse concepts developed by the Court of Justice. The Merger Directive may serve as an example. In *Kofoed*,<sup>65</sup> the referring Danish court asked whether the tax authorities may react to a possible abuse of rights, even though the national legislature has not enacted specific measures to transpose Article 11 of Directive 90/434.<sup>66</sup> The ECJ replied as follows:

Under Article 11(1)(a) of Directive 90/434, by way of exception and in specific cases, Member States may refuse to apply or withdraw the benefit of all or any part of the provisions of that directive, inter alia, where the exchange of shares has tax evasion or tax avoidance as its principal objective or as one of its principal objectives. That same provision also provides that the fact that the operation is not carried out for valid commercial reasons, such as the restructuring or rationalisation of the activities of the companies participating in the operation, may constitute a presumption that the operation has such an objective (see, to that effect, *Leur-Bloem*, paragraphs 38 and 39). [ . . . ]

Thus, Article 11(1)(a) of Directive 90/434 reflects the general Community law principle that abuse of rights is prohibited. Individuals must not improperly or fraudulently take advantage of provisions of Community law. The application of Community legislation cannot be extended to cover abusive practices, that is to say, transactions carried out not in the context of normal commercial operations, but solely for the purpose of wrongfully obtaining advantages provided for by Community law (see, to that effect, Case C-212/97 *Centros* [1999] ECR I-1459, paragraph 24; Case C-255/02 *Halifax and Others* [2006] ECR I-1609, paragraphs 68 and 69; Case C-456/04 *Agip Petroli* [2006] ECR I-3395, paragraphs 19 and 20; and Case C-196/04 *Cadbury Schweppes and Cadbury Schweppes Overseas* [2006] ECR I-7995, paragraph 35). [ . . . ]

As indicated by the Advocate General in point 59 of her Opinion, it is true that, in the main proceedings, there is some evidence which might justify application of Article 11(1)(a) of Directive 90/434. [ . . . ]

However, it is necessary, as a preliminary issue, to determine whether, in the absence of a specific transposition provision transposing Article 11(1)(a) of Directive 90/434 into Danish law, that provision may nevertheless apply in the case in the main proceedings. [ . . . ]

<sup>64</sup> McCarthy (n 50 above) 168.

<sup>65</sup> Case C-321/05 *Hans Markus Kofoed v Skatteministeriet* [2007] ECR I-5795.

<sup>66</sup> Council Directive 90/434/EEC of 23 July 1990 on the common system of taxation applicable to mergers, divisions, transfers of assets and exchanges of shares concerning companies of different Member States (Merger Directive) [1990] OJ L225/1–5.

In that regard, it should be borne in mind that, according to Articles 10 EC and 249 EC [now in essence Articles 4(3) TEU and 288 TFEU], each of the Member States to which a directive is addressed is obliged to adopt, within the framework of its national legal system, all the measures necessary to ensure that the directive is fully effective, in accordance with the objective that it pursues [ . . . ].

Moreover, the principle of legal certainty precludes directives from being able to create obligations for individuals by themselves. Directives cannot therefore be relied upon per se by the Member State as against individuals [ . . . ].

However, the Court observes, first, that, according to the actual wording of the third paragraph of Article 249 EC, Member States may choose the form and methods for implementing directives which best ensure the result to be achieved by those directives (see, to that effect, *Commission v Italy*, paragraph 51). [ . . . ]

Accordingly, provided that the legal situation arising from the national transposition measures is sufficiently precise and clear and that the persons concerned are put in a position to know the full extent of their rights and obligations, transposition of a directive into national law does not necessarily require legislative action in each Member State. Likewise, as noted by the Advocate General in point 62 of her Opinion, the transposition of a directive may, depending on its content, be achieved through a general legal context, so that a formal and express re-enactment of the provisions of the directive in specific national provisions is not necessary [ . . . ].

The Court notes, second, that all authorities of a Member State, in applying national law, are required to interpret it as far as possible in the light of the wording and purpose of the Community directives in order to achieve the result pursued by those directives. Moreover, although it is true that the requirement of a directive-compliant interpretation cannot reach the point where a directive, by itself and without national implementing legislation, may create obligations for individuals or determine or aggravate the liability in criminal law of persons who act in contravention of its provisions, a Member State may nevertheless, in principle, impose a directive-compliant interpretation of national law on individuals (see, to that effect, *Kolpinghuis Nijmegen*, paragraphs 12 to 14, and *Arcaro*, paragraphs 41 and 42). [ . . . ]

As noted by the Advocate General in point 63 of her Opinion, in the main proceedings it is therefore for the national court to ascertain whether there is, in Danish law, a provision or general principle prohibiting abuse of rights or other provisions on tax evasion or tax avoidance which might be interpreted in accordance with Article 11(1)(a) of Directive 90/434 and thereby justify taxation of the exchange of shares in question (see also Case 8/81 *Becker* [1982] ECR 53, paragraph 34). [ . . . ]

If so, it will be for the national court to determine whether the conditions for the application of those national provisions are satisfied in the main proceedings.<sup>67</sup>

According to the ECJ's reasoning in *Kofoed*, the absence of a Danish provision which denies the benefits of the Merger Directive to certain abusive practices would not constitute an infringement of EU law. This view is convincing: Article 11(1)(a) of the Directive does not require the Member States to exclude abusive practices from benefits the Merger Directive would provide for. According to the provision, a 'Member State may refuse to apply or withdraw the benefit of all or any part of the provisions of Titles II, III and IV where it appears that the merger, division, transfer of assets or exchange of shares [ . . . ] has as its principal objective or as one of its principal objectives tax evasion or tax avoidance.' There is no obligation for Member States to implement that exception. Such situations, as mentioned in Article 11(1)(a) of the Directive, are outside the scope of the Directive. According to the system of the Directive, no Member State is prevented from being more generous than is required by the Directive. Therefore,

<sup>67</sup> *Kofoed* (n 65), paras [37–47].

there is no breach of EU law if a Member State refrains from implementing the exception for abusive situations.<sup>68</sup> However, if a Member State exercises its right under the Directive to exclude abusive practices from the benefits granted by the Directive, it has to pay attention to the interpretation of Article 11(1)(a) provided by the Court. That does not mean that referring to the case law of the Court is the only way to implement this provision in domestic law. Member States may exclude only some of the abusive practices covered by Article 11(1)(a) of the Directive. However, they must not go beyond this provision.

The same is true under the freedoms. In *Cadbury Schweppes*, the ECJ made it clear that Member States may only cover 'wholly artificial arrangements' under their CFC regimes. The phrase 'wholly artificial arrangements' has to be understood in the way it has been interpreted by the Court. However, no Member State is obliged to have a CFC regime at all. It is perfectly in line with EU law not to allocate foreign passive income channelled through a legal entity established in a low tax jurisdiction within the EU to the domestic shareholder, even if such an arrangement would qualify as 'wholly artificial'. Neither does a domestic provision constitute an infringement of EU law if its content remains below the threshold of 'wholly artificial arrangements'. However, such a provision has to be interpreted in conformity with EU law, and particularly the Court's case law, as its scope could otherwise reach beyond 'wholly artificial arrangements'. One way to interpret a CFC provision in accordance with EU law is to interpret this provision beyond the scope of 'wholly artificial arrangements' as a presumption which can be rebutted. From *Test Claimants in the Thin Cap Group Litigation* we learned that such presumptions do not necessarily constitute an infringement of the freedoms as long as 'the taxpayer is given an opportunity, without being subject to undue administrative constraints, to provide evidence of any commercial justification that there may have been for that arrangement'.<sup>69</sup> So under EU law, domestic CFC rules may survive, if they can be understood as just shifting the burden of proof to the taxpayer in situations beyond 'wholly artificial arrangements' and only covering 'wholly artificial arrangements'. However, the question whether the methods of interpretation permit alteration of CFC rules in such a dramatic way, or whether those CFC rules must first be left to one side and then changed, is a question of domestic law and not of EU law. EU law is neutral as far as the techniques of its implementation into domestic law are concerned. If domestic law has to be ignored insofar as it contradicts European law, it is also a question of domestic law whether CFC rules still may be applied on 'wholly artificial arrangements' or whether CFC rules may not be applied at all, since no explicit legal basis exists for the application of such rules merely for 'wholly artificial arrangements'.

<sup>68</sup> According to Kromann Reumert ('Recent Danish Tax Developments 2008', 26) the Danish Ministry of Finance announced that it would not seek a ruling on this issue from the domestic court that had referred the case to the ECJ. The Ministry settled the case in favour of Mr Kofoed. In its announcement, the Ministry stated that the decision to settle the case was based on the fact that the National Tax Tribunal in a ruling from 1999 had stated that Article 11(1)(a) of the Merger Directive could not be relied upon by the Danish tax authorities as long as Article 11(1)(a) of the Directive had not been transposed into Danish law. In the opinion of the Danish ministry of taxation, this ruling prevented the Ministry from seeking a ruling against Mr Kofoed.

<sup>69</sup> *Thin Cap* (n 2 above), para [82].

## IV. CONCLUSION

It is not at all clear whether it is justified to refer to the *Cadbury Schweppes* line of case law as far as wholly artificial arrangements are concerned. The abuse concept developed by the Court of Justice concentrates on the object and purpose of the law. It is not required under EU law to extend a benefit which seems to be granted under the wording of a certain provision to situations where the object and purpose of the provision does not permit its application. However, this is not at all surprising. The Court implicitly has taken the position that the wording of a provision is not the end of the interpretation process, but only the starting point. First of all, determining the wording of a provision almost always requires taking into account the history of the provision, the other rules in which the provision is embedded, and the object and purpose of the provision. Therefore it is difficult to see whether there can be a clear meaning at all of the wording as such. Secondly, in order to interpret a provision, one may be required to set aside the wording if the object and purpose of the provision, or other aspects which are relevant in the interpretation process, lead in a different direction. Since the Court follows these interpretation rules regularly, the *Cadbury Schweppes* case law does not seem to be special. However, it is difficult to explain why the Court also developed a subjective criterion in this situation; it does not seem convincing that the object and purpose of the law be taken into account if it can be shown that taxpayers have the intention to circumvent the law if such subjective criteria is not applied to other situations as well.

However, if one accepts that there is a specific *Cadbury Schweppes* case law, according to which, certain situations are qualified as ‘wholly artificial arrangements’, the consequences may differ from the context of EU law. If, as it is the case under the VAT Directive, Member States are required to refuse certain benefits in situations which are considered to be abusive, they have to implement the case law of the Court. However, if Member States may only deny benefits without being obliged to do so, there is no need to implement the case law of the Court in this context. Nothing prevents the Member States from being more generous to taxpayers than is required under the Merger Directive or the freedoms.