

The General Anti-avoidance Rule: its Expanding Role in International Taxation

A norma geral antielisiva: seu crescente papel na tributação internacional

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Abstract

This article discusses the role of and main justifications for general anti-avoidance rules in international taxation. It analyses whether or not a GAAR may be regarded as an international general principle of law taking into account the latest developments within international organizations, including some international courts, and domestic jurisdictions, and the BEPS/OECD work. It also argues what type of GAAR or specific rules would fit more properly as a legal tool to counteract tax avoidance and its consequences. This article was originally published in *INTER-TAX*, Volume 44, Issue 11, 2016, Kluwer Law International.

Keywords: general anti-avoidance rules (GAARs), Base erosion and profit shifting (BEPS), tax avoidance, international taxation.

Resumo

Este artigo discute a função das normas gerais antielisivas e suas principais justificativas do ponto de vista do direito internacional tributário. Analisa se uma norma geral antielisiva poderia ser classificada como um princípio geral de direito internacional considerando também os desenvolvimentos recentes de organizações internacionais, incluindo alguns tribunais nacionais e internacionais, bem como o trabalho da Organização para a Cooperação e Desenvolvimento Econômico (OCDE)/Erosão de Base e Transferência de Lucros (BEPS). Debate também qual tipo de norma geral ou normas específicas seriam mais apropriadas como instrumento para controlar a elisão fiscal e suas consequências.

Palavras-chave: norma geral antielisiva, Erosão de Base e Transferência de Lucros (BEPS), elisão fiscal, tributação internacional.

The outline of this article is the following:

I. Definition and general justifications for GAARs. The role of proportionality in balancing different principles at stake in tax avoidance. GAARs, Mini GAARs and SAARs as rules combined with principles.

1. Definition and main characteristics.

2. GAARs as rules or principles?
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II. GAARs as general principle of international law?

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2. OECD and UN commentaries on model conventions, and domestic courts.
3. International courts rulings on tax avoidance (the ECJ, the ECHR and the Appellate Body of the WTO).
4. What type of GAAR would fit as a general principle of international law?

I. Definition and the conflicting justifications for GAARs. The role of proportionality in balancing different principles at stake in tax avoidance. GAARs, Mini GAARs and SAARs as rules combined with principles

1. Definition and main characteristics

Tax avoidance is quite challenging and the issues raised by general or specific anti-avoidance rules may “go to the foundations of a country’s tax system”¹, and to the fair allocation of taxing rights among different States. In an international and comparative context tax avoidance means any arrangement or transaction made by taxpayers whose sole or main purpose is to reduce their tax burden, what may be legitimate or not depending on the economic factual circumstances and the purpose of tax laws at stake. In this sense, tax avoidance may be abusive, wholly artificial, excessive or too aggressive, and thus illegitimate depending on the fulfilment of two requirements: firstly, objective economic factors that may give or not business purpose or economic substance to the transaction must be ascertained; and secondly, it must be determined the specific purpose of the tax laws in play (the tax law that was supposedly circumvented and the tax law that should arguably be applied to the transactions)². The above two requirements of abuse are in line with the guiding prin-

¹ ARNOLD, Brian J. The Canadian general anti-avoidance rule. *Tax Avoidance and the Rule of Law*, (IBFD, 1997), p. 243.

² Kevin Holmes points out that in most countries the essential issue of domestic and international tax avoidance “comes down to whether the legal form of an arrangement, which a taxpayer designs to minimize the amount of tax that it must pay, prevails over the underlying economic reality of the circumstances of the case” (*International tax policy and double tax treaties – an introduction to principles and application*, IBFD, 2007, p. 358). A general description on the role of general

ciple set out by the OECD on abuse of a tax treaty that means the main purpose for entering into transactions is to obtain a more favourable tax position contrary to the object and purpose of the treaty provisions in play³. Not surprisingly, the UN Commentaries on the UN Model Convention follows the same line of thought⁴. A guiding principle is set out in paragraph 25 of the Commentaries on Article 1 of the UN Model Convention as follows:

“A guiding principle is that the benefits of a double taxation convention should not be available where a main purpose for entering into certain transactions or arrangements was to secure a more favourable tax position and obtaining that more favourable treatment in these circumstances would be contrary to the object and purpose of the relevant provisions.”

Furthermore, on general anti-avoidance rules the UN Commentaries seem to be fair to state that “these two elements will also often be found, explicitly or implicitly, in general anti-avoidance rules and doctrines developed in various countries”⁵.

2. GAARs as rules or principles?

Before discussing the main justifications and its limits for tackling tax avoidance, it may be worth analysing first whether or not a general anti-avoidance rule can be really regarded as either a general legal principle or a just a general rule. There are two main differences between rules and principles according to Dworkin⁶. First, rules are all-or-nothing norms, either they are applicable in a case or they are not, whereas principles may allow some degree of optimization in their application and enforceability as they must take into account other competing principles with which they must be reconciled. Secondly, principles have a dimension of weight and importance that is lacking in rules. Sometimes rules may function as principles⁷.

anti-avoidance rules or doctrines is also given by the OECD Report on BEPS of 12/02/2013, Chapter 4 (*Key tax principles and opportunities for base erosion and profit shifting*, p. 38) according to which they “limit or deny the availability of undue tax benefits, for example, in situations where transactions lack economic substance or a non-tax business purpose”. Further, on tax avoidance definition, see also *Tax avoidance and the law – sham, fraud or mitigation?* Key Haven, 1997, Ed. Adrian Shipwright; and on an international distinction between tax avoidance and evasion, see BAKER, Philip. *Tax avoidance, tax mitigation and tax evasion*, at <www.taxbar.com/Articles>, and *Improper use of tax treaties, tax avoidance and tax evasion*. Paper no 9-A, at <www.un.org/esa/ffd/tax/2013TMTTAN/Paper9A>.

³ Paragraphs 9.5. and 9.6 of the Commentary on Article 1 of the OECD Model Convention.

⁴ Paragraphs 22-26 of the Commentary on Article 1 of the UN Model Convention.

⁵ Paragraph 26 on Article 1 of the UN Convention Model.

⁶ DWORKIN, Ronald. *Taking rights seriously*. HUP, 1978, p. 24-26.

⁷ See also ALEXYS, Robert. *A theory of constitutional rights*. Oxford, 2002, p. 44-66, and On the structure of legal principles. *Ratio Juris*, 13/3, (2000).

As a matter of principle, taking into account how a GAAR is designed, whether or not covering a generality of transactions, its level of abstraction and indeterminacy, its degree of importance in the tax legal system, technically speaking any genuine GAAR may certainly be regarded as a principle of law. Furthermore, in its own right and definition, “a GAAR is a general statement of principle which seeks to thwart a broadly defined category of transactions which reduce or defer” tax liability⁸.

3. Justifications and limits to tackle tax avoidance

To what extent would minimization and deferral of the tax burden be justifiable and legitimate? Taxpayers have the right to legitimately organize their activities and business in the most efficient way, including a tax viewpoint. This is perfectly lawful and legitimate behaviour and a customary doctrine recognized by many countries⁹.

Starting from the pure liberalism point of view, “a radical separation of legal form and economic substance ... [is required, and] ... laws must be addressed to the generality of legal subjects, without distinction as to their social or economic position”¹⁰. This theory is considered untenable, due to its extreme inequalities at a socio-political level. Consequently, pure liberalism has given way to “welfare liberalism”, establishing an adequate and substantive social basis and providing conditions that allow formal equality to be performed¹¹. Thus, interventionist forms supplant the liberal forms of regulation.

Although equality, ability to pay, fairness, and the concept of abuse of rights may support the adoption of general or even specific anti-avoidance provisions, these rules may damage the requirements of certainty, predictability, and protection of fundamental freedoms, which are essential elements in a liberal system. However, Picciotto again highlights that this assertion unrealistically assumes that formal rules can be defined by referring them to completely factual conditions, or objectively ascertainable circumstances. The resort to less precise standards is often made in private law (“good-faith”, “fore-

⁸ OROW, Nabil. *General anti-avoidance rules – a comparative international analysis*. Jordans, 2000, p. 58. Furthermore, anti-avoidance measures are considered as “fundamental policy prohibitions” to abusive tax planning such as in the case of transactions that “lack economic substance or a non-tax business purpose” (OECD Report BEPS 12/02/2013, Chapter 4 (*Key tax principles and opportunities for base erosion and profit shifting*)), p. 38.

⁹ See VANISTENDAEL, Frans. Judicial interpretation and the role of anti-abuse provisions. *Tax Avoidance and the Rule of Law*. IBFD, 1997, p. 132.

¹⁰ PICCIOTTO, Sol. *International business taxation: a study in the internationalization of business regulation*. London: Weidenfeld & Nicholson, 1992, p. 79.

¹¹ Idem, p. 81. On the economics costs and distortions of tax avoidance, see also James and Nobes. *The economics of taxation*. New York: Financial Times-Prentice Hall, 2000, p. 100-103.

seeability”, “reasonableness” etc.)¹². Similarly, it is reasonable to affirm that tax laws based only on specific and formal rules tend to be amended often; to the extent that they could be considered a battlefield between taxpayers and the Treasury. The optimal relationship between tax authorities and taxpayers should be fair play, capable of providing reasonable certainty, stability and predictability – the main objectives of those who support and defend liberal formalism as well. Thus, reasonable general or specific anti-avoidance rules may provide a fair relationship between taxpayers and tax authorities, avoiding abuse from both sides. There may not be a duty (fiduciary duty for those in charge of running a business) to avoid taxes where the avoidance would be pursued by wholly artificial or abusive arrangements. Another great advantage of anti-avoidance rules, depending on how they are provided and enforced, is that they give opportunities to find principles of taxation and grant them “a vital function in the interpretation of tax legislation”¹³.

A different perspective over tax avoidance matters considers the creation of legislative uncertainty as an essential weapon to control situations that would not be acceptable from the point of view of fairness for being rather artificial. Moreover, such situations would not be acceptable from the standpoint of the treatment of equivalent economic situations and of tax collection itself, particularly where the economic principle of neutrality underlies a general anti-avoidance rule¹⁴. “However, discretion and uncertainty are not necessary companions. Indeed, the exercise of discretion is how you offer certainty where legal definition cannot.”¹⁵ For instance, in terms of anti-avoidance measures, they may be specific or general. In this latter case, some discretion is necessarily left to fiscal authorities and judges to consider whether there is, in each case, a business purpose other than artificially avoiding taxes. In the author’s view, the revenue discretion is more appropriate where necessary to ascertain objective factors and legal issues regarding tax avoidance; however, it must be submitted to judicial review. The broader the discretion the closer the scrutiny may be necessary to avoid subjectivism, bias, arbitrariness, and a lack of sound commercial reality, particularly when dealing with business purpose requirement. Thus, the tax assessment founded on tax avoidance must

¹² PICCIOTO, Sol. *Op. cit.*, p. 87.

¹³ ROXAN, Ian. General anti-avoidance rule in action. [1998] B.T.R.140 at 146. On the complexity to tackle tax avoidance, see WEISBACH, David A. Line drawing, doctrine, and efficiency in the tax law (november 1998). University of Chicago Law School, John M. Olin Law & Economics Working Paper n. 62, available at SSRN: <<http://ssrn.com/abstract=106728>>.

¹⁴ According to the principle of neutrality, taxpayers should make economic decisions that are tax neutral, unless tax legislation states otherwise, such as in situations of tax incentives.

¹⁵ GAMMIE, Malcolm. Tax avoidance and the rule of law. In: COOPER, Graeme S. (ed.). *Tax avoidance and the rule of law*. IBFD, 1997, p. 215.

observe the fundamental rights that require no excessive burden of proof and fair rebuttal, no interference with taxpayers' right to manage their own business (except where artificial arrangements are made solely or mainly for tax purposes), no excessive penalties or guarantees, no restrictions to carry economic activities while tax assessment is under way, independent commissioners and judges, and others rights, such as an overall fair assessment that is part and parcel of due process and the rule of law.

Another interesting social and economic aspect was raised by Weeghel¹⁶, who has pointed out the public perception about aggressive tax avoidance in some countries, such as in the UK, where consumers have campaigned to boycott some multinationals for paying very low tax because of their tax avoidance schemes. As a result of that public perception, some companies became more concerned about their reputation in the UK, and searched a fair tax mark, like a fair trade label, which can be obtained by those who meet non-abusive avoidance requirements¹⁷. This would perhaps be a trend in the international scenario as long as taxpayers and other organizations be more aware of the implications of aggressive tax avoidance and of their economic and political power. The work of civil society in tackling tax avoidance has also become increasingly notable and important as shown by some specific non-governmental organizations such as the Tax Justice Network (TNJ) and the Global Alliance for Tax Justice (GATJ)¹⁸.

Having analysed in this section the main justifications for combating tax avoidances as well as their apparently opposing principles, in the next section it will be discussed whether general or specific rules are more appropriate and the main ways to ensure the proper use of tax treaties.

4. General or specific rules/principles?

Another issue regarding tax avoidance is how better to tackle it, such as fixing limits to a general judge-made abuse of law doctrine, and assessing general and specific anti-avoidance rules either separately or concurrently. It is debatable whether a system based on general principles rather than prescriptive rules may be more appropriate, depending on the legal traditions

¹⁶ Regarding the overall concern about tax avoidance, BEPS, and international standards, see van WEEGHEL, Stef, and EMMERINK, Frank. International/European Union/OECD – global developments and trends in international anti-avoidance. *Bulletin for international taxation* (Amsterdam) vol. 67, n. 8, 2013, p. 428-435.

¹⁷ In 2014 SSE, the UK's broadest-based energy company was the first FTSE100 company to achieve the Fair Tax Mark. For every business type, the criteria are divided into two main categories that assess a business on, firstly, Transparency, and secondly, Tax rate, disclosure and avoidance (<www.fairtaxmark.net>).

¹⁸ See further information on those ngos at <www.taxjustice.net> and <www.globaltaxjustice.org>.

and constitutional systems of each jurisdiction¹⁹. In the author's view a system with general principles, such as an objective abuse of rights doctrine (taking into account objective economic factors, the principle of good faith, no application of penalties, objective ascertainment of the purpose of the tax legislation at stake, and an overall fair assessment) is more appropriate to tackle tax avoidance, because it balances equity and legal certainty, whereas prescriptive rules favour legal certainty only or mostly. A combination of a general rule with prescriptive ones, for greater clarity and legal certainty, would be better depending again on what would be more appropriate to the legal system, tradition, and culture of each jurisdiction, but in line with international standards set out by international organizations such as the UN, OECD, and international courts such as the European Court of Human Rights, the European Court of Justice, and the Appellate Body of the WTO, as discussed further in the following section II. 2 and 3.

Where tax avoidance is an issue only for a specific type of transactions, such as reorganizations, mini-GAARs addressing only those transactions may be more efficient, for the sake of simplification, clarity and legal certainty. It may not make sense for a legal system to have a huge arsenal of anti-avoidance rules where taxpayers use only few transactions for tax avoidance purposes. The same can be said in relation to different types of taxes. If avoidance is a problem in the field of corporate taxation only and not in respect of VAT for instance, it would be more cost-efficient to implement a GAAR that covers income tax only. Contrariwise, if there is a substantial loss of revenue in the VAT area as well due to tax abusive transactions, it may make sense to target them via GAARs. If the all taxes within a system are actually affected by abusive behaviour of taxpayers, a GAAR covering all of them may be necessary; and for the sake of fairness, legal certainty, simplification, coherence, and consistency of the tax system that that GAAR should be the same or at the very least very similar to each other for all taxes. It would be a legal and economic contradiction and hard to explain why the same specific transaction, such as a reorganization, may have business purpose for income tax, but not for VAT purposes. This same issue of legal and economic consistency can be found in case of an international transaction where two or more tax jurisdictions are involved. If there is a business purpose for an international reorganization, that same standard must be accepted by two or more countries that are affected, as well as in case of transfer pricing rules, where under Article 9 of the UN

¹⁹ See also on the challenges of tackling avoidance through rules or principles, JONES, John Avery. *Tax law: rules or principles?* [1996] B.T.R., 6, 580. From an economic perspective, see KAPLOW, Louis. Rules versus standards: an economic analysis. *42 Duke Law Journal* 557-629, 1992, available at: <<http://scholarship.law.duke.edu/dlj/vol42/iss3/2>>.

and the OECD Model the arm's length price should be the same and accepted by all States and taxpayers involved.

There are generally five ways to ensure the proper use of tax treaties that may be consistent with international standards. First, the application of domestic GAAR or a specific anti-avoidance rule applicable to tax treaties. Secondly, a specific anti-avoidance rule provided in the treaty itself: v.g. the beneficial owner clause, as generally applied to dividends, interests, and royalties. Thirdly, the limitation on benefits articles, generally based on ownership or control as a residence test to get treaty benefits. Fourthly, a GAAR provided in the treaty itself, such as a general beneficial owner clause, or the principle purpose test²⁰. Fifthly, an anti-abuse doctrine as a general principle of international law (see the cases decided by the Swiss Supreme Court and Israeli Supreme Court, in section II.2.)

The BEPS project of the OECD agreed in the final report of 5 October 2015 the following minimum standards:

- a) Wording in the preamble against double non-taxation and treaty shopping, and either
- b) Limitation on benefits clause – LOB (an extensive or limited version) and the Principle Purpose Test (PPT)²¹, or
- c) PPT alone, or
- d) LOB and anti-conduit rules.

The above minimum standards in my view are compatible with international standards previously analysed for two reasons, as long as taxpayers can challenge their application by the competent tax authorities on proportionality and fairness grounds as discussed in the next section. First, it demonstrate a great concern for abusive tax avoidance, and secondly, it takes into account different positions of individual countries, such as the US and others that are reluctant to adopt the principle purpose test and are in favour of the LOB articles that may bring more certainty to taxpayers and may be less burdensome in terms of tax assessments and supervision.

²⁰ Interesting to note that the treaty between Portugal and Senegal of 2014 sets out in its Article 30 three paragraphs addressing tax treaty abuse: paragraph 1 allows the application of domestic gaar to the treaty, paragraph 2 provides a general beneficial owner clause to get treaty benefits, and paragraph 3 says the treaty would be applicable if one the main purposes of the transaction at stake is to get treaty benefits.

²¹ *Art. X, par. 7*: “Notwithstanding the other provisions of this Convention, a benefit under this Convention shall not be granted in respect of an item of income or capital if it is reasonable to conclude, having regard to all relevant facts and circumstances, that obtaining that benefit was one of the principal purposes of any arrangement or transaction that resulted directly or indirectly in that benefit, unless it is established that granting the benefit in these circumstances would be in accordance with the object and purpose of the relevant provisions of this Convention.”

Having discussed in this and the previous section the apparently conflicting principles that may justify to combat tax avoidance and the ways to ensure it, in the next section it will be analysed whether and how they may interact and be reconciled.

5. The role of proportionality and balancing in controlling tax avoidance

If conflicting principles are at stake regarding tax avoidance, such as legal certainty and tax equity²², they should be reconciled with each other in order to reach a fair balance protecting to an optimal extent both principles. In the author's opinion neither of them should unconditionally prevail over the other, and the principle of proportionality is an analytical tool to reach that fair balance²³. Moreover, proportionality coupled with reasonableness may balance all tax principles that justify tackling tax avoidance, mainly equity and the doctrine of abuse of rights, against other relevant principles, such as good faith, legal certainty, and predictability²⁴. All of them are important and none of them should be absolute or exclusive. First, general or specific anti-avoidance rules should be suitable for the attainment of the desired objective (to avoid artificialities and abuses, for example); second, the necessity of the measure in a sense that it is the least restrictive of individual freedoms that could be adopted; and third, the requirement of the proportionality of the measure to the restrictions involved (balancing). Thus, if a tax measure, such as joint taxation of spouses, is too intrusive to the freedom to opt for separate taxation and discriminatory, it may be unlawful for being disproportionate. Treating the family as a tax unity may be reasonable either for tax avoidance or simplification purposes. However, joint taxation may be disproportionate where this tax treatment results in taxing spouses or civil partners more heavily than non-married couples who live together, particularly if there

²² "Tax equity demands that artificial tax avoidance schemes should be of no effect, yet certainty demands that the tax laws should be such that an individual can arrange affairs in the expectation that he will not have to pay tax." (TILEY, John. *Revenue Law*, 2005, p. 101-02)

²³ On tax avoidance and proportionality, see ROLIM, João Dácio. *Proportionality and fair taxation*. Kluwer International, 2014.

²⁴ Other general principles of international law such as equality of States, reciprocity, good faith, the legal validity of agreements, and the freedom of the seas, may be construed and applied according to the principle of proportionality in its role of weighing apparently conflicting interests and ascertaining and making them effective and as compatible as possible with each other. As Georges Abi-Saab pointed out "... there are certain general principles of international law, or of law *tout court*, without which it is impossible to imagine how any legal system can function – in other words, principles inherent in the concept of legal system itself – such as the principles of good faith and proportionality" in The Appellate Body and treaty interpretation, p. 459 in SAC-ERDOTI, Giorgio; YANOVIBH, Alan and BOHANES, Jan (ed.). *The WTO at ten: the contribution of the dispute settlement system* (CUP, 2006).

is an underlying policy or constitutional objective for the State to recognize, protect and encourage the family²⁵.

Regarding the application of any *gaar* to tax treaties, the standards of reasonableness and the principle of proportionality may bring more certainty to taxpayers where indeterminate or open ended concepts are applied. For example, if the PPT is applied, taxpayers have to right to challenge their economic and legal assumptions, being able to demonstrate that objective (as opposing to subjective) economic factors should be taken into account, as well as a purposive and consistent application of treaty articles submitted to an independent body, either judicial or set up via arbitration.

Having discussed some conflicting justifications and opposing principles for tackling tax avoidance and concluded that the general rules to tackle it may be a more appropriate and cost-effective tool, in the next section it will be analysed whether or not it can be considered as a general principle of international law.

II. GAARs as general principle of international law?

1. Article 38 of the statute of the ICJ (OECD countries, BRICS and G-20)

Under Article 38, c, of the Statute of the International Court of Justice²⁶, if a general principle is recognized by civilized nations, it must be applied as a primary source – not as subsidiary means – of international law²⁷. Both domestic legal concepts and those derived from existing international practice can fall within “the recognized catchment area”²⁸.

²⁵ See THURONYI, Victor. *Comparative tax law*. Kluwer, 2003, p. 92-5. The German Constitutional Court decision that balanced the equality of rights of the two sexes, the constitutional protection of the family, and the purpose of “bringing the working wife back to the home” (6 BVerfGE 55, decision of 17 January, 1957, excerpted in KOMMERS, Donald. *The constitutional jurisprudence of the Federal Republic of Germany* (DUP, 1997), p. 498; and the US Supreme Court in *Hoeper v. Tax Commission of Wisconsin*, decided in 1931, 284 U.S. 206. See also the judgment of the Constitutional Court of Spain n. 45/89 (STC 45/1989), of 20 February 1989, based on the principle of proportionality to guarantee non-discrimination between married couples and cohabitantes in the light of the protection of family.

²⁶ Art 38 of the Statute of the I.C.J. provides that the Court shall apply: “A. international conventions, whether general or particular, establishing rules expressly recognized by the contesting states; b. international custom, as evidence of a general practice accepted as law; c. the general principles of law recognized by civilized nations; d. subject to the provisions of Article 59, judicial decisions and the teachings of the most highly qualified publicists of the various nations, as subsidiary means for the determination of rules of law.”

²⁷ GAARs might also be seen as an international customary law since they would be a general practice accepted as law; however, as GAARs are regarded as general principles in domestic systems it would be more appropriate to classify them as such for international law purposes.

²⁸ SHAW, Malcolm N. *International law*. 6. ed. Cambridge, 2008, p. 99. The ICJ in *Amco v Republic of Indonesia* stated that while a practice or legal provisions common to a number of nations would be

Thus, one fundamental legal basis for recognition of a GAAR as a general principle of international law would be its recognition in the legal system of civilized nations as it seems to be the case at the present stage. This issue of regarding a general anti-avoidance rule or doctrine as a general principle of international law has been argued for many years and some tax commentators were against it – even against the application of a domestic anti-avoidance rule to tax treaties –, whereas Vogel and Ward seemed to be a minority in favour of regarding it as such general principle²⁹. As analysed further in this section the ultimate basis for considering a GAAR (or a similar abuse of rights doctrine) as a general principle of international law is its recognition by civilized states. Where national courts apply a domestic GAAR to tax conventions they would be applying it as a general principle of international law as well. Where there is no domestic GAAR there would still be scope for applying a general anti-abuse doctrine based on the abuse of rights in line with international recognition analysed above by interpreting the treaty itself³⁰. Besides the purposive, contextual, and in the good faith interpretation that must be given to treaties, under Art 31, paragraph 3(c), of the Vienna Convention on

an important source of international law (SHAW, Malcolm N. *Idem*, p. 100n116).

²⁹ WARD, David A. (Abuse of tax treaties. *Essays on international taxation*. Kluwer, 1993, p. 403); and VOGEL, Klaus (*Klaus Vogel on double taxation conventions*. 3. ed. Kluwer, 1997, p. 66 and 125). Stef Van Weeghel, being more sceptical about considering GAAR as general principle of international law, argued that a higher standard of the abuse of rights should apply to taxpayers (that are not a party to the treaty) in comparison with the States when they abuse the treaty (The improper use of tax treaties. *Series on International Taxation* n. 19. Kluwer, 1998, p. 99-100). The argument about not being party to the treaty may be arguable according to international law that confers rights to legal persons and individuals. It would be as if the application of the convention on human rights could not be limited by abusive behaviour of taxpayers as they are not parties to the convention. On the other hand, it is right to say that an international court might be more appropriate to set the standards of abuse of rights than a variety of domestic courts; however, they may have a common interpretation in respect of international standards of abusive transactions and may be better placed to evaluate the facts of each case. Among those against considering GAARs as general principle of international law, see Lang and MAISTO, G. Norme anti-elusive, abuso del diritto e convenzione internazionali per evitare le doppie imposizioni sui redditi. *Elusione ed abuso del diritto tributario*, apud BRACCO, Pietro. *Cahiers de droit fiscal international – tax treaties and tax avoidance: application of anti-avoidance provisions*. 2010. vol. 95a, p. 438; and LANG, Michael. *Abusive application of international tax agreements*, proceedings of a Seminar at the 54th Congress of the International Fiscal Association in Munich in 2000, IFA, 2001, p. 16 and 24).

³⁰ As LOWE, Vaughan. Reader in International Law, rightly points out there is an abuse of rights principle of international law that prevents “states exercising rights in arbitrary manner”; this principle is different from the abuse of rights doctrine as a general anti-avoidance rule, which in its own right can be recognized as a general principle of law recognized by civilized nations, what would be in line with the international principle of abuse of rights, as “states always have a legitimate interest in repressing tax evasion...”, and in the last decades a legitimate and more general interest in tackling tax avoidance (*How domestic anti-avoidance rules affect double taxation conventions*, proceedings of a Seminar held in Toronto, in 1994, during the 48th Congress of the international Fiscal Association, Kluwer Law International, IFA, 1995, p. 7-8).

the Law of Treaties³¹, it shall be taken into account together with the context, “any relevant rules of international law applicable in the relations between the parties.” As the International Court of Justice regards the terms rules and principles as essentially the same within international law³², general anti-avoidance rules as general principles of law of civilized nations should also be taken into consideration in the contextual interpretation of tax treaties.

Nearly all the 34 OECD countries have domestic general anti-avoidance rules or doctrines, but also all the five BRICS countries (Brazil, Russia, India, China, and South Africa) do. Furthermore, out of the G-20 only Mexico has no general anti-avoidance rule or doctrine, although it has been adopting a GAAR in its latest Double Tax Conventions into which it entered³³. Needless to point out that countries with GAARs are considered civilized and represent more than 85 per cent of the worldwide gross domestic production and more than 67 per cent of world population³⁴.

2. OECD and UN commentaries on model conventions, and domestic courts

The work of international organizations may also play a role in regarding a principle of law as a principle of international law. In this sense, the work

³¹ “Article 31 General rule of interpretation

1. A treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose.

2. The context for the purpose of the interpretation of a treaty shall comprise, in addition to the text, including its preamble and annexes:

(a) any agreement relating to the treaty which was made between all the parties in connection with the conclusion of the treaty;

(b) any instrument which was made by one or more parties in connection with the conclusion of the treaty and accepted by the other parties as an instrument related to the treaty.

3. There shall be taken into account, together with the context:

(a) any subsequent agreement between the parties regarding the interpretation of the treaty or the application of its provisions;

(b) any subsequent practice in the application of the treaty which establishes the agreement of the parties regarding its interpretation;

(c) any relevant rules of international law applicable in the relations between the parties.”

³² See the *Gulf of Maine* case, ICJ Reports, 1984, p. 246, 288-90, Shaw (2008), p. 98n109.

³³ In some Latin American countries where there is no express GAAR their domestic courts may apply a broader meaning of sham to comprise some features of the business purpose test, such as in Colombia.

³⁴ Taking into account only the OECD countries, the BRICSs, others in the G-20 (Argentina and Indonesia, for example, not considering the countries in the previous groups), and plus some Asian countries that have a GAAR (Pakistan, for instance) over 67% of the worldwide population are living under a GAAR regime (see population data of 2012, by Unesco, at <<http://stats.uis.unesco.org/unesco/TableViewer/document.aspx>>, and the OECD data of 2009 at <<http://dx.doi.org/10.1787/888932502619>>). In terms of GDP the percentage of the worldwide economy activity under a GAAR would be higher, representing over 85%, taking into account the GDP of countries that have a GAAR (data of 2012, at <<http://data.worldbank.org>>).

of the OECD has been remarkable in tackling tax avoidance, in particular when it amended the OECD Commentaries in 2003 to recognize two legitimate lines of thought adopted by countries to counteract tax avoidance: application of domestic general anti-avoidance rules (GAARs) to tax treaties or from the interpretation of a treaty itself. States can deny its application to abusive transactions based on the object and purpose of tax conventions as well as the obligation to interpret them in good faith (Article 31 of the Vienna Convention on Law of Treaties)³⁵. This view has also been taken by the United Nations Commentary which recognizes the possibility to apply domestic GAARs or doctrines to double tax conventions as well as by interpreting the treaty itself³⁶. Some domestic courts already took the latter view as it was in the case of the Swiss Federal Tribunal in *A Holdings ApS v Federal Tax Admin* (2005) that “referred to an (unwritten) treaty principle that prohibits treaty abuse, which can be derived from Art. 31(1) of the Vienna Convention”³⁷.

3. International courts rulings on tax avoidance (the ECJ, the ECHR and the Appellate Body of the WTO)

It is also worth pointing out that some international courts, such as the Appellate Body of the World Trade Organization (WTO)³⁸, the European

³⁵ See paragraphs 9.5. and 9.6 of the Commentary on Article 1 of the OECD Model Convention. Only Luxembourg made an observation not agreeing with the majority view by stating that domestic anti-abuse rules can only be applied through the mutual agreement procedure (paragraph 27.6). Also Netherlands made an observation stating that domestic measures may be justified only in specific cases of abuse or clearly unintended use, and quite rightly submitted to the principle of proportionality (paragraph 27.7). About the right ambulatory application of these commentaries, see Craig Elliffe. Cross border tax avoidance: applying the 2003 OECD commentary to pre-2003 treaties. *British Tax Review*. May 1, 2012, Issue 3, p. 307.

³⁶ Paragraphs 22-26 and 39-39 of the Commentary on Article 1 of the UN Model Convention.

³⁷ See JUNG, Marcel R. Trends and developments in Swiss anti-treaty shopping legislation and treaty shopping case law. *European Taxation*. IBFD, June 2011, p. 230-44. See also another case decided by the Swiss Supreme Court, *X Holding ApS*, that confirmed that a “structure was abusive and denied DTC benefits on the basis of the general unwritten concept of abuse”, DANON, Robert. *Resolving income tax treaty disputes: Switzerland*, 2013, unpublished. Also the Supreme Court of Israel supported this view in *Yanko-Weiss Holdings (1996) Ltd v Halon Assessing Office*, (2007) 10 ITLR 524, decision of 30 December 2007; see further comments on these cases, WARD, David. Access to tax treaty benefits. *Report for the Advisory Panel on Canada’s System of International Taxation*, September 2008, at <www.apcsit-gcrfi.ca>, and DUFF, David. *Responses to treaty shopping: a comparative evaluation*. *Tax treaties: building bridges between law and economics*. Eds. Michael Lang, Pascuale Pistoni, Josef Schuch, Claus Staringer, Alfred Storck, Martin Zagler. IBFD, 2010, p. 75-102.

³⁸ The WTO has accepted to scrutinize measures to combat tax evasion and avoidance under Article XX of the GATT as possible justifications for restrictions on imports in the cases *Argentina – measures affecting the export of bovine hides* and the import of finished leather (WT/DS155/R, *Bovine Hides*) and *Dominican Republic – measures affecting the importation and internal sale of cigarettes* (WT/DS302/AB/R, *Dominican Republic – Cigarettes*). In both cases the specific measures were disallowed because other alternative measures less restrictive to imports were available to

Court of Human Rights (ECHR)³⁹, and the European Court of Justice (ECJ)⁴⁰, recognize combating tax avoidance as a legitimate and imperative requirement in the public interest to justify some restrictions on the international fundamental freedoms and rights. This recognition, in the author's view, makes stronger the argument in favour of regarding general measures or doctrines to tackle tax avoidance as general principles of international law. If those measures are legitimate and allow limitations on international rights, at

reach the legitimate objective of counteract tax avoidance and evasion. Regarding services the *GATS (1995)*, Article XIV, *caput* and its paragraph (d) expressly provides the following exception: "(d) inconsistent with Article XVII (national treatment), provided that the difference in treatment is aimed at ensuring *the equitable or effective (6) imposition or collection of direct taxes* in respect of services or service suppliers of other Members", and note (6) states that "measures that are aimed at ensuring *the equitable or effective imposition or collection* of direct taxes include measures taken by a Member under its taxation system which: (iii) apply to non-residents or residents in order to prevent the avoidance or evasion of taxes, including compliance measures." Thus, tax avoidance as recognized by case law of the AB (GATT for direct and indirect taxes) or as provided by the treaty itself (GATS) is a justification for restrictions on imported goods and services.

³⁹ On tax avoidance as a legitimate justification for retrospective taxation, in case of artificial arrangements (no business purpose), see the cases of *A., B., C. and D. v the UK* (Application n. 8531/79), and *M. A. and Others v Finland* (Application n. 27793/95); on tax avoidance and evasion as a legitimate justifications for a possible restriction on the fundamental right to freedom of movement, see *Riener v Bulgaria* (Application n. 46343/99); and tax avoidance in principle as a legitimate justification in the general interest for procedural measures "to secure the payment of taxes" (right to property), see the *Hentrich v France* case (Application n. 13616/88). In this case the Court held a French law with anti-avoidance purposes, which authorized the fiscal authorities to buy property sold at undervalue market price, as a *de facto* expropriation, as the law did not provide for any possibility of rebuttal and there were less restrictive alternatives to avoid tax evasion and avoidance.

⁴⁰ The ECJ has evolved imperative requirements in the general interest, such as fiscal supervision, combating tax avoidance, tax coherence and allocation of taxing powers between Member States, to justify restrictions on the fundamental freedoms of movement of goods, persons, services, and capital. See on tax avoidance taken together with allocation of taxing rights between States in relation to direct taxation the following cases, *Marks & Spencer (C-446/03)*, *Rewe Zentralfinanz (C-347/04)*, and *SGI (C-311/08)*; on tax avoidance in its own right to justify restrictions on the four freedoms, *ICI v Colmer Case C-264/96*, *Cadbury Schweppes, C-196/04*, *Emsland-Starke Case C-110/99*, *De Lasteyrie du Saillant Case C-9/02*, and *Lankhorst-Hohorst Case-C 324/00* (artificial arrangements); on tax avoidance as a justification for retrospective taxation, *Stichting Goed Wonen(C-376/02)*; *Gemeente and Holin Groep (C-487/01 and 7/02)*; and within the VAT on tax avoidance to justify substantive measures that may limit the right to credit and apparently undermine the VAT fundamental principle of neutrality, see *Skipalle, Ampafrance*, as well as the general anti-avoidance doctrine the *Halifax* case C-255/02, in which the Court took into consideration the purposes of the tax provisions in play that cannot be distorted by implementation of inappropriate or abusive transactions with no economic substance to obtain tax advantages. Whereas in *Starke* and *ICI* and other cases mentioned above the Court referred only to the element of artificiality or wholly artificial arrangements, in *Halifax* it appears to have gone further by stating that it is sufficient that the requirement of lacking an essential economic objective other than a tax benefit for a series of transactions to be abusive. This was still made clearer in *Part Service*, in which the Court reiterated that there is abuse where the principal (not the sole) objective of a series of transactions is to pursue tax advantages against the purpose of the tax rules at stake.

the very least they must be considered as important and principled justifications within EU Law and the fundamental four freedoms, the international fundamental rights (ECHR), and the international trade law (WTO). Thus, counteracting tax avoidance is a legitimate objective recognized by domestic and international jurisdictions⁴¹, but anti-avoidance measures provided by law or judicial doctrine must be proportionate to that end⁴². In other words, they must be balanced with other interests and principles at stake, such as the fundamental freedoms⁴³, the fundamental rights⁴⁴, and non-protectionism in international trade⁴⁵, in order to be less intrusive to those rights under the necessity test as part of proportionality.

4. What type of GAAR would fit as a general principle of international law?

What type of GAAR would be more appropriate to consider as a general principle of international law? It is arguable that a better type of GAAR or doctrine would be the one that requires as its first element solely (and not mainly) tax motivation⁴⁶. The requirement for solely tax reasons is closer to the sham doctrine⁴⁷, and generally tax avoidance is different from the definition of sham, as its second element encompasses situations where the tax motivation is the main or predominant reason to enter into a transaction.

The European Court of Justice appeared to follow in direct taxation the doctrine of sham (wholly artificial arrangements) so as to avoid only transactions that are solely tax motivated⁴⁸. Whereas the objective element of abuse in direct taxation is more focused on the artificiality of transactions, the abuse

⁴¹ Still from an international perspective see the report of the International Bar Association's Human Rights Institute Task Force on Illicit Financial Flows, Poverty and Human Rights, *Tax abuses, poverty and human rights* according to which the "term 'tax abuse' also includes tax practices that may be legal, strictly speaking, but are currently under scrutiny because they avoid a 'fair share' of the tax burden and have negative impacts on the tax revenues and economies of developing countries". *International Bar Association*, 2013, p. 7.

⁴² See above section I.5 of this article (*The role of proportionality and balancing in controlling tax avoidance*).

⁴³ See the cases mentioned above in which the ECJ submitted general and specific anti-avoidance rules to the principle of proportionality.

⁴⁴ See the cases referred above to which the principle of proportionality was applied as a key principle of interpretation of the Convention.

⁴⁵ Tax avoidance may not justify disguised protectionism within the WTO agreements, particularly under Article XX of the GATT and Article XIV of the GATS to which the tests of reasonableness and proportionality are applied. See above again *Bovine Hides* and *Republic Dominican – Cigarettes*.

⁴⁶ Its second element is the specific purpose of the tax laws in play, see section I.1 above and note 2.

⁴⁷ In civil law countries the idea of simulation (sham) is similar to wholly artificial arrangement.

⁴⁸ That view is slightly different from the notion of valid economic reasons provided by the Merger Directive 90/334/EEC Article 11(1)(a), under which a restructuring or reorganization has no valid commercial reasons if its principal (predominant, not solely) objective is tax avoidance.

for VAT purposes encompasses not only wholly artificial arrangements, but also transactions with the principal objective of tax avoidance. The Court apparently applied a more stringent test of abuse perhaps because VAT is more harmonized and must be applied harmoniously within the States, whereas in direct taxation States retain their fiscal sovereignty unless there is a disproportionate interference with the fundamental freedoms. On the other hand, the tax avoidance requirement in tandem with the fair allocation of taxing rights may differ from the autonomous tax avoidance requirement for restrictions to the fundamental freedoms in direct taxation⁴⁹. Whereas the former allows Member States to tackle any abusive transaction, in which there may be some business purpose other than tax mitigation, the latter encompass only wholly artificial arrangements. The Court also made this clear in *Société de Gestion Industrielle SA (SGI)*⁵⁰, in which Belgian transfer pricing rules that applied an arm's length standard were upheld to protect a fair allocation of taxing rights between the States involved. These transfer pricing rules did not address only wholly artificial prices or arrangements. Thus, not only the requirement of fair allocation of taxing rights was taken together and balanced with a broad notion of avoidance⁵¹, but also the specific measures to secure arm's length prices between related parties in cross-border transactions were closely scrutinized under a business purpose test⁵².

The ECHR and the AB of the WTO have also accepted tax avoidance not only when artificial arrangements were made, but also in cases of the main and substantial objective of the arrangements was tax avoidance⁵³.

Furthermore, it is worth noting that it is the general idea of a legal conception present in different legal systems that is regarded as a general principle of international law⁵⁴, and not any specific law of a particular State⁵⁵. As

⁴⁹ See note 40.

⁵⁰ Case C-311/08 [2010] ECR-0000. See O'SHEA, Tom. ECJ Upholds Belgian Transfer Pricing Regime. *Worldwide Tax Daily* 2010 WTD 19-1.

⁵¹ Paragraph 66 of the judgment.

⁵² The Court first stated that the taxpayer must be "given an opportunity, without being subject to undue administrative constraints, to provide evidence of any commercial justification that there may have been for that transaction"; and secondly, "where the consideration of such elements leads to the conclusion that the transaction in question goes beyond what the companies concerned would have agreed under fully competitive conditions, the corrective tax measure must be confined to the part which exceeds what would have been agreed if the companies did not have a relationship of interdependence" (paragraphs 71-72 of the judgment).

⁵³ See notes 38 and 39.

⁵⁴ The International Court of Justice's reasoning in *Barcelona Traction* relied on the 'general conception' of the limited liability company in municipal legal systems, (ICJ Reports 1970 p 3, 33-5), a position repeated in *Diallo* (judgment of 30 November 2010, paragraph 47), *Brownlie's principles of public international law*. 8. ed., p. 37).

⁵⁵ The ICJ stated in *Barcelona Traction* (para. 50), "It is to rules generally accepted by municipal legal

analysed above, the general definition of GAARs comprises two elements; first, the main purpose for entering into transactions is to obtain a more favourable tax position (generally with no business purpose), and secondly, the interpretation of the treaty or tax provisions in play must not be contrary to their object and purpose (purposive interpretation of the object matter)⁵⁶. “These two elements will also often be found, explicitly or implicitly, in general anti-avoidance rules and doctrines developed in various countries.”⁵⁷

Finally, it would not make sense to consider “that international law has repeatedly acknowledged the principle of domestic law that a company has a legal personality distinct from that of its shareholders”⁵⁸ and not consider the abuse of rights doctrine for tax purposes as a principle of international law, taking into account the GAARs existent in many civilized countries, the position of international organizations such as the UN and the OECD, some domestic courts of civilized countries, and the decisions of international courts regarding tax avoidance as a legitimate justification for accepting some restrictions on international fundamental rights and freedoms.

In conclusion, as the international standards provided by international organizations and courts taken together with the recognition and introduction of GAARs by civilized nations, it may be logical and reasonable its recognition as a general principle of international law. Furthermore, according to international and domestic standards analysed above as well as the purposive and contextual approaches to international treaties, a GAAR that would be more appropriate as a general principle of law would be that which provides as its first element the main (not sole) purpose for entering into transactions to obtain a more favourable tax position (generally with no business purpose), and its second element an objective and purposive interpretation of double tax conventions.

systems which recognize the limited company whose capital is represented by shares, and not to the municipal law of a particular state, that international law refers.” (*The statute of the International Court of Justice, a commentary*. 2. ed. Eds. Andreas Zimmermann, Christian Tomuschat, Karin Oellers-Frahm, Christian J. Tams. Oxford, 2012, p. 839, fn768).

⁵⁶ See also paragraphs 9.5. and 9.6 of the Commentary on Article 1 of the OECD Model Convention.

⁵⁷ Paragraph 26 on Article 1 of the UN Commentary to the UN Convention Model.

⁵⁸ Quotation from the International Court of Justice in *Ahmadou Sadio Diallo* case (para. 155).