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THE GENERAL ANTIAVOIDANCE RULE IN TAX LAW: COMPARING DIFFERENT MODELS AND COMMON FEATURES

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Summary

The aim of this research is to investigate the structure and role of a statutory general anti-avoidance rule (GAAR) in the Italian tax system also in the light of the judicial principle of abuse of law developed by the Supreme Court and with a view on the different GAARs enforced by other selected countries.

The first Chapter of the thesis addresses some preliminary issues regarding the general conditions for a GAAR to be enforceable in the Italian tax system. Firstly, it is clarified that a "general rule" is to be intended as a rule which captures a large range of cases and that it is formulated in a way which do not lends itself quite readily and directly the conditions for its application as the task of specifying the content of the rule itself is left to the legal practice. Secondly, it is noted that this kind of rules appears quite useful in the field of taxation as they contribute both to the flexibility of the system and to discourage aggressive tax planning which takes advantage of a specifically targeted rather than purposive legislation. In this respect it is argued that "general rules" are in principle compliant with the principle of legality governing the tax system as their application is still based on statutory interpretation without the need to refer to social standards or to alter the taxable facts defined by the Parliament. Thirdly, it is argued that a "general anti-avoidance rule" can be considered to be compliant with the fundamental principles governing the Italian tax system as long as it is broadly based on the *fraus legi* doctrine. The alternative approach based on the U.S. *economic substance doctrine* would lead to a potential breach of the principle of legality provided by art. 23 Cost. as it entails that taxable facts can be reconstructed by tax authorities relying on their economic similarities notwithstanding the legal form considered by the Parliament. At the same time a different approach based on the *substance over form doctrine* as developed by U.K. Courts, even if could be considered in line with the requirements of art. 23 Cost., appears unsatisfactory because it addresses tax avoidance in terms of statutory interpretation and this would conflate tax avoidance with tax evasion. Thus, it is concluded that in order to respect the principle of legality while keeping tax avoidance separated from tax evasion it is preferable to ground the GAAR on the *fraus legi* doctrine.

In relation to the above, Chapter I is also dedicated to understand how *fraus legi* has been intended to operate in the field of tax law and, more specifically, how it was conceived to count as a basis for a suitable statutory GAAR. The last paragraphs of the Chapter at hand are dedicated to illustrate how different countries developed their own approach to the GAAR. In this respect it is concluded that no uniform GAAR model exists, although there are several recurring design features that may be considered as "leading practices".

In this respect it is observed that most GAARs have some common design features which require some combination of the following elements: a) identification of a scheme or arrangement; b) doctrine to be used for the identification of tax avoidance (*fraus legi*, *abuse of law*, *economic substance*); c) some form of "test" to be used to assess whether a scheme or arrangement is to be qualified as tax avoidance under b).

With reference to a) it is argued that there is a wide consensus among GAARs as it is predominant the use of the terms "scheme" or "arrangement" as catch-all concepts to ensure that GAAR applies to all possible kind of transactions and acts.

The major differences between GAAR appear to be related to point b) and c). In fact, civil law countries – like Spain, Belgium and France – mainly rely on the *fraus legi* doctrine, and more recently on the concept of "abuse of law" (even is interpreted broadly), whereas common law countries – like Australia, New Zealand and South Africa – typically refer to the economic substance doctrine with some exception, like in Canada, where the GAAR is intended to operate in the light of a purposive approach to interpretation of statutes. Furthermore, in common law countries a GAAR – especially in Australia and New Zealand – is assumed to operate as a "taxing provision" (i.e. as an autonomous source of taxation) which applies where all the other tax rules fail provided that a transaction has tax avoidance as its main purpose and it is reasonable that in the circumstances under scrutiny the tax burden would have been higher. On the contrary, for civil law countries – like Spain and France – a GAAR is not intended as a taxing provision, since, coherently with the *fraus legi* doctrine, tax authorities are requested to apply only those specific tax rules that result to be circumvented.

However, under some GAARs – like in Canada, South Africa and India –, it is included a "misuse or abuse provision" which, like in civil law GAAR, requires an arrangement to produce tax results that are not consistent with the object, spirit or purpose of a particular tax provision or treaty before GAAR can be applied. Similarly, the recent GAAR enacted in UK with Finance Act 2013 is based on the concept of abuse of law.

On this basis it is argued that, notwithstanding the difference between common law and civil law GAARs, it could be observed an "hybrid approach" in GAAR designing.

In Chapter II it is investigated the particular approach to GAAR designing followed by the Italian Parliament. In this respect it is pointed out that, thought during the '80s some attempts to introduce a GAAR were developed, the Italian Parliament was traditionally reluctant to introduce such a rule as it was considered to impair the certainty and stability of the tax system. In fact, with art. 10 of Law n. 408/1990 it was enacted only a "targeted" general anti-avoidance rule which allowed tax authorities to deny those tax benefits obtained in specific transactions, like merger, transformation, demerger, capital reduction, liquidation, valuation of partnerships, provided that they were realized without sound business reasons and

for the sole purpose of fraudulently obtaining a tax saving. As expected the approach followed by the Parliament was largely inspired by the *fraus legi doctrine,* although it incorporated a "business purpose test" similar to the one developed by the U.S. jurisprudence which was also already adopted by art. 11, para. 1(a), of the "Merger Directive" n. 434/1990. This approach was maintained with the new GAAR adopted by the Parliament with art. 37-bis of the Presidential Decree n. 600/73 and which was enacted by Law n. 358/1997.

In fact, also art. 37-bis was based on the *fraus legi* doctrine and incorporated a business purposes test and its applicability was restricted only to certain transaction. In particular, the first para. of article 37-bis, which is formulated like a *Generalklausel,* provides that three criterion must be fulfilled in order to determine the existence of a tax-avoidance transaction: (a) the circumvention of obligations/prohibitions; (b) the obtaining of a tax reductions/refunds otherwise not due; (c) the lack of business purpose (other than tax savings). However, in comparison to art. 10, Law n. 408/1990, art. 37-bis introduced an important innovation as it requires tax authorities to respect a specific procedure to apply art. 37-bis. This procedure aims at safeguarding taxpayers from a discretionary usage of art. 37-bis which in fact put a strong assessment power in the hands of tax authorities.

In relation to the functioning of art. 37-bis some points are raised as to whether it could be intended as a "rule governing the interpretation of other tax rules" and as a rule that makes implicit reference to the "abuse of legal forms" criterion.

With reference to the first issue it is observed that for a scholar this should entail that art. 37-bis is based on the *analogia* so that it plays a role similar to that of Art. 12, "Provision on the Law in General", c.c. in private law. However, some doubts are raised about this approach since the use of analogy presupposes that art. 37-bis could be used to tax facts that otherwise would be untaxable and this appears to be in breach of the principle of legality set forth by Art. 23 Cost. So it is concluded that it is preferable to understand art. 37-bis in terms of *fraus legi* rather than by way of *analogia*.

In relation to the potential role of the criterion of the "abuse of legal forms" it is concluded that it appears to be at the heart of art. 37-bis functioning. In fact, due to the structure of our tax system, tax avoidance is possible mainly because by adopting certain legal forms the taxpayer can duly realize those taxable fact which reduce his tax burden; however, this is not sufficient to have a tax avoidance transaction to the effect of art. 37-bis: it is also required that those legal forms are implemented without a sound business reason; thus, if also this condition obtains it can be said that these legal forms have been abused as they were used for no *bona fide* reasons. In this respect it is also observed that this reasoning leads to the further conclusion that the business purpose test (as well as the criterion of economic substance) should not be considered as strictly opposed

to the “abuse of legal form” criterion, as they turn out to be two sides of the same coin.

In the last paragraphs of Chapter II the overall procedure to assess tax avoidance under art. 37-bis is examined, also in connection with some challenges posed by the Supreme Court.

In this respect it is remarked that the above procedure represent an essential feature of art. 37-bis which cannot be replaced by other procedure provided by the system as under the procedure at hand taxpayer are not simply encouraged to collaborate with tax authorities but they are offered the chance to defend themselves before the notice of assessment is issued.

Chapter III of the thesis is dedicated to the principle of abuse of law, as developed by the European Court of Justice (ECJ) and by the Italian Supreme Court. In this respect, it is firstly clarified that the ECJ’s concepts of abuse of law generally relies on the criterion of “wholly artificial arrangement” (i.e. arrangement not supported by an adequate economic substance) to separate legitimate from impermissible tax planning activities.

Therefore, Member State have been progressively induced to rely on such a criterion to safeguard the compatibility with EU law of the domestic GAARs from which may derive a restriction to the Treaty freedoms or of other rights provided by EU law.

On this basis it is therefore to be understood the first attempt of the Italian Supreme Court to combat tax avoidance on a general basis relying of the ECJ’s principle of abuse of law. However, the Supreme Court quickly acknowledged that the ECJ’s principle could be hardly applied to purely domestic cases where no community law of Treaty freedom was at issues. Therefore, at the end of 2008 the Supreme Court relied on art. 53 Cost. to introduce a domestic principle of abuse of law. In particular, this principle is considered by the Court as an immanent principle of the tax law, thus applicable retrospectively and to all kind of transactions, which precludes the taxpayer to obtain tax savings through the misuse of legal forms in line with law provisions but aimed to obtain tax benefits or tax savings in the lack of significant business reasons.

One of the main issues posed by the introduction of the principle of abuse of law by the Italian Supreme Court regards its relationship with art. 37-bis. For the Court, in fact, the principle at hand represents an unwritten anti-avoidance rule which applies generally, whereas art. 37-bis is limited only to certain transactions, and that can be invoked *ex officio* by the judge, whilst art. 37-bis can be duly applied only if the aforementioned safeguard procedure is respected. This reveals that the principle at hand clearly frustrates the Parliament’s attempt, which is at the heart of art. 37-bis, of balancing tax authorities’ assessment powers with taxpayers’ rights. Furthermore, this situation introduce serious inequalities because tax authorities can easily “abuse of the abuse of law principle”, that is with reference to a transaction covered by art. 37-bis they could ground the tax assessment directly on the abuse of law principle in order to get rid of the special

safeguard procedure provide by art. 37-bis which would render much more complex the assessment procedure.

In this respect it is argued that via the abuse of law principle the Supreme Court is forcing the introduction of a different "model" of GAAR as opposed to the targeted rule adopted by the Parliament with art. 37-bis. However, it is concluded that Supreme Court's approach is untenable because, especially in civil law countries, judges are required to apply constitutional principles in line with statutory provisions otherwise they have to raise a constitutional challenge with reference to those provisions; furthermore, the constitutional principles that the Supreme Court considered as a ground for the abuse of law principle can't be applied in isolation, but they should be coordinated with other constitutional principles like that of equality. In this respect, some Tax Courts have maintained that it would be in breach of the principle of equality stated by art. 3 Cost. to admit that the same avoidance transaction is to be assessed under a special safeguard procedure depending on tax authorities choice to rely on the art. 37-bis or abuse of law principle. This should cast serious doubt over the possibility to apply *ex officio* the abuse of law principle as claimed by the Supreme Court as long as art. 37-bis – or a similar provision – is in place.

The last paragraph of Chapter III introduces the long-standing issues of imposing penalties on tax avoidance in the light of some recent cases decided by the Supreme Court.

The starting point of the analysis conducted in this paragraph is represented by the traditional hypothesis which considers tax avoidance lawfully, thought morally and socially undesirable, as it does not lead to a breach of statutes as tax evasion does. Thus, according to this view, no penalties shall be imposed on tax avoidance.

This conclusion is, however, considered to be unconvincing. In fact, as argued by some scholars, the constitutional principle of solidarity (art. 3, Cost) and of ability to pay (art. 53, Cost.) impose a limit on aggressive tax planning, so taxpayer must take into account art. 37-bis when filing their own tax returns. Thus, if the tax return is assessed under art. 37-bis penalties for unfaithful tax return will be applicable.

The above view has received some validation from the Supreme Court with some cases decided at the end of 2011 and in mid 2012. In fact, according to the Court a finding of tax avoidance may lead to a penalty if, relying on a statutory rule, tax avoidance transactions can be ascertained with a reasonable predictability. For the Court this means that if a tax avoidance finding is grounded on a statutory general anti-avoidance rule, like the one provided by art. 37-bis, then, the imposition of penalties (even criminal ones) is to be considered legitimate. On the other hand, if a tax avoidance transaction has been assessed invoking the judicial principle of abuse of law, penalties cannot be imposed, as this would breach the principle of legality.

However, it is agued that the case law at hand appears unconvincing with reference to some aspects.

On one hand, general anti-avoidance rules are usually worded broadly and this could lead to some issues with reference to the principle of strict construction that is required for the application of penalties; on the other hand, the proposed dual treatment of tax avoidance transactions, depending on whether they are assessed on the basis of a statutory general anti-avoidance rule or judicial doctrine or principle, may introduce too much subjectivity in the imposition of any penalty and, more generally, it could lead to unreasonable discrimination between similar tax avoidance transactions.

On this basis, it is argued that the issue of tax avoidance's penalty regime is to be addressed from a different perspective. However, this point will be examined in the last Chapter of the thesis as it requires a bit of comparative inquiry among GAARs enacted by other countries which will be addressed in Chapter IV.

The inquiry regarding those GAARs enacted by some selected countries has been conducted at an higher level in the sense that the aim of the research was to find out the general features of these rules also with reference to penalties regime and safeguard procedure (if any). Particular attention is posed to the development of the GAARs and to its in relationship with the judiciary approach to tax avoidance. The reason behind this inquiry is that it could be of some help to understand how art. 37-bis can be improved and if there are some common features of a GAAR that express its functioning and that the Italian Parliament should not miss to adopt in relation to a future reform of art. 37-bis.

In relation to the above I have considered the GAARs enacted in Australia, New Zealand, Canada, South Africa, France, Spain and Belgium. Even if *common law* and *civil law* GAARs operate on quite different basis, it appears instructive to consider both. In fact, the aforementioned *common law* countries have a long-standing tradition of GAAR, so they are a valuable resource to be taken in consideration. At the same tame it is important to reflect on those GAARs adopted in France, Spain and Belgium because, like in the case of Italy, all these countries adopted a certain "model" of GAAR as a result of the influence of some judicial approach to tax avoidance. In particular, this is the case of France where the abuse of law principle developed by the Higher Courts overtook the statutory GAAR which, then, was overhauled by the Parliament exactly to adopt the judicial abuse of law principle and to enact a unitary safeguard procedure which previously was jeopardized – like in Italy – by the judicial approach to the abuse of law principle.

On the basis of the above comparative background, Chapter V addresses some *de iure condendo* issues in the light of a possible reform of art. 37-bis based on the new framework set by the abuse of law principle endorsed by the Supreme Court. In this respect two main issues were considered: on one hand, the judicial use of statutory GAAR and, on the other one, the proper penalty regime to be

introduced with reference to those tax avoidance transactions that can be assessed by tax authorities on the basis of the GAAR.

In respect to the first issues it is argued that the hypothesis of a codification of the abuse of law principle appears to be the most plausible approach – which, furthermore, has been endorsed also by the Italian Parliament in some recent proposal for amending art. 37-bis. However, it is argued the codification at hand should not be limited, like in the case of the U.S. codification of the economic substance, to a "clarification" of the abuse of law principle developed by the Supreme Court. In fact, as claimed in the first Chapter, every "general rule", of which GAAR is just an example, is formulated in such a way that leaves open to judges and officials, and whoever is going to apply the rule, the task of specifying the tangible content of the rule itself. Thus, a GAAR which simply clarifies a judicial principle or doctrine would probably fail to grant a meaningful method to control how Courts will then use the codified principle or doctrine. Therefore, a proper codification should be intended in a substantive manner, that is as providing tangible guidance for judges and tax authorities. In this respect it is argued it should be followed somewhat the approach at heart of the Australian and South African GAARs which provide for some objective criteria to rely on in order to find out if a given transaction is to be considered as a tax avoidance transaction. Thus, a GAAR based on the codification of the abuse of law principle should spell out similar criteria as this would allow Parliament to impose some serious constraints on how the abuse of law principle is to be applied by Courts.

To this effect it is also argued that procedural rules are important too. In fact, such rules would guarantee that the taxpayer is involved in the process that leads to the application of the GAAR and that this process is governed by rules set out by the Parliament exactly with the aim of balancing taxpayers' right and tax authorities' assessment powers. So by enacting such procedural rules the Parliament could avoid the risk that the codified principle of abuse of law is applied with too much directionality. An example of this approach could be find in France where the Parliament has not only codified the abuse of law principle developed by the Higher Courts, but it also provided for a special safeguard procedure which is based, on one hand, on the principle that any assessment based on the GAAR should be conducted in consultation with the taxpayer and, on the other hand, that in case the taxpayer does not agree with the position of the tax authorities he can resort to a specific "GAAR Committee" which, in this case, it is to be heard in advance to the issuance of the assessment notice.

Finally, in the last Chapter it is addressed the issue related to the suitable penalty regime for tax avoidance. In fact, in Chapter III it is argued that penalties should be applied to tax avoidance if a GAAR has been enacted, but that a specific penalties regime is required. In this respect two different models are considered in para. 3 of Chapter V. Firstly it is examined the French approach

which provides, on one hand, for a GAAR with a strict scope of application, as it allows to assess only those tax avoidance transactions whose exclusive aim is a tax benefit, and, on the other, for a general shortfall penalties rule which expressively mention the GAAR as one of those case in which it is applicable. In this respect it is argued that thought this approach could pass the strict construction requirement which penalties provisions have to satisfy in order to be substantially compliant with the principle of legality set by art. 25 Cost., it is nonetheless claimed that this approach reduce significantly the assessment power of the GAAR – as it is can be applied in the most frequent cases where the tax avoidance aim is “only” predominant. Subsequently, a different approach is considered. In fact some common law countries, like Canada, UK, Australia and South Africa enacted a specific “promoters” and “disclosure” penalty regime whose aim is to enforce transparency and collaboration between taxpayers and tax authorities in tackling tax avoidance. The ground of this penalty regime is that promoters of tax avoidance schemes and taxpayers implementing them are required to disclose those schemes which show certain “hallmarks” of tax avoidance (which are stated by statutes or by regulations).

Relying on the above it is argued that the idea of a “disclosure penalty regime” should be taken considered in the light of a codification of the principle of abuse of law. In fact it would offer a general deterrent for tax avoidance without the need to narrow the scope of the GAAR – like in the case of France – in order to guarantee that the principle of legality is respected by a penalty provision that simply refers to the GAAR to spell-out the conditions for its application. In this respect it is argued that a proper penalty regime for tax avoidance should be based on a “multilevel approach” meaning that further to the “disclosure penalty regime” it should be enacted a specific penalty to be applied as a consequence of an assessment based on the GAAR. However, to ease the respect of the principle of legality it is suggested that this *ad hoc* penalty should be formulated on a independent basis from the GAAR. This would allow the Parliament to define strictly the conditions for imposing such a penalty without the need to narrow down the scope of the GAAR – which would lead to a loss in terms of assessment powers (for example the GAAR could be maintained applicable to tax avoidance schemes where the purpose of tax benefit is only predominant, whereas the penalty at hand would be applicable only where tax avoidance is the sole purpose of the scheme). In this respect it is also argued that such an approach would be a better way to guarantee proportionality in the penalty system since the higher penalties would be imposed only with reference to those tax avoidance schemes whose features, which will be expressively considered in the penalty rule, are representative of the most serious and damaging forms of tax avoidance.

However, whatsoever approach is deemed to be preferable, the above considerations should be intended as an evidence that the issues of the proper penalty regime for tax avoidance can’t be addressed on a judicial basis as it

requires the introduction of a specific penalty regime which can be enacted only by the Parliament. And in fact art. 8 of the draft bill no. 1058/2013 provides that the Italian government should amend the overall tax penalties system also with reference to tax avoidance.