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European and International Tax Moot Court Competition - 2012/2013

Memorandum for the applicant
Memorandum for the defendant

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Il presente lavoro nasce dalla partecipazione dell'Università Luiss Guido Carli alla European and International Tax Moot Court Competition organizzata dalla European Tax College Foundation di Lovanio.

Si tratta di una competizione che simula un processo, in cui le delegazioni di alcune università europee ed americane si affrontano su uno specifico tema di diritto tributario internazionale e/o comunitario. Simulando tanto la fase scritta quanto il contraddittorio orale dinanzi all'autorità giudiziaria di un ipotetico Stato, le differenti squadre hanno proceduto, in questa edizione, all'analisi di un caso avente ad oggetto la compatibilità con il diritto comunitario di una clausola generale anti-abuso (in vigore in un ipotetico Stato Membro dell'Unione Europea), ed il suo rapporto con una convenzione internazionale contro la doppie imposizioni (stipulata con un altro Stato Membro dell'Unione Europea), con riferimento ad un'operazione di "*profit shifting*". In tale contesto è stata analizzata la giurisprudenza della Corte di Giustizia Europea in materia di rapporto tra le norme dei singoli Stati Membri e le libertà fondamentali garantite dal Trattato sul funzionamento dell'Unione Europea. È stato oggetto di approfondimento anche il tema dell'interpretazione dei trattati contro le doppie imposizioni.

Il paragrafo 7 della Sezione IV del *Memorandum for the applicant* ed i paragrafi 6, 6.1. e 6.2. della Sezione IV del *Memorandum for the defendant* sono stati redatti dal dott. Giuseppe Giangrande.
I paragrafi 1, 2, 3, 3.1. e 4 della Sezione IV del *Memorandum for the applicant* ed il paragrafo 3 della Sezione IV del *Memorandum for the defendant* sono stati redatti dal dott. Gianpaolo Sbaraglia.
I paragrafi 3.2., 3.2.1., 5, 5.1., 5.2., e 6 della Sezione IV del *Memorandum for the applicant* ed i paragrafi 1, 2, 2.1., 2.1.1., 2.1.2. e 2.2. della Sezione IV del *Memorandum for the defendant* sono stati redatti dalla dott.ssa Sarah Supino.
Il paragrafo 7.1. e 7.2. della Sezione IV del *Memorandum for the applicant* ed il paragrafo 4.5. della Sezione IV del *Memorandum for the defendant* sono stati redatti dal dott. Valentino Tamburro.

Il dott. Alessio Persiani, la dott.ssa Federica Pitrone ed il dott. Federico Rasi hanno assistito gli studenti nella preparazione dei lavori e nella successiva fase orale.
I lavori sono stati diretti dal Prof. Giuseppe Melis e dal Dott. Eugenio Ruggiero quali *team coach* della delegazione LUISS.

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II. STATEMENT OF FACTS

GLOBALCO is a European multinational group with companies in many countries across the world.

GLOBALCO EUROPALIA is a public company belonging to the GLOBALCO group, located in the EU State of EUROPALIA. Its shares are listed on several stock exchanges across the world.

GLOBALCO CHEESELAND is a long standing company with effective business operations, centralising the financial activities of the GLOBALCO group and established in CHEESELAND, another EU state. It is a company with a substantial trading activity of its own within the multinational group, but that also fulfils a holding activity in the same multinational group

CANDERON is a company also located in EUROPALIA, but that runs a totally separate and unrelated business. It does not belong to the GLOBALCO group.

GLOBALCO EUROPALIA has sold an important piece of real estate located in EUROPALIA to CANDERON.

The tax value of the real estate in the books of GLOBALCO EUROPALIA is 10.000.000 €. The fair market value is 60.000.000 € which equals thepurchase price between the parties. The gain on the transaction is calculated at 50.000.000 €.

In order to realize this transaction, GLOBALCO EUROPALIA set up TRANSFERO, a special vehicle in EUROPALIA which did not have any other function than to make transfers of real estate described in the case possible.

TRANSFERO was held by GLOBALCO EUROPALIA with 2% of the shares and by GLOBALCO CHEESELAND with 98%.

The capital for the investment in TRANSFERO amounted to 10.000.000 €. Both shareholders contribute proportionally to the capital, part of which came either from the funds of GLOBALCO CHEESELAND and from a small loan from a CHEESELAND bank. The bank loan amounted to € 1.000.000 and was guaranteed by TRANSFERO shares put in escrow with the agreement of GLOBALCO CHEESELAND.

The proceeds of the sale were used in the financial operations of the group, where the CHEESELAND company fulfils the function of financial coordination. Part of the proceeds

(25.000.000 €) were used in buying the shares of another EUROPALIA company that is integrated in the group structure, the remainder was used in business transactions elsewhere in the world.

The transaction to transfer the real estate to CANDERON was carried out through the following operations:

a) During the calendar year 2010, the real estate which had to be transferred to CANDERON was sold for 10.000.000 € to TRANSFERO;

b) After that, both companies holding TRANSFERO, i.e. GLOBALCO EUROPALIA and GLOBALCO CHEESELAND, sold their shares in TRANSFERO to CANDERON for a price of 60.000.000 €;

c) Twenty months after having acquired the shares, CANDERON liquidated TRANSFERO in order to simplify the legal structure, without being liable for any taxes, since when a company owns 100% of the shares of another company such liquidation is deemed to be a tax free reorganisation. As a consequence, TRANFERO was exempt from tax and the tax base of the assets transferred was carried forward by CANDERON.

A specific provision of EUROPALIA Tax code allows the constitution of a vehicle to transfer assets at tax value, between companies belonging to the same group and even between unrelated parties, fulfilling the conditions that (i) the transferor and the transferee are both EUROPALIA companies and that (ii) immediately after the sale the transferee shall be liable to corporate income tax on income from a business activity in which the asset is included.

The transferor company can also use an associated company (a newly established or an existing company associated with the transferor company) which would subscribe the dominant part of the shares of the special purpose vehicle company. Latter on, the assets would be transferred, at tax value, from the transferor to the special purpose company. The shares of the special purpose company would afterwards be sold (by both transferor and associated company) to a third party (transferor).

EUROPALIA allows the application of this provision even when the associated company (the one the taxation is shifted to) is subject to a lower tax rate or exempted from corporate income tax.

The EUROPALIA Tax Code even establishes that capital gains realised on shares held in companies are subject to corporate income tax on shares held by corporate shareholders.

Therefore, through the special tax provision allowing the constitution of a vehicle to transfer assets

at tax value, the capital gain on the transfer of the asset is deferred. The sale of the asset is made at tax neutrality but the subsequent sale of shares of the special purpose entity is subject to capital gains tax.

In order to ensure a fair application of tax benefits, a general anti-abuse provision is provided for, establishing that account must not be taken of a transaction if taxation in accordance with the rules applicable to the transaction(s) would run counter to the purpose of the applicable provisions of the tax law.

Moreover, the tax treaty between EUROPALIA and CHEESELAND follows the OECD model convention of 2010, except for art. 13/4° that is not incorporated in the tax treaty. Also EUROPALIA has no domestic rules whereby a sale of shares of a company holding mainly real estate is equated to a transfer of the underlying assets.

As a consequence of the aforesaid sale, either GLOBALCO EUROPALIA or GLOBALCO CHEESELAND realized taxable capital gains which were respectively taxable in the State of EUROPALIA (where GLOBALCO EUROPALIA is resident) and CHEESELAND (where GLOBALCO CHEESELAND is resident).

Unlike EUROPALIA, the general tax law of CHEESELAND provides for a PEX regime for capital gains realised on shares, requiring the holding company to have a minimum holding of 5% and without requiring an holding period.

Thereby, the gains realized by GLOBALCO EUROPALIA were subject to EUROPALIA corporate income tax whereas the gains realized by GLOBALCO CHEESELAND were subject to a PEX regime.

It means that most of the capital gains (98%) risen by the sale of TRANSFERO were taxed in the hands of GLOBALCO CHEESELAND, in the State of CHEESELAND; therefore, they were subject to the PEX regime.

The tax administration of EUROPALIA has taken the position that the use of GLOBALCO CHEESELAND for the transfer constitutes a scheme as described in the said general anti-abuse provision, since this company is not subject to capital gains tax.

On the basis of this general anti-abuse provision, the tax administration has issued an assessment notice to GLOBALCO EUROPALIA for corporate income tax on the total amount of the capital gain (i.e. 50.000.000 €), maintaining that the capital gain realised by the sale of TRANSFERO had to be fully taxed on behalf of GLOBALCO EUROPALIA.

Afterwards, GLOBALCO EUROPALIA has:

a) protested this assessment, but the assessment has been maintained by the tax administration and by the Tax Tribunal;

b) appealed the decision of the Tax Tribunal before the highest administrative court of EUROPALIA, taking the position that the assessment is unlawful, because it is a violation of the freedom of establishment and/or the free movement of capital of the TFEU and that the tax administration of EUROPALIA is not justified in using the anti-abuse provision, because the tax assessment also violates the provisions of the tax treaty between EUROPALIA and CHEESELAND.

III. ISSUES

The present case involves many juridical questions and topics that can be summarised as follows:

PART A: EUROPALIA TAX CODE AND EU LAW

1. The favorable tax treatment provided by domestic provisions about real asset sale is applied to Globalco Europalia Case.

2. If the transaction is considered a cross-border transaction is not an hypothesis of abuse of EC Law. There is a correct use of the UE freedoms.

3. The domestic anti-abuse clause constitutes an obstacle of EU freedom.

   3.1 There are two restrictions with reference to the freedom of establishment and free movement of capitals.

   3.2 There is a presence of a genuine economic activity which excludes an artificial arrangement, wholly or partly, to obtain a tax aims.

4. The Europalia tax code provisions is discriminatory.

   4.1 The situations of the internal and external taxpayer are comparable, in the light of the scope pursued by the internal specific provision.

   4.2 The provisions applied is discriminatory since a transaction involvingEuropalia companiesis taxed more favourably than an identical one involving a foreign company.

5. The Europalia tax code provisions violate the freedom of establishment.

   5.1 The group which a foreign company belongs to cannot apply the convenient provision to transactions involving the foreigner.

   5.2 A foreign company is not free to organise itself in Europalia, i.e. creating various branches or subsidiaries and, in general, organizing a transnational EU group.

   5.3 The Europalia anti-abuse clause renders less attractive for foreign companies the exercise of their right of establishment, so producing even a dissuasion from investing in such State.

6. *In subsidiary order*: the asserted restriction is not justified.

6.1 This obstruction is not justified under the coherence of the national tax system.

6.1.1 There is not a *specific direct link* between the tax neutrality of the sale and the taxation on subsequent capital gains.

6.1.2 The tax neutrality of the sale is linked to the following tax liability of the asset transferee, and the transferee in the Globalco transaction (Canderon) is still liable to corporate income tax on income from a business activity in which the asset is included.

6.2 This obstruction is not justified under the need to protect tax evasion and tax revenue losses.

6.2.1 An operation involving companies paying taxes in different Member States cannot be considered as aimed to avoid taxation only because the involved States provide for different tax systems.

6.2.2 The Globalco group transaction is not aimed to avoid taxation, since the group has just used the scheme allowed by the Europalia tax code, without reaching the purpose to avoid taxation.

6.3 The provision is not proportional.

6.3.1 There are other less restrictive solutions to adopt, among all the exchange of information between the involved States.

PART B: THE INTERPRETATION OF DOUBLE TAXATION CONVENTIONS

7. Treaty interpretation

7.1 The Treaty Interpretation is based on the real intention of the parties, and everything that is not contained in the agreement is not part of the autonomy of the parties negotiating.

7.2 Failure to include an OECD provision (Art. 13, par. 4) should not be read in the light of the existence of a domestic legislation regulating the matter.

7.3 The Globalco case is a tax deferral case rather than a double non-taxation case. Indeed, the capital gain will be realized by Candeon, when it will sell to a third person the real estate.

IV. ARGUMENTS

1 PRELIMINARY ISSUE: THE DOMESTIC PROVISIONS OF EUROPALIA TAX CODE ARE NOT CORRECTLY APPLIED

1. The assessment notice issued to Globalco Europalia provides the application of the specific provision no. (3) of ETC. In fact, on the basis of the GAAR, Tax Authority maintains that the conditions of the specific provision no.(4) of ETC are not fulfilled. Preliminarily, we will demonstrate that the GAAR is not applicable at the Globalco case and that the specific provision no. (3) was not correctly applied.
2. This latter provision contains a specific anti-abuse clause, where the arm's length principle is applied when a transaction is carried out without a business purpose. The following specific provision no.(4) provides that the previous one is not applied if the transaction is carried out between related companies both resident in Europalia. According with the Tax Code of Europalia, the specific provision no.(4)cannot be applied to cross-border situations.
3. In the Globalco case, Tax Authority has considered the real estate transaction like a cross-border situation because of the participation of Globalco Cheeseland in Transfero. However, specific provision no.(4) refers to the case in which a part of transaction is directly a foreign subject. In the Globalco case, the participation of Globalco Cheeseland does not give to the real estate transaction a cross-border nature. In fact, the sale of real estate is realized between Globalco Europalia and Transfero, that are both Europalia companies belonging to the same group. Then, the transaction cannot be considered strictly a cross-border operation. Tax administration had applied incorrectly specific provision no. (3) by considering this operation as an abusive practice, as stated in GAAR.
4. Tax Administration upheld that there was not a business purpose in this transaction, which was realized exclusively to obtain a tax saving. On the contrary, as above described, this transaction can be considered an usual sale of real estate asset within the same domestic group, regulated by thespecific provision no.(4). In fact, this transaction represents a restructuring operation to which a favorable tax treatment is applied. A business purpose is not required, as expressly provided for by the specific provision no. (4).
5. Nevertheless, the Tax Administration did not fulfill the burden of the proof required by GAAR. Firstly, we will demonstrate that the transaction separately, or together with other transactions, does not form part of a scheme resulting in a material tax benefit to the taxpayer.

Secondly, we will explain that the taxation is in accordance with the rules applicable to the operation and does not run counter to the purpose of the applicable provisions of the tax law.

6. Firstly, the taxpayer has realized this transaction complying with the ETC, without obtaining a material tax benefit. In particular, ETC provides for two ways to tax a real estate transaction: (i) the normal CIT or (ii) a special procedure trough which the capital gain on the asset is deferred. The Globalco Group has just chosen the second way, so that the capital gain on real estate will be deferred.

7. The taxation is only deferred (tax deferral system), without obtaining a tax advantage. In fact, a capital gain is taxed in a second phase, according with the provision at issue and with the parliamentary documents of Europalia State, too. The income, as a capital gain, is deferred and the taxpayer has not realized a tax avoidance scheme. Then, there is neither the prevalent scope of tax saving (subjective element), nor an artificial arrangement (objective element) to achieve, wholly or partly, a tax benefit.

8. Secondly, a domestic real estate transaction was realized and the specific provision no.(4) of ETC has to be applied because it does not represent a tax abuse scheme. On the contrary, Tax Administration incorrectly applied the specific provision no.(3) of ETC, that was invoked further to the application of the GAAR. There is not a tax saving aim because Globalco Europalia complies with specific provision no. (4), choosing the tax deferral regime.

2. THE ABUSE OF EU LAW AND DIRECT TAXES

9. According to Tax Authority of Europalia, even though the real asset sale is carried out with a domestic company (Transfero) the participation that Globalco Cheeseland holds in it (98%), gives to the operation a cross-border nature. Considering this operation as transnational, this case could be solved with the application of EU Law. So, it is necessary to verify the absence of abuse of EU law and, in subsidiary order, a correct exercise of UE Freedoms.

10. Firstly, there is an abusive practice when exercises EU freedoms are exercised to avoid the domestic law system. In this sense, an artificial scheme without business purpose must be realized.[1]

11. Thus, according with this structure, there are some elements for abuse of law hypothesis:

[1] See C-279/93, *Schumacker*; C-23/93, *TV10*; C–367/96, *Kefalas*; C-212/97, *Centros*. See EVERS, M. – GRAAF, A. D., *Limiting Benefit Shopping: Use and Abuse of EC Law*, in *EC Tax Review*, 2009/6, p. 285.

- The objective element: (i) the absence of economic activity, (ii) the unnatural scheme realized, (iii) the cross-border situation;
- The subjective element: the prevalence of avoidance scope over other interest or aims.

12. This analysis can regard also taxation area, when the taxpayer abuses of the EU Freedoms to avoid taxation of Member State.[2]
13. In Globalco case, the domestic restriction is not justified because the taxpayer uses correctly freedoms contained in TFEU without obtaining an unlawful tax saving.
14. On the other hand, it is important to remark that the abuse of EU tax law in tax matter regards exclusively the harmonized taxation. In other words, it is referred to the taxation introduced by EU law. So, the domestic measures, adopted to prevent tax avoidance and tax fraud must respect the principles contained in the EU law.
15. In the light of the EU law interpretation, on the contrary, the same treatment with reference to direct taxation is not provided.
16. The measures for tax avoidance and evasion about direct taxation are exclusive jurisdiction of each Member State. The Member State can use the better legislation to contrast tax avoidance or tax fraud in the domestic and cross-border situations, as long as they respect the EU freedoms. This interpretation of the abuse of tax law is confirmed by important judgments of ECJ.[3] The principle of the prohibition of abusive practice, as defined by ECJ case-law, cannot be extended to the field of non-harmonized taxes. In fact, the EU judges excluded the existence of any principle that would legally bind the Member States to prevent tax abuse in direct tax matter.
17. For those reasons, the prevention of abuse of tax law in the direct taxation remains a matter referred to domestic jurisdiction of Member States even though ECJ formulated a general notion of abuse of Tax Law, since this last is not applied to direct taxes.
18. This interpretation is expressed also by Communications about tax anti-avoidance in direct taxation. All that demonstrates that in direct tax matter a general principle in EU tax law is not formulated.[4]

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[2] See C-110/99, *Emsland-Stärke*. See also VANISTENDAEL, F., *Halifax and Cadbury Schweppes: one single European theory of abuse in tax law?*, in *EC Tax Review*, 2006, 4, p. 193.

[3] See C-529/2010, *Safilo*; C-417/2010, *3 M Italia*. See also ZALASIŃSKI, A., *The Principle of Prevention of (Direct Tax) Abuse: Scope and Legal Nature – Remarks on the 3M Italia Case*, in *European Taxation*, 2012.

[4] See Communication of 10 December 2007, 785. See DE BROE, L., *Some observations on the 2007 communication from the Commission: The application of anti-abuse measures in the area of direct taxation within the EU and in*

(continued...)

19. In the Globalco Case, the abuse of EU tax law is excluded, because the tax assessment notified to Globalco Europalia regards the violation of the GAAR about the direct taxation regulated by ETC. The ECJ case-law about the prohibition of abuse of EU tax law cannot be used.

20. In conclusion, the taxpayer uses correctly EU Freedoms and therefore the abuse of them is excluded.

3 THE RELATIONSHIP BETWEEN THE DOMESTIC GAAR AND THE FREEDOM OF ESTABLISHMENT/CITIZENSHIP

21. In the previous paragraphs, an abusive practice has been excluded taking in consideration both domestic law than EU law. In particular, if there is not abuse of EU law, EU freedoms have correctly been used. Consequently, it occurs to analyze the relationship between the domestic GAAR and the freedom of establishment, to prove that this domestic provision is not in line with EU law.

22. In fact, while specific provision no. (4) gives a favourable tax treatment to the transaction carried out by companies within the same group in Europalia State, the specific provision no. (3), that in Globalco case was applied further to the application of GAAR, gives a worse tax treatment to a transnational operation (that consists in the application of the fair value to the real estate asset transaction in absence of business purpose).

23. If such point is correct, the different tax treatment could entail a violation of the EU freedoms. In this case, the EU freedoms are violated both if they were used by Globalco Europalia than if they were used by Globalco Cheeseland.

24. This provisions could represent a restriction both for Globalco Europalia and Globalco Cheeseland for the following issues.

3.1. THE OBSTACLE TO THE FREEDOM OF ESTABLISHMENT OF GLOBALCO EUROPALIA

25. We are going to demonstrate that the freedom of establishment with reference to Globalco Europalia was violated by the joint application of the GAAR and the specific provision no. (3) ofETC (that excludes the application of Specific provision no. (4)).

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relation to third countries, in *EC Tax Review*, 2008, 3. See European Commission Recommendation of 6.12.2012, C (2012) 8806, *On Aggressive Tax Planning*.

26. In fact, if two companies within the same group fix their residence in the Europalia State, a favorable tax treatment is applied. On the contrary, if only a part of the same group fixes its residence in another State, both companies are discriminated. In this case, Globalco Europalia is discriminated.

27. Therefore, there is a restriction of the freedom of establishment of Globalco Europalia. Specific provision no. (4) of ECT excludes tax purpose of transaction exclusively if all subjects fix their residence in Europalia State.

28. Preliminary, it is important to underline when the GAAR constitutes an obstacle of the EU freedom mentioned, according with ECJ case-law.

29. Firstly, the refusal of the tax advantage in question on the ground that "*the transferee company in which the taxpayer has a holding is established in another Member State, is likely to have a deterrent effect on the exercise by that taxpayer of the right conferred on him by Article 49 TFEU to pursue his activities in that other Member State through the intermediary of a company*."[5]

30. Such inequality of treatment thus constitutes a restriction of the freedom of establishment for nationals of the Member State concerned, and, moreover, on that of nationals of other Member States resident in that Member State, "*who have a holding - or another participation in this company - in the capital of a company established in another Member State, provided that holding gives them definitive influence (directly or indirectly) over the company's decisions and allows them to determine its activities.*"[6]

31. Thus, the joint application of this GAAR and specific provision no. (3)represents an important violation of the freedom of establishment.

32. Secondly, this restriction could be applied in Europalia State if there is a tax saving in the transaction carried out by taxpayer. In this case, tax avoidance is excluded when the parts of a real estate transaction are both Europalia companies. The measure described is more favorable for domestic group than a multinational group. This reason does not comply with TFEU principles.[7]

33. 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 so a

[5]Case C-436/00, *X and Y*, paragraph 32.
[6] C-436/00, *X and Y*, point 37. See also caseC-251/98 *Baars*, paragraphs 22 and 28 to 31; case C-208/00, *Überseering*, paragraph 77.
[7] See the subsequent analysis about the *rule of reason*.

fiscal measure which compromises the exercise of a fundamental freedom guaranteed by the TFEU cannot be justified.[8]

34. Then, the application of GAAR with the aim at excluding the application of tax deferral disposition stated in specific provision no. (4) is clearly in contrast with art. 49 TFEU, since the specific provision no. (4) is applied only to domestic situations.

35. In general, the ECJ has held that tax saving reasons do not constitute an abusive practice if the carried transaction reflects economic activities. In fact, in this case, the taxpayer realized a restructuring operation, constituted by different transactions, which satisfies the above mentioned condition.[9]

36. Moreover, it is necessary to remark that there is an economic substance both in Europalia State than in Cheeseland State. The two companies carry out real business activity and the transaction assessed by Tax administration constitutes a normal real estate transaction with the creation a SPV, allowed by Europalia Tax Authority for the domestic transaction. So, this operation does not represent an artificial arrangement to avoid taxation in Europalia State.

37. In other words, the entire operation has a genuine purpose as required by ETC. The "business activity test"[10] is realized. Europalia Globalco carries out an activity that is effective and genuine and not such as regarded as purely marginal and ancillary.[11]

38. Moreover, the domestic provision against the abusive practices can also breach art. 54 TFEU, concerning the freedom of citizenship, when a specific domestic provision restricts the application of EU law for the multinational enterprise's group.

39. In a ECJ case-law,[12] the domestic provision at issue in the main proceedings constituted a restriction within the meaning of Article 49 TFEU for a company that is established in another Member State (in the present case, Globalco Cheeseland), and which is treated, within the meaning of Article 56 TFEU, in the same way of a natural person that wishes to carry out his activities through the intermediary of a branch or a company within the same group in the Member State concerned.

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[8] See case C-436/00, *X and Y*, point 62. See also case C-478/98 *Commission* v *Belgium*, paragraph 45.

[9] See case C-196/04, *Cadbury Schweppes plc & Cadbury Schweppes Overseas Ltd/Commissioners of Inland Revenu*e, that affirmed that "*further stated that a restriction on the freedom of establishment cannot be justified when, despite the existence of tax motives.*" See also KIEKEBELD B., *Anti-abuse in the Field of Taxation: Is There One Overall Concept?*, in *EC Tax Review*, 2009, p. 4.

[10] See also the paragraph 1.

[11] See case C-53/81, *Levin*; case C-196/87, *Staymann*; case C-176/96, *Lehtonen*. See WEBER, D., *Tax avoidance and the EC Treaty Freedoms*, EUCOTAX, Kluwer law, 2005, p. 9.

[12] See case C-250/95 *Futura Participations and Singer*, point 24; Case C-307/97 *Saint-Gobain ZN*, point 35.

40. The circumstance that the Member State may refuse a tax benefit, thus depriving the transferor of a tax advantage, only because a party of the transaction is situated in another Member State does not comply with Article 49 TFEU.[13]

41. In fact, this provision penalizes domestic company (which is, in this case, Europalia Globalco), only because a company of the same group (Globalco Cheeseland) is situated in another Member State (Cheeseland).

42. In conclusion, as we have demonstrated before, with reference to the exercise of the taxation power, the Member States cannot breach EU law. In particular, such allocation of tax right among different jurisdiction does not allow Member States to introduce discriminatory measures, which does not comply with EU law.[14][15]

3.2 THE DISCRIMINATION OF GLOBALCO CHEESELAND

43. The joint application of the GAAR and of the specific provision no. (3)also determines several consequences upon the foreign company involved in the transaction, i.e. Globalco Cheeseland. In fact, it discriminates the foreign company and violates its EU freedoms.

44. Firstly, it produces a discrimination, prohibited by EU law,[16] based only on the nationality of the investor, as we will immediately show.

45. According to the ECJ case-law, in order to demonstrate if a provision is discriminatory, it is important to verify if: (i) the internal and external situations are comparable, (ii)the provision at issue treats foreigners differently and worse than national taxpayers.[17] As we will demonstrate, both the conditions are fulfilled in the Globalco case.

46. First of all, the difference in treatment at issue relates to situations which are objectively comparable. Such comparability is undeniable since it is determined by the joint application of the GAAR and the specific provisionno. (3) of ETC that involves the disapplication of the specific provision no. (4),providing for a tax deferral regime only for domestic companies.

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[13] See Joined cases C-397/98, C-410/98 *Metallgesellschaft and Others,* point 42.

[14] See case C-170/05, *Denkavit Internationaal BV, Denkavit France SARL v. Ministre de l'Économie, des Finances et de l'Industrie*; case C-436/00*X and Y*; see also case C-221/89 *Factortame II*.

[15] See the subsequent paragraphs about the *rule of reason*.

[16] The non-discrimination principle is set out by art. 18 of TFEU, which establishes that *within the scope of application of the Treaties, and without prejudice to any special provisions contained therein, any discrimination on grounds of nationality shall be prohibited.*

[17] See opinion of advocate general Kokott delivered on case C-75/11, paragraph 47.

47. According to ECJ case-law, where national legislation establishes a criterion for the taxation of income paid, account must be taken of that criterion in determining whether the situations are comparable.[18]

48. The ETC provides that the tax deferral is granted if, immediately after the transfer of the asset, the transferee shall be liable to corporate income tax on income from a business activity in which the asset is included. The specific provision no. (4) of ETC aims to ensure that the favorable regime will granta temporary (and not final) tax benefit, as even expressed in the parliamentary documents, by shifting the tax liability from a taxpayer (the transferor) to another (the transferee).

49. Looking at the aim of the provision at issue (which should be the main criterion for the comparability test, regardless of the nationality of the involved taxpayers),[19]the situation of the internal shareholder (Globalco Europalia) and of the foreign shareholder (Globalco Cheeseland) are fully comparable, since the main issue at stake in the aim of the provision is that the transferee of the asset is liable at taxes for such asset (as Canderon is, in the Globalco case); so the fact that Globalco Cheeseland is a non-resident company cannot constitute itself an element of disapplication of the tax deferral regime.[20]

50. Moreover, as we will demonstrate, the provision at issue provides for a worse tax treatment if a foreign company is involved in the transaction.

51. It is clear that the tax treatment of the transaction at issue depends on the participation of a foreign company. If a foreign company takes part to the transaction, the capital gain generated by such transaction is subject to immediate taxation of the capital gain of real estate. On one hand, if the participating company is Europalian, then the taxation will be deferred. Clearly, this last company has cash-flow advantages for itself and for the whole group, since the financial activities of groups are usually managed in a centralized treasury. On the other hand, the foreign company and its group will have cash-flow disadvantages,[21] by receiving a worse treatment.

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[18]See, to that effect, Case C-170/05,*Denkavit International and Denkavit France*, paragraphs 34 and 35; case C-303/07 *Aberdeen Property Fininvest Alpha* , paragraphs 51 to 54; case C-540/07 *Commission v Italy*, paragraph 43; case C-284/09 *Commission v Germany*, paragraph 60; Joined Cases C-338/11 to C-347/11, paragraph 65; and, very recently, case C-387/11, *Santander Asset Management SGIIC and Others* , paragraph 28.

[19]See C-18/11, paragraph 17.

[20]See, to that effect, case C-337/08, *X Holding*, paragraph 23; caseC-270/83,*Commission v France*, paragraph 18, and case C-446/03,*Marks & Spencer*, paragraph 37. Among scholars, see O'SHEA, T., *Marks and Spencer v Halsey (HM Inspector of Taxes): restriction, justification and proportionality*, in *EC Tax Review*, 2006, p. 66; WATTEL, P., *Red Herrings in Direct Tax Cases before the ECJ*, in *Legal Issues of Economic Integration*, 2004, p. 81.

[21]See Opinion of Advocate General Mischo delivered on case C-436/00, *X and Y.*

52. Furthermore, the discrimination must be retained as existing if we consider that Europalian Tax Authority allows the application of the special provision even when the internal associated company is subject to a lower tax rate or is exempted from CIT. In this case, the capital gains on shares will not be taxed, in any case, but the tax neutrality of the sale will be ensured, anyway. So, the fact that the foreign company can apply the PEX regime does not constitute a different situation than a domestic company that is subject to a lower tax rate, or that is exempt from CIT. Then, there is no reason for the joint application of the GAAR and the specific provisionno. (3)to a foreign companies, only because they are subjected to a lower tax rates abroad.

53. For all the aforesaid arguments, we can conclude that a transaction involving Europalian companies is taxed more favourably than an identical one that involving non-Europalian companies. This last is discriminated by the application of the provisions at issue.

3.2.1. THE OBSTACLE TO THE FREEDOM OF ESTABLISHMENT OF GLOBALCO CHEESELAND

54. Not all restriction to the exercise of EU freedoms are caused by a discriminatory rule. Even in a lack of a discrimination, it is nonetheless necessary to investigate if a EU freedom is violated.[22] In the Globalco case, the national measure at issue restricts the freedom of establishment in Europalia of a foreign company, such as Globalco Cheeseland, which wantsto exercise this freedom by setting-up subsidiaries in Europalia, as we shall demonstrate.

55. As we have mentioned in the previous paragraph, the tax treatment of the transaction at issue depends on the participation of a foreign company, i.e. the involvement of Globalco Cheeseland.

56. Its freedom to invest and establish itself in Europalia and, in this particular case, *to organise itself in different Member States, including* [Europalia]*, is restricted because in* [Europalia] *it would not be able to benefit from transfers, such as the transfer at issue, in the same way as a* [Europalian] *company without such a foreign company among its shareholders.*[23]

[22]See ECJ, judgment in case C-236/84, *Hauptzollamt Dusseldorf*. See also case C-55/75, *Balkan-Import*; case C-52/81, *Werner Faust*. Among scholars, see HELMINEN, M., *Must the Losses of a Merging Company be Deductible in the State of Residence of the Receiving Company in EU?*, in *EC Tax Review,* 2011, p. 172; SEITZ, G., *National Income from the Cross-border Internal Transfer of Assets – Why the Amendments to the German Income Tax Act Violate the Freedom of Establishment*, in *Intertax*, 2008, p. 44; O'SHEA, T., *Freedom of Establishment Tax Jurisprudence: Avoir Fiscal re-visited*, *EC Tax Review*, 2008, p. 259.
[23]Opinion of Mr Advocate General Mischo on case C-436/00, *X and Y*, paragraph 28.

57. In other words, Globalco Cheeseland is not free to invest and establish itself in Europalia and, in this particular case, it is not free to *organise itself in different Member States,*[24] i.e. creating various branches or subsidiaries and, in general, organizing a transnational EU group, even considering that the ECJ has often taken into consideration the phenomenon of groups, giving juridical relevance to the deep links between companies which belong to the same group.[25] In this sense, according to the ECJ opinion it is forbidden the fact that the Globalco group is not able to apply the favourable regime to transaction involving Globalco Cheeseland, only for the fact that a group member taking part to the transaction is a foreigner.

58. In this meaning, the joint application of GAAR and of the specific provisionno. (3)moves toward an indirect dissuasion for Globalco Cheeseland to establish itself in such State. Moreover, TFEU does not allow any national measure which is liable to *hamper* or to *render less attractive* the exercise of fundamental freedoms guaranteed by TFEU.[26] This principle has been recently reaffirmed by ECJ in the case *National Grid Indus,* when the ECJ has stated that "*it is also settled case-law that all measures which prohibit, impede or render less attractive the exercise of the freedom of establishment must be regarded as restrictions on that freedom.*"[27]

59. Considering either the relevance of multinational groups in EU law or the wide definition of the freedom of establishment, each domestic provision which hinders the exercise of the fundamental EU freedoms for foreign companies[28] must be considered as a violations of EU law. In the Globalco case, this violation was made with the joint application of GAAR and specific provision no. (3) of ETC.

60. As a result, we can conclude that the specific provision no. (4) of ETC renders less attractive for Globalco Cheeseland the exercise of its right of establishment, so producing even dissuasion from investing in Europalia. For these reason, the application of these joint rules

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[24]Opinion of Mr Advocate General Mischo on case C-436/00, *X and Y,* paragraph 29.

[25]Among all, see case C-418/07,*Papillon*, point 50. Even the CCCTB proposal constitutes a proof of the deeper and deeper attention paid to the phenomenon of groups in the European Union, and the EC Treaty must be interpreted in line with the objectives of Communitylaw (teleological method of interpretation). See GARRIDO, B., *Interaction between the Interpretation of the Non-discrimination Provisions in Tax Treaties and in the EC Treaty: An Apparent Rather than Real Conflict*, in *EC Tax Review,* 2009, p. 157.

[26]Opinion of Advocate General Tizzano A. in case C-442/02,*CaixaBank*, point 25; see also case C-19/92 (*Kraus*), point 32; case C-55/94(*Gebhard*), point 37; C-470/04, point 26.

[27]See C-371/10, *National Grid Indus*, paragraph 36, explicitly referring to case C-442/02 *Caixa Bank*, paragraph 11; C-298/05, *Columbus Container Services* , paragraph 34; case C-157/07, *Krankenheim Ruhesitz am Wannsee-Seniorenheimstatt*, paragraph 30; case C-96/08,*CIBA*, paragraph 19. Among scholars, see DOUMA S., *Non discriminatory tax obstacles*, in *EC tax review*, 2012, p. 67.

[28]See the opinion of the Advocate-General in the case C-293/06, ***DeutscheShell***, paragraph 44. **See also** case C-293/06, ***DeutscheShell*****, paragraph 28; case** C-55/94 *Gebhard*, paragraph 37; and case C-442/02 *CaixaBank France*. Among scholars, see DOUMA, S., *Non discriminatory tax obstacles*, in *EC tax review*, 2012, p. 67.

must be considered an obstacle to the freedom of establishment, as granted by art. 49 of TFEU.

4. THE RELATIONSHIP BETWEEN THE SPECIFIC DOMESTIC ANTI – ABUSE CLAUSE AND THE FREE MOVEMENT OF CAPITALS

61. Other thanhindering the freedom of establishment, the provisions at issue can even hamper the exercise of the free movement of capitals, so determining a violation of art. 63 TFEU.

62. Examining the different phases of this transaction aimed to the sale of Transfero's shares from Globalco Europalia and Globalco Cheeselandto Canderon, we can note that those companies hold their shares in Transfero, a SPV. The sale of shares by the two companies and the sale of the real estate to Transfero can represent a cross-border movement of capitals because a foreign company is involved in those transactions.

63. In particular, a general characteristic of the movement of capitals is that it concerns unilateral transfers of value. It involves financial operation essentially regarding the investment of the funds (as even Transfero could be retained) rather than the remuneration for a service. From ECJ case-law it appears that every issue which is deeply tied to a capital movement (for example, a mortgage on real estate or the payment of dividends on the shares) also falls under the application of the free movement of capital principle.[29]

64. Thus, in this sense, it is common ground that the domestic provision at issue dissuades the companies liable to Europalian tax on gains on real estate, from selling of assets to foreign company, because the specific provision no. (4) is not applicable in case of cross-border transaction. In fact, if an Europalian company sells the asset to a foreign company, it will immediately pay the capital gain taxes on the asset. The Europalia company will prefer to sell asset to domestic companies and so the foreign investors will have less opportunity to invest in Europalia. Thus, it constitutes, for each company, a restriction of the free movement of capitals within the meaning of art. 63TFEU.[30]

65. In the light of all the foregoing considerations, insofar as it concerns the TFEU provisions about the free movement of capitals, we have to note that art.63 TFEU "*precludes a national provision which excludes the transfer of shares from the tax benefit made on that transaction where the transfer is carried out with the participation of a foreign legal person to a third*

[29] See cases C-222/97 *Trummer*; and C-35/98, *Verkooijen*.
[30] See case C-478/98 *Commission* v *Belgium*.

company (Candeon) in which the transferor directly or indirectly has a holding or is within the same multinational group."[31]

66. Therefore, a specific anti avoidance rule or a GAAR to fight tax avoidance and tax evasion complies with the free movement of capitals only when[32] it does not constitute anunreasonable restriction.

67. Alternatively, as we have demonstrated, ETC provisions hamper the free movement of capitals[33]when it is exercised in the State of Europalia by foreigners which reside in other Member States.

5 *IN SUBSIDIARY ORDER*: THE OBSTACLE TO THE EU FREEDOMS IS NOT JUSTIFIED

68. As demonstrated in the previous paragraphs, the Europalia tax provisions at issue are discriminatory and restrict the EU freedoms. It is, however, necessary to consider whether that restriction may be justified in light of the provisions of the TFEU.

69. No justifications can be given with reference to the reasons stated in art. 52 TFEU, *i.e.* public order, public security and public health, since these matters are not relevant at all in this case.

70. Anyway, it is also necessary to verify the possible applicability of the other justifications accepted by the Court under its *rule of reason* for different or restrictive tax treatment of cross-border situations as compared to similar domestic situations. In particular, they are (i) the need to protect the coherence of the national tax system and (ii) the need to avoid tax evasion.

71. The matter, as we will try to explain in the following paragraphs, deserves a negative answer.

5.1 COHERENCE OF THE NATIONAL TAX SYSTEM

72. One of the most important justifications often invoked by States in order to justify restrictive measures is the fiscal coherence. Anyway, the Court has generally been very reluctant to accept this justification.[34]

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[31] See case C-346/00*X and Y*, point 74.

[32] See precedent paragraph 2.

[33]LECLERCQ, L. – RAINDRE, V., *Real Property Investments in France –ECJ Finds France's 3% Tax to be Incompatible with the Free Movement of Capital, Bulletin for international taxation*, 2008, p. 13.

[34] The issue of fiscal coherence was invoked also in other cases, such as Case C-371/10, *National Grid Indus*, Joined Cases C-338/11 to C-347/11, Case C-380/11*Della Valle*, but it was always rejected. See also Opinion of Advocate General Kokotton C-371/10, *National Grid Indus*, paragraph 44. Among scholars, see CORDEWENER, A. – KOFLER, G., VAN THIEL, S., *The clash between European freedoms and National direct tax law: public interest defences*

(continued...)

73. The leading case, in this matter, is the *Bachmann*[35]case, in which the Court decided to accept this justification only if a "direct link" between the advantage and the disadvantage was proved. In recent cases, the ECJ has better defined the meaning of coherence for tax purposes. It has stated that a direct link is required between the concerned tax advantage and the compensating of that relief by a particular tax levy; moreover, the direct nature of that link must be examined in the light of the aim pursued by the rules in question.[36]

74. Undoubtedly, ETC establishes that capital gains realised on shares are subject to CIT. Anyway, this is not enough to invoke the justification of coherence of the tax system, since a link between the taxation of gains and the tax benefit on the previous sale of asset shall be demonstrated. As we will prove, examining the ETC it is not possible to find out a clear direct link between the sale at tax neutrality and the subsequent taxation on sale of shares, as we shall demonstrate.

75. Globalco Europalia is assessed because the associated company (*i.e.* Globalco Cheeseland) does not reside in the Europalia and is subject to a PEX regime. The restrictive provision would be justified, by the fiscal coherence, only if the tax neutrality were ensured at the condition that gains a rising on the subsequent sale of shares would have been taxed. This conclusion cannot be upheld.

76. In fact, ETC and Europalian Tax Authority allow the application of the specific provision no. (4) even when the domestic associated company which should pay taxes on the capital gain a rose from the sale of shares is subject to a lower tax rate or is exempt from CIT. In these cases, notwithstanding the capital gains could be not taxed, the tax neutrality for the previous sale of the asset is anyway ensured by ETC.

77. Then, if the domestic law itself allows the application of the tax neutrality to the sale of the asset also when the subsequent capital gains on shares are not taxed, so it means that there is not a *specific direct link* between the tax neutrality of the sale and the taxation on subsequent

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Available to the member states, in *Common Market Law Review*, 2009, p. 1951, and ECJ cases listed therein.

[35]See case C - 204/90, *Bachmann.*

[36]See case C-250/08,*Commission v Belgium*, paragraph 71; Joined Cases C‑338/11 to C‑347/11, paragraph 51; case C-418/07 *Papillon*, paragraph 44; case C-303/07, *Aberdeen Property Fininvest Alpha*, paragraph 72. Among scholars, see HELMINEN, M., *Must the Losses of a Merging Company be Deductible in the State of Residence of the Receiving Companyin EU?*, in *EC Tax Review,* 2011, p. 172; CORDEWENER, A. – KOFLER,G. – VAN THIEL, S., *The clash between european freedoms and National direct tax law: public interest defences Available to the member states*, in *Common Market Law Review*, 2009, p. 1951.

capital gains.[37] The relation between the provision allowing the sale at tax neutrality and the provisions stating the taxation of gains is "accidental", rather than specifically created.

78. In ECJ case-law,[38] in order to accept the justification concerning the requirement of a *direct* link between the tax advantage and the compensating of that advantage by a particular tax levy, we have to analyze the direct nature of that link in the light of the aims pursued by the rules in question.[39]In absence of this specific link, the justification at issue cannot be invoked.

79. Tax Authorities does not apply the GAAR and the specific provision no. (3) when the transferor of the shares (as Globalco Cheeseland in Globalco case) is a domestic company which is exempt from CIT. It maintains that in such case the coherence of the national tax system is fulfilled. On the other hand, if the transferor of that shares is a foreign company, Tax Authority applies the above mentioned joint rules by stating that the coherence of the national tax system is not fulfilled, only because the transferor company is a foreigner.

80. Globalco Europalia has not tried to avoid taxation at all, since the aim of the provision guaranteeing the tax benefit is to defer the taxation from the Europalian transferor to the Europalian transferee of the real estate. This last, which records the real estate asset at the tax value, could pay the taxes on the gain on the sale of the real estate, that the transferor has not paid in force of the specific provision no. (4). In the Europalia case, the transferee of the real estate (which is Transfero) is still liable for gains on the sale of the asset received by Globalco Europalia (also Canderon will be liable to tax, when it liquidates Transfero and records the real estate asset at its fiscal value). It means that the coherence aimed by the provision at issue is still guaranteed.[40]

81. For all the aforesaid reasons, since (i) the *link* between the tax neutrality and the subsequent taxation of shares lacks, and (ii) the sale at tax neutrality is better linked to the *subsequent taxation of gains on the transferee*, which is surely held in the transaction at issue, in the Europalia case the fiscal coherence is respected and cannot be invoked as a reason to justify

[37]See CORDEWENER, A. – KOFLER, G. – VAN THIEL, S., *The clash between European freedoms and National direct tax law: public interest defences Available to the member states*, in *Common Market Law Review*, 2009, p. 1951, referring to cases C-279/93, *Schumacker*, paragraph 40;C-80/94 *Wielockx*; C-484/ 93,*Svensson and Gustavsson,* paragraph 15; C-422/01, *Ramstedt*, paragraph 30, and others.

[38]See case C-250/08,*Commission v Belgium*, paragraph 71; Joined Cases C‑338/11 to C‑347/11, paragraph 51.

[39]See cases C-418/07 *Papillon*, paragraph 44; C-303/07, *Aberdeen Property Fininvest Alpha*, paragraph 72.

[40]For a critical analysis to the *Bachmann* opinion about the coherence justification, in comparison with the case 436/00 *X and Y* statement, see WATTEL, P., *Red Herrings in Direct Tax Cases before the ECJ*, in *Legal Issues of Economic Integration*, 2004, p. 81.

the restriction provoked by the joint application of the GAAR and the specific provision no. (3) of ETC.[41]

5.2. PREVENTION OF TAX AVOIDANCE AND TAX REVENUE LOSS

82. The prevention of tax avoidance as a further justification of the restriction of the freedoms at stake cannot be invoked, either, because of the following reasons.

83. As preliminary remarks, the situation in which the transferor company (Globalco Cheeseland in this case) has its seat abroad, does not represent itself a risk of tax evasion, since such company is in any case subject to the tax legislation of the State in which it is established.[42]The State of residence (which is Cheeseland, in this case) provides for a more favourable tax regime and it does not constitute itself a justification to the restriction. More specifically, Globalco Cheeseland is subject to Cheeseland tax system to all intents and purposes, and the circumstance that this last State provides for a PEX regime is none of Europalia State's concern.

84. ECJ has of ten affirmed that an operation involving companies which pay taxes in different Member States cannot be considered as aimed to avoid taxation only because the involved States provide for different tax systems. In fact, each State deals with tax revenues in a merely *internal* context because of the lack of a deep harmonisation in EU in matter of direct taxes.[43]In particular, "*for companies to seek to profit from differences between national tax systems is a legitimate form of economic conduct and is indeed inevitable in an internal market in which taxation of corporations is not harmonized. Accordingly it is settled case-law that revenue shortfalls do not constitute an overriding reason in the public interest.*"[44]

85. Anyway, the prevention of tax avoidance may be considered an independent justification whether it is proved that the restrictive measure specifically aims to prevent the creation of

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[41]See Opinion of Advocate General Sharpstonon case C-250/08*Commission v. Belgium*, paragraphs 50-51.

[42]See C-250/95, *Futura Participations SA and Singer*; C-81/87, *Daily Mail*; C-324/00, *Lankhorst-Hohorst*; C-284/2006 *Burda*. Among scholars, see GARCIA NOVA, C., *Tax Neutrality in the Exercise of the Right of Establishmentwithin the EU and the Funding of Companies*, in *Intertax,* 2010, p. 568, regarding the use of the comparative advantages of taxation, in case 436/00, *X and Y,* of 21 November 2002.

[43] As we have also said in par. 1. For a survey on different way of taxing capital gain, see ZIELKE, R., *Taxation of Capital Gains in the European Union, Norway, and Switzerland: An Empirical Survey with Recommendations for EU Harmonization and International Tax Planning,* in *Intertax*, 2009, p. 382; For an analyses of the case law of the European Court of Justice concerning the capital gains tax regimes of the EU Member States, see O'SHEA, T., *European Community Tax Law: Taxation of Capital Gains,* in *The Tax Journal*, 2008, p 15.

[44]Opinion of Advocate General Kokott on case C-371/10, *National Grid Indus*, paragraph 103, referring to cases C‑324/00 *Lankhorst-Hohorst*, paragraph 36; C‑9/02,*de Lasteyrie du Saillant*, paragraph 51; and C‑196/04, *Cadbury Schweppes and Cadbury Schweppes Overseas*, paragraph 49.

wholly artificial arrangements which do not reflect economic reality, in order to escape the tax normally due on the profits generated in the national territory.[45] This did not happen in the Europalia case, for the following reasons:

a) the taxation in accordance with the rules applicable to the transactions does not run counter to the purpose of the applicable provisions of the tax, as stated in GAAR;

b) the transfer of assets between unrelated companies, using the special procedure with a SPV, is not considered itself as a wholly artificial transaction, since it has been generally accepted by the Tax Authority of Europalia, because there is no final loss of tax revenue since the transferee is still liable for taxes due on the asset.

86. The Globalco group has just used the scheme allowed by the ETC; in fact, the final transferee of the real estate asset (Canderon) is still liable for tax purposes, since it will pay taxes on gains that will rise from the future sale of the asset.

87. It means that, according to the Europalia Tax Authority, the sole fact that one of the companies is not Europalian determines the inapplicability of the favorable rule (stated in specific provision no. (4)), even if the transaction is not aimed to avoid taxation, at all; anyway, as examined above, this circumstance cannot entail itself a risk of tax evasion.

88. For all the aforesaid, the provision at issue cannot be justified by the prevention of tax avoidance and tax revenue losses.

6. <u>THE PRINCIPLE OF PROPORTIONALITY</u>

89. The measure at issue would be proportional if it ensured the achievement of its aim, without restricting the fundamental freedoms of EU law more than is necessary for that purpose. It does not seem that this proportionality requirement is met in this particular case.[46]

90. A measure is proportional if:[47]

a) it is appropriate for attaining the objective;

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[45] See, to that effect, cases C‑524/04 *Test Claimants in the Thin Cap Group Litigation*, paragraph 72 et seq.; C‑303/07 *Aberdeen Property Fininvest Alpha*, paragraphs 63 and 64; C-31/08*SGI*, paragraphs 65 and 66. See also Opinion of Advocate General Kokott on C-371/10, *National Grid Indus*, paragraph 102.

[46]Opinion of Advocate General Tizzano in case C-516/99, *Schmid*; case C-250/95, *Futura Participations SA and Singer*; case C-81/87*, Daily Mail*; case C-264/96, *Imperial Chemical Industries*.

[47]See ZALASIŃSKI, A., *Proportionality of Anti-Avoidance and Anti-Abuse in the ECJ's Direct Tax Case Law,* in *Intertax*, 2007, p. 310, and all literature cited there.

b) it is not disproportionate to its aim (proportionality in the narrower sense), which means that no other measure is available which is less restrictive of freedoms.

91. The internal rule at issue, as applied in the Globalco case, aims to impede that the taxpayer could avoid its tax duties. At this purpose, it treats less favourably any transaction involving a foreign company, presuming evasion or abuse as soon as a company established in another Member State takes part to the transaction. As we will immediately show, the measure is clearly disproportionate to its objective, not fulfilling the aforesaid condition *sub b).*

92. The provision is not in line with the ECJ case-law according to which the tax avoidance does not necessarily have to be ensured within a purely national context. Double taxation agreements should also be taken into account.[48]In fact, double taxation conventions prevent situations in which there is no longer any State empowered to tax gains.

93. With reference to the Globalco case, the double taxation agreement between Europalia and Cheeseland has been signed. It could be relevant in so far as it shares the taxation of capital gains between the two contracting States, indeed, in order to avoid that the taxpayer *is not taxed at all*; moreover, it includes the special provision about the exchange of information.

94. The joint application of the GAAR and the specific provision no. (4) is too restrictive and such a restriction goes beyond what is necessary to contrast tax evasion. In fact, the same result which it aims to (i.e. avoiding that the taxpayer is not taxed anywhere) could be reached through the procedure of the exchange of information, which is an alternative and non-restrictive measure that States can adopt.[49]

95. In the case at issue, the State of Europalia could exchange information with the State of Cheeseland (or with any other State which foreign companies involved in such an operation reside in), in order to know if the foreign taxpayer has declared the revenues rising up as a consequence of that operation. This would be a less restrictive measure, still underlining that the circumstance that the involved State provides for a less restrictive tax system should not be relevant, as a justification to the restriction.

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[48]The same argument can be used with reference to the coherence of tax system. See Opinion of Mr Advocate General Mischo on C-436/00,*X and Y*. See also C-80/94,*Wielockx*.

[49]ECJ, judgement in cases C-250/95, *Futura Participations SA and Singer*; C-81/87*, Daily Mail*; C-264/96,*Imperial Chemical Industries*. See also Opinion of Mr Advocate General Poiares Maduro delivered on caseC-436/03*Marks & Spencer*, paragraph 81. Among scholars, with reference to proportionality of the fiscal supervision as a justification, see HELMINEN, M., *Must the Losses of a Merging Company be Deductible in the State of Residence of the Receiving Company in EU?*, in *EC Tax Review,* 2011, p. 172, with reference to cases C-204/90 *Bachmann*; C-55/98 *Vestergaard*;C-422/01 *Skandia and Ramstedt*;C-383/05 *Raffaele Talotta v. Belgian State,* paragraph 36;C-136/00 *Danner*; C-520/04 *Turpeinen*, paragraphs 36 and 37.

96. For all the aforesaid reasons, the presumption that the involvement of a foreign company to a transaction is aimed only at avoiding taxes is not proportional to the scope pursued, so that the provision at issue does not respect the principle of proportionality as provided for by EU law.

7. INAPPLICABILITY OF ART. 13(4), OECD MODEL

97. Moreover, it should be noted that the action of the Tax Authority reveals a total incoherence, as it has not been sufficiently careful to note that, in the interpretation of a law, an excessively expansive interpretation goes beyond the intention of the legislator; thus we must adhere to what is in the text of the law and draw no material consequences from the law's silence interpretation.

98. In fact, when the law wanted to regulate the matter in further detail, it did regulate the matter; when it did not want to regulate the matter in further detail, it remained silent: "*ub ilex voluit dixit, ubi noluit tacuit*". In light of this brocard, we will proceed to demonstrate how the failure to provide for the OECD anti-abuse clause in art. 13 (4) in the double taxation convention between Europalia and Cheeseland is the fundamental reason for its effective inapplicability to the present case. In fact, the legislative *vacuum* left about the prediction of the OECD anti-abuse clause represents the will of the parties to not provide for such a provision. In this sense, such a clause would provide a strong disincentive to foreign investment, excluding the application of PEX regime in foreign State.

99. All this is justified by the fact that, moreover, OECD Model is not a source of international tax law. Indeed, it is a recommendation, an explanatory and interpretative document, absolutely useful and shared as a tool to assist in the correct application of the Conventions, but from which the individual agreements between States can disagree.

7.1 THE RULES ON THE INTERPRETATION OF TREATIES

100. The OECD Model Convention and the OECD Commentary carry a significant weight in the interpretation process if the contracting States chose to follow the wording of the OECD Model in drafting a certain provision. It is then only reasonable to assume that they intended such a provision to have the meaning it has in the OECD Model. This applies accordingly if the text of a provision differs from the OECD model. In this case, the different formulation will result in a difference in meaning.

101. Under the Vienna Convention,[50] 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.[51]

102. Indeed, the interpretative problems must be solved only through interpretation in each individual case.[52]

103. As scholars noted,[53] the absence of any of the specific provisions in a specific tax treaty must give a strong indication that the two contracting States either failed to consider this particular abuse, or lacked in the common intention to hamper it. Accordingly, for example, the absence of any form of anti-conduit provision in a convention suggests that one or both of the States was not troubled by the prospect of treaty shopping. Therefore, in the present case, art. 13 (4) OECD Model does not apply, because it is not required. In fact, the Tax Treaty between Europalia and Cheeseland follows the OECD Model Convention 2010, except for art. 13 (4) that is not incorporated in the tax agreement. Therefore, this anti-abuse rule cannot be taken in consideration to support the Tax Administration's claims, because the OECD Model Convention is not a source of international tax law. It is only an interpretation model of the standards agreements. This assumption comes from the formal and substantial autonomy given to the States to conclude all DTCs.

104. On the basis of the previously recognized, the *vacuum* in the Convention represents the real intention of the parties not to regulate the anti-abuse clause in terms of capital gains, in order to avoid the discrimination of foreign investors, which would not benefit from the PEX regimein the State of origin if this clause was applied. This way, the parties have agreed to a kind of double non-taxation because their real intention was not to provide in any way an anti-abuse clause which discouraged foreign investment.

105. In this sense, it is also unusable except that detects the lack of provision of the OECD clause in the convention against double taxation, in the light of already present domestic rules regulating the matter, because the said clause has not been deliberately mentioned.

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[50] See Articles 31-33, Vienna Convention on the Law of Treaties, that represent a general rule for the interpretation of international agreements. See, VAN RAAD, C., *Materials on International and EC Tax Law*, Vol. 1, 2002-2003, *International Tax Center Leiden/IBFD Amsterdam*, p. 800 et seq.

[51] See art. 31 (1) VCLT.

[52] See ECJ judgement in the case C-436/00, *X and Y*.

[53] See BAKER, P. – TIZHONG, L., *Improper Use of Tax Treaties: the new Commentary on Article 1 and the Amended Article 13(5)*, in *Bulletin for International Taxation*, 2012.

7.2. TAX DEFERRAL AND DOUBLE NON-TAXATIONCOMPLYWITH ETC

106. Whereas ETC allows a tax deferral of the capital gain rising from real estate property, we will explain that in this case there was just a tax deferral and not a definitive exemption or a double non taxation. Moreover and in any case, we will explain that a double non-taxation of income could arise by a tax treaty.

107. First of all, the real estate was sold from Europalia to Transfero at an amount equal to its "tax value", without the realization of any capital gain. The capital gain on Transfero shares, realized from Globalco Cheeseland, was not taxed in Europalia because the tax treaty recognise to Cheeseland its right to tax.

108. Secondly, with reference to the shifting of the taxation of profits from one company to another, the way of transferring assets between unrelated companies, using the special procedure with a special purpose vehicle has been generally accepted by the tax administration of Europalia, because there was no final loss of tax revenue.

109. Tax administration intended that the final loss of tax revenue was a consequence of the PEX regime applicable to Globalco Cheeseland. We have to considerate that a PEX regime avoids, *inter alia*, the double taxation of unrealized capital gains. In fact, the transfer of real estate from Transfero to Canderon was done at the tax value of this asset. Thus, when Canderon sells real estate to a third company there will be a realized capital gain on fixed asset that will be taxed. As stated in the ETC, there is no time limit for the disposal of the shares with reference to the "temporary relief". Indeed, the tax value of this asset, in Candeon balance sheet, is still equal to Euro 10.000.000,00 and represents an unrealized capital gain that cannot be taxed by Tax Administration in the hands of Globalco Europalia.

110. On the basis of the previously recognized, the *vacuum* in the Convention represents the real intention of the parties not to regulate the anti-abuse clause in terms of capital gains, in order to avoid the discrimination of foreign investors, which in the State of origin would not benefit from the PEX regime. In this way, the parties have agreed a double non-taxation. Scholar notes[54] that if double non-taxation is legitimate where both States apply the same tax treaty rule, but the residence State is prevented from taxing under the treaty and the source State does not levy tax domestically, then it is difficult to understand why double non-taxation becomes illegitimate just because the source State would have applied a different tax treaty rule if it had to apply the treaty.

[54]See LANG, M., *2008 OECD Model: Conflicts of Qualification and Double Non-Taxation*, in *Bulletin for International Taxation*, 2009.

111. A double non-taxation is one way of avoiding double taxation. Moreover, a DTC, which concerns the allocation of taxing rights, can be interpreted as providing relief from taxation only to the extent required to avoid double taxation that would occur in the absence of such DTC; the commentary on the OECD model does not requires anything more.[55][56]

112. In conclusion, the case can be solved underlining that the ETC provisions are not correctly applied because the operation at issue is a domestic real estate transaction and it is not an abusive practice.

113. If this transaction were considered as a cross-border situation, there would have not been an abuse of EU freedoms, anyway. Taxpayer correctly exercised EU freedoms, and the joint application of GAAR and the specific provision no. (4) constitutes an obstacle to both the freedom of establishment and the free movement of capitals.

114. The provisions of the ETC, as applied in the Globalco case, discriminate both the domestic company and foreign company within the same group which take part to the transaction and even constitute an obstacle to the exercise of their EU freedoms. Moreover, the restriction is not justified under the ECJ rule of reason.

115. Moreover, if we read the Double Taxation Convention between Europalia and Globalco, the lack of Article 13(4) is an expression of the parties' freedom. On the other hand, the use of this clause could make it impossible to exploit the PEX regime in Cheeseland for cross-border operations. Anyway, the failure to provide for the OECD clause does not automatically implies the introduction of this clause or an alignment at the same.

116. The main issue at stake is the following: the taxation is not avoided but it is just deferred on the transferee of the real estate transaction, which is still liable to tax in the Europalia State. Thus, the *ratio* of the domestic rule is not violated, at all.

[55]See § 21 of the OECD Model Commentary on Article 13.
[56] See WATERS, M., *General report*, in *IFA (ed.) Double non-taxation*, *Cahiers de droit fiscal international*, 2004.

V. TABLE OF ABBREVIATIONS

Art.	Article
CIT	Corporate income tax
DTCs	Double Taxation Conventions
ECJ	European Court of Justice
EU Law	European Union Law
EU	European Union
ETC	Europalia Tax Code
GAAR	General Anti Avoidance Rule
MS	Member States
PEX	Participation Exemption
SPV	Special purpose vehicle
TFEU	Treaty on the Functioning of the European Union
TEU	Treaty on European Union
VCLT	Vienna Convention on the Law of Treaties

European Tax Moot Court Competition 2012/2013

MEMORANDUM FOR THE DEFENDANT

Registration number: I/001

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II. STATEMENT OF FACTS

GLOBALCO is a European multinational group with companies in many countries across the world.

GLOBALCO EUROPALIA is a public company belonging to the GLOBALCO group, located in the EU State of EUROPALIA. Its shares are listed on several stock exchanges across the world.

GLOBALCO CHEESELAND is a long standing company with effective business operations, centralising the financial activities of the GLOBALCO group and established in CHEESELAND, another EU state. It is a company with a substantial trading activity of its own within the multinational group, but that also fulfils a holding activity in the same multinational group

CANDERON is a company also located in EUROPALIA, but that runs a totally separate and unrelated business. It does not belong to the GLOBALCO group.

GLOBALCO EUROPALIA has sold an important piece of real estate located in EUROPALIA to CANDERON.

The tax value of the real estate in the books of GLOBALCO EUROPALIA is 10.000.000 €. The fair market value is 60.000.000 € which equals thepurchase price between the parties. The gain on the transaction is calculated at 50.000.000 €.

In order to realize this transaction, GLOBALCO EUROPALIA set up TRANSFERO, a special vehicle in EUROPALIA which did not have any other function than to make transfers of real estate described in the case possible.

TRANSFERO was held by GLOBALCO EUROPALIA with 2% of the shares and by GLOBALCO CHEESELAND with 98%.

The capital for the investment in TRANSFERO amounted to 10.000.000 €. Both shareholders contribute proportionally to the capital, part of which came either from the funds of GLOBALCO CHEESELAND and from a small loan from a CHEESELAND bank. The bank loan amounted to € 1.000.000 and was guaranteed by TRANSFERO shares put in escrow with the agreement of GLOBALCO CHEESELAND.

The proceeds of the sale were used in the financial operations of the group, where the CHEESELAND company fulfils the function of financial coordination. Part of the proceeds

(25.000.000 €) were used in buying the shares of another EUROPALIA company that is integrated in the group structure, the remainder was used in business transactions elsewhere in the world.

The transaction to transfer the real estate to CANDERON was carried out through the following operations:

d) During the calendar year 2010, the real estate which had to be transferred to CANDERON was sold for 10.000.000 € to TRANSFERO;

e) After that, both companies holding TRANSFERO, i.e. GLOBALCO EUROPALIA and GLOBALCO CHEESELAND, sold their shares in TRANSFERO to CANDERON for a price of 60.000.000 €;

f) Twenty months after having acquired the shares, CANDERON liquidated TRANSFERO in order to simplify the legal structure, without being liable for any taxes, since when a company owns 100% of the shares of another company such liquidation is deemed to be a tax free reorganisation. As a consequence, TRANFERO was exempt from tax and the tax base of the assets transferred was carried forward by CANDERON.

A specific provision of ETC allows the constitution of a vehicle to transfer assets at tax value, between companies belonging to the same group and even between unrelated parties, fulfilling the conditions that (i) the transferor and the transferee are both EUROPALIA companies and that (ii) immediately after the sale the transferee shall be liable to corporate income tax on income from a business activity in which the asset is included.

The transferor company can also use an associated company (a newly established or an existing company associated with the transferor company) which would subscribe the dominant part of the shares of the special purpose vehicle company. Latter on, the assets would be transferred, at tax value, from the transferor to the special purpose company. The shares of the special purpose company would afterwards be sold (by both transferor and associated company) to a third party (transferor).

EUROPALIA allows the application of this provision even when the associated company (the one the taxation is shifted to) is subject to a lower tax rate or exempted from corporate income tax.

The ETC even establishes that capital gains realised on shares held in companies are subject to corporate income tax on shares held by corporate shareholders.

Therefore, through the special tax provision allowing the constitution of a vehicle to transfer assets

at tax value, the capital gain on the transfer of the asset is deferred. The sale of the asset is made at tax neutrality but the subsequent sale of shares of the special purpose entity is subject to capital gains tax.

In order to ensure a fair application of tax benefits, a general GAAR is provided for, establishing that account must not be taken of a transaction if taxation in accordance with the rules applicable to the transaction(s) would run counter to the purpose of the applicable provisions of the tax law.

Moreover, the tax treaty between EUROPALIA and CHEESELAND follows the OECD model convention of 2010, except for art. 13/4° that is not incorporated in the tax treaty. Also EUROPALIA has no domestic rules whereby a sale of shares of a company holding mainly real estate is equated to a transfer of the underlying assets.

As a consequence of the aforesaid sale, either GLOBALCO EUROPALIA or GLOBALCO CHEESELAND realized taxable capital gains which were respectively taxable in the State of EUROPALIA (where GLOBALCO EUROPALIA is resident) and CHEESELAND (where GLOBALCO CHEESELAND is resident).

Unlike EUROPALIA, the general tax law of CHEESELAND provides for a PEX regime for capital gains realised on shares, requiring the holding company to have a minimum holding of 5% and without requiring an holding period.

Thereby, the gains realized by GLOBALCO EUROPALIA were subject to EUROPALIA corporate income tax whereas the gains realized by GLOBALCO CHEESELAND were subject to a PEX regime.

It means that most of the capital gains (98%) raised by the sale of TRANSFERO were taxed in the hands of GLOBALCO CHEESELAND, in the State of CHEESELAND; therefore, they were subject to the PEX regime.

The tax administration of EUROPALIA has taken the position that the use of GLOBALCO CHEESELAND for the transfer constitutes a scheme as described in the said general GAAR, since this company is not subject to capital gains tax.

On the basis of this general GAAR, the tax administration has issued an assessment notice to GLOBALCO EUROPALIA for corporate income tax on the total amount of the capital gain (i.e. 50.000.000 €), maintaining that the capital gain realised by the sale of TRANSFERO had to be fully taxed on behalf of GLOBALCO EUROPALIA.

Afterwards, GLOBALCO EUROPALIA has:

c) protested this assessment, but the assessment has been maintained by the tax administration and by the Tax Tribunal;

d) appealed the decision of the Tax Tribunal before the highest administrative court of EUROPALIA, taking the position that the assessment is unlawful, because it is a violation of the freedom of establishment and/or the free movement of capital of the TFEU and that the tax administration of EUROPALIA is not justified in using the GAAR, because the tax assessment also violates the provisions of the tax treaty between EUROPALIA and CHEESELAND.

III. Issues

The present case involves many juridical questions and topics that can be summarised as follows:

PART A: ETC AND EU LAW

1. The ETC provisions are compatible with the non discrimination principle
   1.1. The domestic and foreign situations are not comparable.
   1.2. The provisions applied are not discriminatory since they do not provide for a worse treatment for the involved foreign company.

2. The ETC provisions do not violate the freedom of establishment.
   2.1. Subjectively, the taxpayer involved in the assessment as a consequence of the application of the Europalia provisions is only the resident one, i.e. Globalco Europalia.
   2.2. The transaction is merely domestic, since it is wholly carried out in Europalia.
   2.3. For these two reasons, the situation involved in the assessment is purely domestic in a whole, so that the EU rules cannot be invoked.

3. *In subsidiary order*: the asserted restriction is justified.
   3.1. The asserted restriction is justified also under all the possible justifications accepted by the ECJ under its *rule of reason.*
      3.1.1. This obstruction would be justified under the coherence of the national tax system, since the previous tax benefit and the subsequent tax levy are linked to each other and they are also provided for in the light of a common objective.
      3.1.2. This obstruction would be justified by the need to protect tax evasion and tax revenue losses, since it aims to avoid that taxpayers carry out wholly artificial transaction solely to avoid taxation in Europalia.
      3.1.3. The provision is proportional because there are not any other less restrictive solutions able to reach the same aim.

4. The transaction realized an hypothesis of abuse of EU freedoms.
   4.1. There is not a genuine economic activity bat exclusively an artificial scheme to obtain tax advantage.
   4.2. The prevalence of substance over form could be applied.

PART B: THE INTERPRETATION OF DOUBLE TAXATION CONVENTIONS

5. Treaty interpretation
    - 5.1. The relationship between domestic GAAR and tax treaty in a monistic legal system can be analysed taking into account case-law in monistic countries.
    - 5.2. The transactions carried out are a typical example of treaty shopping, that have to be counteracted by tax administration.
    - 5.3. The Treaty Interpretation is based on the circumstances underlying the agreement between the parties.
    - 5.4. Art. 13, par. 4, OECD Model was not voluntarily recalled in Double Taxation Convention because the same principle has already been mandated by the domestic legislation regulating the matter.

IV. ARGUMENTS

1. THE ETC PROVISIONS ARE COMPATIBLE WITH THE NON-DISCRIMINATION PRINCIPLE

1. Preliminarily, the transaction carried out by the Globalco group, with specific reference to the involvement of a foreign company that is not subject to capital gains tax, constitutes a scheme as described in the GAAR of ETC. In fact, as we will demonstrate, it results in a material tax benefit to the taxpayer, and this benefit is the main reason of the operations carried out. Moreover, it goes counter the purpose of the specific provision no. (4), allowing a transfer at tax value only with reference to domestic transactions. As a consequence of the GAAR application, account must not be taken of the tax effects of the operation, *i.e.* the tax neutrality of the sale of the asset, provided for by the specific provision no. (4), because the conditions required are not fulfilled. The asset must be considered as sold at its market value and, as a consequence, Globalco Europalia is assessed as if the asset was disposed of for consideration equal to the fair market value, as stated in specific provision no. (3).

2. The taxpayer upholds that the aforementioned application of the GAAR violates EU law since it is discriminatory. Our contention, as argued below, is that the GAAR, as applied in the case at issue, does not violate the non-discrimination principle.

3. In order to verify if the application of the GAAR to the Globalco case is discriminatory, it is necessary to clarify what a discrimination is, under EU law and case-law.

4. The non-discrimination principle is set out by art. 18 of TFEU.[57] This provision has a very broad scope, so that we need to refer to the ECJ decision to better understand its meaning.

5. According to the ECJ jurisprudence, in order to check if a provision is discriminatory, it is important to verify if: (i) the domestic and cross-border situations are comparable and if (ii) the provision at issue treats foreigners differently and worse than national taxpayers.[58]

6. As we will immediately see, this argument cannot be applied to the Globalco case, because (i) the domestic and the cross-border situations are not comparable in the case at issue and because (ii) the foreigner taxpayer is not treated worse than the resident one. With reference to the comparability, the situation of Globalco Cheeseland is not comparable with the situation

[57] This provision establishes that *within the scope of application of the Treaties, and without prejudice to any special provisions contained therein, any discrimination on grounds of nationality shall be prohibited.*
[58] For a very recent case, see opinion of advocate general Ms Kokott delivered on case C-75/11, point 47.

of a resident taxpayer that carrying out the same business under the favourable tax regime provided for by the ETC.

7. In fact, the comparability of a cross-border situation with a domestic situation must be examined having regard to the aim pursued by the national provisions at issue.[59] The pursue of the national provision at issue is to grant a temporary relief and not a final benefit, as even said in the parliamentary documents, and this tax relief is temporary just because the non-taxed transfer of the asset is followed by the taxation of the gains on shares. Indeed, the aim pursued by the tax provision is to tax the subsequent capital gain on shares. The foreign company who sells the shares is not taxed in Europalia. Right for this reason, it is not comparable to the resident company to the aim pursued by the law.

8. Anyway, even if the Court should maintain that the situations are comparable, the provision does not constitute a discrimination, for the following reasons.

9. The non-discrimination principle has been interpreted by ECJ as aimed to avoid that foreign people or companies would receive a worse treatment than national ones. Since the *Avoir fiscal* case, according to the ECJ, this principle establishes that "*all nationals of member states who establish themselves in another member state* [...] *receive the same treatment as nationals of that state and it prohibits* [...] *any discrimination on grounds of nationality resulting from the legislation of the member state*".[60]

10. If we look at the Globalco case, we immediately see that the only foreign company which is involved in the operation is Globalco Cheeseland. Anyway, it is not the one which receives the worse treatment. In fact, it is not assessed by the Europalia Tax Authority and its capital gain remains exempt in Cheeseland, since the tax assessment is issued to Globalco Europalia (which is the national company), and not to the foreigner Globalco Cheeseland.

11. It means that the Tax Authority applies the GAAR to the resident company (i.e. Globalco Europalia) and not to the foreign one (Globalco Cheeseland). This last is not involved in the assessment and ordinarily applies its PEX regime.

12. Not all disparities are necessarily discriminations within the meaning of EU law[61] and, for all the aforesaid, the application of the GAAR is not a "discrimination", as meant by European law and case law, since it does not treat the foreign company worse than the resident one.

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[59] See C‑337/08, *X Holding*, paragraph 22; C-18/11, par. 17.
[60] See C-270/83, *Avoir fiscal*, point 14.
[61] This statement was referred to the application of the non-discrimination principle stated by Art. 18 TFEU. See ECJ,
(continued...)

2 THE GAAR IS COMPATIBLE WITH THE FREEDOM OF ESTABLISHMENT

13. Having demonstrated that the provision does not constitute a discrimination, we are going to maintain that it does not constitute an obstacle to the fundamental EU freedoms conferred by the Treaty, either.[62] In fact, the EU freedoms have no bearing on this case and European law does not apply.

14. Considering the foreign company involved (i.e. Globalco Cheeseland), the relevant freedom at stake is the freedom of establishment, since Globalco Cheeseland owns the 98% of Transfero. In fact, the existing case-law effectively excludes the application of free movement of capitals in a situation when the effective control or dominant influence exists since, in such cases, the restriction of the free movement of capital would be an unavoidable consequence of the restriction to the freedom of establishment.[63]

15. Restrictions to the freedom of establishment of nationals of a Member State in the territory of another Member State shall be prohibited. Such prohibition shall also apply to restrictions on the setting-up of agencies, branches or subsidiaries by nationals of any Member State established in the territory of another Member State.[64] This principle, as meant by the ECJ, sets out that foreign companies which are residents in a Member States must be allowed to establish in another Member State (*i.e.*, by setting there a branch) and this last must not impede or even obstruct it with domestic law provisions.[65]

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judgment in case C-236/84, *Hauptzollamt Dusseldorf*; C-55/75, *Balkan-Import*; C-52/81, *Werner Faust*.

[62] For a comparison between the meaning of "discrimination" and of "restriction" as upheld by ECJ, see, among all, HELMINEN, M., *Must the Losses of a Merging Company be Deductible in the State of Residence of the Receiving Company in EU?,* in *EC Tax Review,* 2011, p. 172.

[63] See Case C-524/04, *Thin cap*; Case C-492/04, *Lasertec*; Case C-102/05, *Stahlwerk Ergste Weatig*; Case C-284/06, *Burda*. Among scholars, see HEMELS, S. (and others), *Freedom of Establishment or Free Movement of Capital: Is There an Order of Priority? Conflicting Visions of National Courts and the ECJ,* in *EC Tax Review*, 2010, p. 19.

[64] It is set out in Title IV, Chapter 2, of the TFEU, in particular, art. 49, par. 1. Art. 54 extends this protection to companies, setting out that *companies or firms formed in accordance with the law of a Member State and having their registered office, central administration or principal place of business within the Union shall, for the purposes of this Chapter, be treated in the same way as natural persons who are nationals of Member States.*

[65] Among all, C-264/96; C-303/07, *Aberdeen Property Fininvest Alpha*; C-307/97 *Compagnie de Saint-Gobain v. Finanzampt Aachen- Innenstadt*, paragraph 35; C-446/03 *Marks & Spencer*, paragraph 30; C-196/04 *Cadbury Schweppes*, paragraph 41; and more recently, Case C-18/11, paragraph 12. Among scholars, see HELMINEN, M., *Must the Losses of a Merging Company be Deductible in the State of Residence of the Receiving Company in EU?*, in *EC Tax Review,* 2011, p. 172; HELMINEN, M., *EU Tax Law: Direct Taxation*, IBFD, 2009, p. 73; SEITZ, G., *National Income from the Cross-border Internal Transfer of Assets – Why the Amendments to the German Income Tax Act Violate the Freedom of Establishment*, in *Intertax*, 2008, p. 44; O'SHEA, T., *Freedom of Establishment Tax Jurisprudence: Avoir Fiscal re-visited*, *EC Tax Review*, 2008, p. 259.

16. In other words, in order to invoke the protection of the freedom of establishment, the involved taxpayers' exercise of the freedom should be hampered. It does not happen in the Globalco case.

17. The only foreign company involved in the transaction is Globalco Cheeseland. Globalco Cheeseland exercises its freedom of establishment in Europalia by controlling a subsidiary in such state (Transfero) and the position of Globalco Cheeseland concerns the freedom of establishment since it owns the 98% of Transfero.

18. Anyway, Globalco Cheeseland's freedom of establishment is not obstructed through the application of the GAAR, since this last provision does not determine any negative consequences upon Globalco Cheeseland.

19. Even in matter of capital gains on fixed assets, indeed, the ECJ has stated that domestic law violates EU law only if it restricts a EU freedom. With specific regard to the disposal of an asset, ECJ has upheld that the domestic provision was restrictive when non-residents were subject to a higher tax liability than residents on such disposal of assets.[66]

20. On the contrary, as a taxpayer, Globalco Cheeseland is not involved in the assessment in consequence of the application of the GAAR, since the assessed company is the resident one, *i.e.* Globalco Europalia.[67] In fact, this last has tried to carry out a transaction involving also a non-resident (Globalco Cheeseland) only to shift most of the capital gains in the hands of the foreigner. Its aim was only at avoiding taxation of capital gains on the sale of shares in Europalia.

21. For this reason, the provision at issue does not restrict Globalco Cheeseland's freedom of establishment; it better avoids the abuse of the specific provision no. (4) by the resident company.

22. Moreover, also analysing the case from the home country perspective, we cannot consider that the restricted freedom is exercised by Globalco Europalia. In fact, Globalco Europalia does not exercise its right of establishment in another Member State, since its subsidiary (which is Transfero) is also situated in Europalia. We can neither say that it exercises its freedom as guaranteed by EU law just by involving a foreign company in the operation, since such an

[66] Among all, see Case C-562/07, *Commission vs Spain*, paragraph 27.

[67] See also, with regard to capital gains, C-443/06, *Hollman*. For a wider analysis, see UUSTALU, E., *The compatibility of Estonian tax treatment of real estate income with EU law*, in *Intertax*, 2011, p. 449.

event should be considered *too uncertain and indirect* to regard a legislation as liable to hinder the freedom of establishment.[68]

23. Summarizing, for all the aforesaid, since (i) there is a restriction of a freedom only if a Member State hinders the establishment in another Member State of a foreigner[69] and (ii) *that establishment is generally exercised by the setting up of agencies, branches or subsidiaries* or *by taking part in the incorporation of a company in another Member State,*[70] then the application of the GAAR in the Globalco case cannot be considered as a restriction of the freedom of establishment, because:

    a) from the host country perspective, Globalco Cheeseland's freedom of establishment is not impeded through the application of domestic rules;

    b) from the home country perspective, Globalco Europalia does not exercise its freedom of establishment at all.

24. The reason of the tax assessment is that Globalco Europalia has carried out a transaction that does not fulfil the conditions provided for by the specific provision no. (4), because it involves a foreign company to avoid capital gain taxation on shares in Europalia. Therefore, only Globalco Europalia must be assessed, which is the resident company.[71]

25. The doubt if the activity carried out by Cheeseland Globalco, as concerns the application of the GAAR and the exclusion of the tax benefit provided for by the specific provision no. (4), is covered by the freedom of establishment deserves a negative answer. The tax assessment does not involve foreign companies, so that the EU law cannot be invoked since the application of the GAAR does not obstruct the freedom of establishment.

2.1. *IN SUBSIDIARY ORDER*: THE ASSERTED RESTRICTION TO THE FREEDOM OF ESTABLISHMENT IS JUSTIFIED

26. Should this Court hold that the GAAR obstructs the freedom of establishment granted by art. 48 of the TFEU, nonetheless this obstruction would be justified under all of the other justifications accepted by the Court under its *rule of reason*, and, in particular, (a) the need to protect the coherence of the national tax system, (b) the need to avoid tax evasion.

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[68] See Case C-190/98, *Graf*, point 25.

[69] O'SHEA, T., *Freedom of establishment tax jurisprudence: Avoir Fiscal re-visited*, in *EC Tax Review*, 2008, p. 259.

[70] See C-81/87 (*Daily Mail*), point 17.

[71] See, e.g., C-152/94, *Van Buynder*, paragraphs 10 and 13; Case C-196/04, *Cadbury Schweppes,* paragraphs 54 and 68. Among scholars, EVERS, M. – DE GRAAF, A., *Limiting Benefit Shopping: Use and Abuse of EU law*, in *EC Tax Review*, 2009, p. 279.

2.1.1. COHERENCE OF THE NATIONAL TAX SYSTEM

27. As we will demonstrate, the provision at issue is justified by the need to maintain the coherence of the Europalia tax system, since the taxation on the subsequent capital gains at the time of the transfer of the vehicle's shares is the logical complement of the tax neutrality previously granted in respect of the transfer of the asset.

28. In many cases, the ECJ has held that the need to safeguard such coherence may justify rules that are liable to restrict fundamental freedoms, starting from the well-known *Bachman* case and even later.[72]

29. However, the ECJ has always reaffirmed that, for an argument based on such a justification to succeed, two conditions must be fulfilled:

    a) a direct link must be established, according to settled case-law, between the tax advantage concerned and the compensating of that advantage by a particular tax levy;[73]

    b) the direct nature of that link falling must be examined in the light of the objective pursued by the rules in question.[74]

30. The domestic provisions provided for by ETC fulfils both the aforementioned conditions.

31. With regard to the former condition *sub a)*, it is clear that the previous tax advantage (i.e. the sale of the asset at tax neutrality) and the subsequent tax levy (i.e. the taxation of the capital gains) are linked, since the exemption on the sale of the asset is rather *conditional*[75] on the following taxation on capital gains. In fact, the provision allowing the transfer of the asset at tax neutrality is collocated in a system which does not provide for a PEX regime, since ETC establishes that capital gains realised on shares held in companies are subject to corporate income tax.

32. If the taxation of capital gain is allocated abroad, the link between the previous tax benefit and the subsequent taxation is broken, since the taxation of this gain is not levied in Europalia.

[72] See Case C-204/90, *Bachmann,* paragraph 21; in the same day the Court delivered judgement in the infringement proceedings brought by the Commission against Belgium under art. 169 ECT on largely the same issues (case C-300/90, *Commission v. Belgium*). Even later, the Court has very often held that the need to safeguard such coherence may justify rules that are liable to restrict fundamental freedoms; among all, see C‑157/07 *Krankenheim Ruhesitz am Wannsee-Seniorenheimstatt*, paragraph 43; C-250/08, *Commission v Belgium*, paragraph 70; C-379/05, *Amurta* , paragraph 46.

[73] See C-250/08, *Commission v Belgium*, paragraph 71; Joined Cases C‑338/11 to C‑347/11, paragraph 51.

[74] See C-418/07 *Papillon*, paragraph 44; C-303/07, *Aberdeen Property Fininvest Alpha*, paragraph 72.

[75] See Joined Cases C-338/11 to C-347/11, paragraphs 30, 40, 52, where ECJ clearly stated that the previous benefit must be conditional on the following tax levy.

This is the first demonstration that, should the court maintain that the provisions at issue are restrictive since they do not apply to foreigners, the restriction would be anyway justified by the need to locate both the previous benefit and the subsequent taxation in the Europalia State, i.e. for reasons of tax coherence.

33. We can give another proof of the fact that that the previous tax advantage is ensured because there is the subsequent tax levy. In fact, even in merely domestic situations, when taxpayers have attempted to escape the taxation of capital gains on the sale of shares following the transfer of assets under the domestic law (*i.e.* by generating losses), the Tax Administration has used this GAAR to tax the capital gains on the following sale of shares, and this position of the tax administration challenging successfully the tax avoidance scheme has been upheld by the highest administrative court of Europalia. This circumstance confirms that there is not a benefit on the sale of the asset if there is not a subsequent tax levy on the gains on shares and, then, that the former and the latter are linked to each other.[76]

34. Proved that the previous tax benefit and the subsequent taxation are linked, it is not difficult to prove that they are both provided for in the light of the objective pursued by the rules in question, with regard to the latter condition *sub b*. In fact, the tax neutrality applied to the sale of the asset at the occasion of a restructuring within a group of companies is an exception to the general rule which provides for the taxation of gains on fixed assets and it is provided for only because the subsequent sale of capital gains is taxed. In fact, the special measure was introduced with the precise intention of the legislator *to grant temporary relief and not to grant final or conclusive relief*, as clearly expressed in the parliamentary documents.

35. In conclusion, it is important to underline a last issue. In the Papillon case, the ECJ has overruled the *Bachmann* principle, maintaining that *the further condition that the tax advantage and levy must concern one and the same taxpayer appears to have been abandoned by the Court in its judgment in Manninen. Incidentally, this further criterion would seem to be fulfilled in the present case, because it would be artificial not to regard the companies of a group whose very aim is to seek treatment as a tax unit as not being the 'same' taxable person within the meaning of that case-law.*[77] It is relevant in the Globalco case, since the fact that the benefit is only for the original owner of the real estate (who can transfer the asset in a tax neutral way, and it means without paying taxes on gains) and the

[76] Among all, see Case C-379/05, *Amurta*. See also Case C‑157/07 *Krankenheim Ruhesitz am Wannsee-Seniorenheimstatt*, paragraph 42; C-250/08, *Commission v Belgium*, paragraph 70.

[77] Opinion of Advocate General Kokott on case C-418/07, *Papillon*, paragraph 52. See also Case C-418/07 *Papillon*, points 50, 51.

correlative disadvantage is not only his (since the capital gains are taxable upon the owners of the shares, which do not necessarily correspond to the original owner of the asset) is not relevant anymore, in order to exclude that the justification of the coherence can be invoked.

36. So, the justification coherence in the Europalia case can be invoked even if the tax benefit is upon Globalco Europalia and the subsequent tax levy is upon both Globalco Europalia and Globalco Cheeseland.

37. For all the aforementioned reasons, should this Court hold that the GAAR obstructs the freedom of establishment, nonetheless this obstruction would be justified under the coherence of the national tax system, since the previous benefit and the subsequent tax levy are linked to each other and they are also provided for in the light of a common objective.

2.1.2. PREVENTION OF TAX EVASION AND TAX REVENUE LOSS

38. The aim of avoiding tax evasion may constitute another justification for the restriction of a fundamental freedom. It is out of dispute that the GAARs basically aim at avoiding tax evasion. In this case, the tax evasion is reached by avoiding the subsequent tax on the capital gains of the shares. This aim is reached by allocating the capital gains in Cheeseland, which provides for a PEX regime also for capital gains realised on shares, indeed. As a consequence, the GAAR also aims to avoid the free choice of the taxing jurisdiction, so that resident companies involve non resident companies in the operation with the only aim of allocating some of the taxable income abroad.[78]

39. In the Globalco case, the transaction at issue consists in the transfer of an asset to Canderon. This transfer could even be realized through a direct sale or, alternatively, by involving another Europalian company.

40. On the other hand, Globalco Europalia has opted for the constitution of a SPV, *i.e.* Transfero, without opting for the direct sale of the real estate, and then has sold its shares, that were un-proportionally assigned to a foreign company (Globalco Cheeseland), allocating the most part of the taxable revenues in a state providing for a very favourable tax regime.[79]

[78] See C-337/08, *X Holding*, paragraph 32; to that effect, see also Case C-231/05, *Oy AA*, paragraph 56, and C- 414/06 *Lidl Belgium*, paragraph 34. Among scholars, see UUSTALU, E., *The compatibility of the Estonian tax treatment of real estate income with EU law,* in *Intertax*, 2011, p. 449. See also See also Opinion of Mr Advocate General Poiares Maduro delivered on case 436/03*Marks & Spencer*, paragraph 78.

[79] This argument will be better explained in paragraph 3.

41. Transfero is a vehicle which does not carry out an own business activity other than conserving the acquired asset till its liquidation. It was created with the only aim of allocating the 98% of its shares (with the subsequent (un) taxable capital gains) in Cheeseland, in a wholly artificial way, instead of realizing the capital gain on shares in Europalia (as would have happened if the transaction had not been carried out artificially).

42. For this reason, the application of the GAAR to the Globalco case is aimed at avoiding that the resident company abuses of domestic tax benefits through operations lacking with economical purpose. It is not applied to the foreigners, but it is better applied to the resident companies that use foreigners to avoid their tax duties. Globalco Europalia has created Transfero with the aim of avoiding Europalian taxes, so that Europalia Globalco itself (and not Globalco Cheeseland) has received the tax assessment.

43. In conclusion, the GAAR, by impeding the application of the specific provision no. (4), pursues the objective of preventing tax evasion and this purpose represents a justification to the asserted restriction to the exercise of EU freedoms.

2.2. THE PRINCIPLE OF PROPORTIONALITY

44. Furthermore, it is necessary to point out that the restriction provided by the GAAR is proportional to the purpose pursued.[80]

45. The GAAR complies with the principle of proportionality, because it is appropriate, necessary and proportional to the purpose pursued. In fact, *in a situation in which the advantage in question consists in the possibility of making a transfer of income, thereby excluding such income from the taxable income of the transferor and including it in the taxable income of the transferee, any extension of that advantage to cross-border situations would* [...] *have the effect of allowing groups of companies to choose freely the Member State in which their profits will be taxed, to the detriment of the right of the Member State of the subsidiary to tax profits generated by activities carried out on its territory.*[81]

46. In the Globalco case, in particular, the involvement of the foreign company realizes the aim of avoiding domestic taxation on capital gains, which would have risen upon Globalco Europalia itself (if it would have been the only shareholder of Transfero) or upon another Globalco

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[80] See ZALASIŃSKI, A., *Proportionality of Anti-Avoidance and Anti-Abuse in the ECJ's Direct Tax Case Law,* in *Intertax*, 2007, p. 310.

[81] Case C-231/05 *Oy AA*, point 64.

Europalia's resident associate. The operation is directly aimed to subtract tax revenues to the Europalia State.[82]

47. *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*[83], and the only way to avoid that taxable capital gains are realized in States providing for a PEX regime is forbidding it, by the GAAR, indeed.[84]

48. In conclusion, the provision is proportional because there are not any other less restrictive solutions able to reach the same aim.

3. <u>ABUSE OF THE EU FREEDOMS IN DIRECT TAXES</u>

49. As shown in the previous paragraphs, the application of the GAAR to the Globalco Europalia case does not entail a violation of the non-discrimination principle, nor it entails a restriction of the EU freedoms. Moreover, it represents an abuse of EU freedoms in direct taxation, as we will now demonstrate.

50. Firstly, it is very important to remark that the GAAR of ETC does not obstruct the cross-border operation if the taxpayer demonstrates a genuine business activity (business test[85]). Clearly, this shows the unrestrictive nature of mentioned provision that has not violated the non-discrimination principle.[86] In fact, the GAAR of ETC was introduced to counteract artificial schemes aimed at avoiding taxation, even in cross-border situations. Therefore, only if there is a business purpose in every transaction, the operation is not considered as an abusive practice.

51. The application of GAAR, that excludes the tax benefit provided for by the specific provision no. (4), complies with the EU law, too. In fact, also according to EU law and principles, if the tax advantage is the exclusive or prevalent aim of the transaction the taxpayer cannot invoke the application of the non-discrimination principle or the EU Freedoms violation. The

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[82] See HELMINEN, M., *Must the Losses of a Merging Company be Deductible in the State of Residence of the Receiving Company in EU?,* in *EC Tax Review,* 2011, p. 172, also with reference to the case 231/05, *OyAA*, and Case C-446/03, *Marks & Spencer*.

[83] See C-446/03, *Marks & Spencer,* paragraph 57. See also O'SHEA, T., *Marks and Spencer v Halsey (HM Inspector of Taxes): restriction, justification and proportionality*, in *EC Tax Review*, 2006, p. 66.

[84] See also Opinion of Advocate General Kokott delivered on case 470/04, *N.* Among scholars, see ZALASIŃSKI, A., *Proportionality of Anti-Avoidance and Anti-Abuse in the ECJ's Direct Tax Case Law,* in *Intertax*, 2007, p. 310.

[85] See art. 3 of ETC.

[86] See previous paragraph. See also ECJ C-196/04, *Cadbury Schweppes*.

prevalent explanation of the ECJ[87] affirms that "*community law cannot be relied on from abusive or fraudulent ends and a Member State is entitled to take measures designed to prevent certain of its nationals from attempting, under cover of the rights created by the Treaty, improperly to circumvent their national legislation or to prevent individuals from improperly or fraudulently taking advantage of provision of community law.*"[88]

52. Then, for all the aforesaid reasons, it is possible to consider the different transactions as a single transaction to achieve a tax purpose. In the first phase, the taxpayer has taken a tax advantage using a favorable tax treatment for the real asset sale within the same group, and, in the second phase, the tax relief consists in the liquidation of Transfero that was realized (i) by shifting the capital gain on Transfero shares on Globalco Cheeseland (98%), that has a PEX regime and (ii) with the purchase of real asset by Canderon with a tax neutrality regime.

53. The entire transaction is carried out exclusively to obtain a tax advantage. The Globalco group exploits the freedom of establishment[89] of Globalco Cheeseland only to avoid taxation in Europalia State. So, this transaction does not comply with the EU freedoms provided by TFEU, since it turns into an abuse of EU law[90] as upheld by ECJ.[91]

54. In particular, according with ECJ case law,[92] there is an abusive practice when the taxpayer invokes EU law freedoms application (i) in absence of business activity, (ii) if the prevalent aim is obtaining a tax advantage (in other words an aggressive tax planning) and (iii) if the scheme is artificial, as in case of unnatural use of every type of act or transaction[93].

55. (i) We want to demonstrate that the taxpayer has used the EU freedoms above mentioned only for tax purposes and in absence of business activity by incorporating a letter box company (Transfero) only to involve Globalco Cheeseland (and the EU Freedoms) in these transactions. The un-proportional share out of the Transfero's shares confirms that the main aim of the Globalco Cheeseland involvement was to allocate most of the taxing rights in Cheeseland. In fact, in Cheeseland there is a PEX regime, not available in Europalia. All the aforesaid is proved by the structure of the whole operation.

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[87] Among all, see C-110/99, *Emsland-Stärke*.
[88] WEBER, D., *Tax avoidance and EC Treaty* freedoms, *EUCOTAX*, *Kluwer law international*, 2005, pp. 168-169.
[89] Art. 49 TFEU regarding the right to establish a part of the same group in another Member State.
[90] See C-279/93, *Schumacker*; C-23/93, *TV10*; C-367/96, *Kefalas*; C-212/97, *Centros*.
[91] See C-255/02, *Halifax*, C-524/04, *Tests Claimants in the Thin Cap Group Litigation*; C-425/06, *Part Service*.
[92] See precedent notes.
[93] See EVERS, M. – GRAAF, A. D., *Limiting Benefit Shopping: Use and Abuse of EU law*, in *EC Tax Review*, 2009/6, pp. 285-287.

56. In fact, since the tax deferral regime can apply only to resident companies, the incorporation of Transfero (a vehicle that does not carry out other business activity than passing through the real estate), was necessary to fulfill this condition. On the other hand, with the direct participation of Globalco Cheeseland to the transaction, the above mentioned condition would have not been fulfilled. For this reason, the Globalco group has abused of the EU freedoms, so breaching the ratio of the domestic law.

57. On the other hand, if Globalco Europalia had directly sold the real estate asset to Canderon – without the interposition of Transfero – the emerging capital gain would have been immediately taxed (on the amount of 50.000.000). Thus, Transfero has been incorporated for a double shifting of taxation:

    a) firstly, the capital gain on the real estate have been turned into capital gain on shares;

    b) secondly, the profits (98% of these shares) have been artificially shifted in the hands of Globalco Cheeseland, only to take advantage from the PEX regime which the State of Cheeseland provides for.

58. (ii) Therefore, the reorganization (sale of asset) in the same group carried out by the taxpayer has the main aim to achieve a tax benefit. This particular operation is realized instead of the direct sale of real estate to Canderon. In this sense, an abusive transaction is realized, which can be considered also as an aggressive tax planning.

59. About this phenomenon, in direct taxation, the European Committee affirmed that:[94] "*Aggressive tax planning consists in taking advantage of the technicalities of a tax system or of mismatches between two or more tax systems for the purpose of reducing tax liability. Aggressive tax planning can take a multitude of forms. Its consequences include double deductions (e.g. the same loss is deducted both in the state of source and residence) and double non-taxation (e.g. income which is not taxed in the source state is exempt in the state of residence*[95]*).* Moreover, EC stated that it is necessary to prevent aggressive tax planning adopting, in domestic tax law of every Member State, a general anti-abuse rule.[96]

60. *(iii)* This scheme can be considered as an artificial arrangement because "Transfero creation" has granted to Globalco Europalia a tax advantage. In fact, the tax treatment provided for by

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[94] See European Commission Recommendation of 6.12.2012, C (2012) 8806, *On Aggressive Tax Planning*. About a legal right to tax saving see ALMENDRAL, V. R., *Tax Avoidance and the European Court of Justice: What is at Stake for European General Anti-Avoidance Rules?*, in *Intertax*, Vol. 33, Issue 12, 2005, pp. 564-565.

[95] See paragraph 5, which explains that the Globalco case is a typical case of Treaty Shopping.

[96] See also points 4 e seq. of European Commission Recommendation of 6.12.2012, C (2012) 8806, *On Aggressive Tax Planning*.

the ETC was introduced to relief and to advantage the domestic reorganization in the same group.

61. On the other hand, in this case, a specific new related party was incorporated and different operations was carried out to avoid domestic taxation. There is not an effective restructuring scope.

62. Another issue that we want to analyze is the compliance of GAAR (and the subsequent non-application of the specific provision no. (4)) with the EU tax law, with reference to provisions about transnational reorganizations and, specifically, to art. 15(1) of the Council Dir. 2009/133 EC (Merger Directive).

63. In general, this directive is applied to the cross-border transactions, mergers, divisions, transfers of assets, operations and reorganizations in multinational group (like in the Globalco case, since the combination of transactions has a transnational nature because of the participation of the foreigner Globalco Cheeseland which owns 98% of Transfero's shares).[97] In this sense, a specific provision was introduced with art. 15, to counteract the tax avoidance or tax evasion. In fact, if the operation is not carried out with valid commercial reasons, such as the restructuring or rationalization of the activities of the companies participating to the operation, it is presumed that such operation is mainly aimed to achieve tax evasion or tax avoidance. In other words, the Europalian GAAR, with reference to the cross-border restructuring or reorganization transactions, is in line with art. 15 of the Merger Directive.[98]

64. In conclusion, the taxpayer, without an effective economic reason, has carried out an abusive practice in this cross-border situation, abusing of the freedom of establishment. This implies the application of the GAAR, which is in line with art. 15 of the "Merger Directive", too.

4. RELATIONSHIP BETWEEN DOMESTIC GAAR AND TAX TREATY

65. In this section we will explain that tax treaty override complies with EU law and international law, and that the absence of a specific anti-avoidance rule in a tax treaty allows the application of domestic GAAR.

66. Tax treaties are international agreements with the aim of avoiding international double taxation by distributing tax revenues fairly among the contracting States. Their purpose is

[97] See art. 1 of Council Dir. 2009/133 EC, "Merger Directive".
[98] See C-126/10, *Foggia-SGPS*. See C-321/05, *Kofoed*. See also ZALASIŃSKI, A., *Case-Law-Based Anti-Avoidance Measures in Conflict with Proportionality Test – Comment on the ECJ Decision in Kofoed*, in *European Taxation*, December 2007, pp. 574 e seq.

further to eliminate tax barriers to trade, encourage foreign investment and prevent discrimination and tax avoidance.[99] In order to achieve these aims, tax treaties interact with domestic tax law: they have to become part of domestic law.[100] The issue of tax treaty interpretation is relevant with reference to the relationship between domestic GAAR and tax treaty.

67. The ECJ,[101] does not consider tax treaty overrides incompatible with EU law, as long as the Member States involved do not tax, in the end, cross-border investment heavier than comparable domestic investment.[102] In "Globalco case" there is no heavier taxation over Globalco Europalia than in a comparable domestic situation. Moreover, Globalco Europalia avoided domestic taxation of capital gain by interposing a SPV, Transfero, that is a wholly artificial arrangement created solely for tax purposes.

68. In other important ECJ decisions,[103] with reference to abusive practices, the ECJ held that an abusive practice can be defined as transactions carried out for no commercial reasons other than to profit from a tax advantage.[104]

69. The Europalia legal system is monistic and international law generally prevails over domestic law. There were two case-law in Switzerland,[105] a monistic country, where Federal Court has held that the domestic anti-abuse law does not conflict with the treaty obligations of Switzerland. The Court held that in order to be abusive, the exercise of a right must be clearly contrary to the purpose for which it has been granted, i.e. the right is exercised to obtain advantages which for that right have not been conceived. Consequently, the use of a provision of a tax treaty could be abusive if such use is in clear contradiction with the purpose for which that treaty provision has been enacted.

70. In a treaty-shopping case-law[106] in Austria, the Court stated that: "*According to art. 31 VC the purpose of a treaty is important for its interpretation. The purpose of the tax treaty is to assign taxing rights between the two Contracting States on the basis of objective criteria. In*

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[99] See VOGEL, K., PROKISCH, R.G., *General Report on the Interpretation of Double Taxation Convention*, in *Cahiers de Droit Fiscal International* (CDFI), Vol. LXXVIIIa (1993), at 55 et seq.
[100] See also HEINRICH, J. – MORITZ, H., *Interpretation of tax treaties*, in *European Taxation*, IBFD, 2000.
[101] See C-298/05, *Columbus Container*.
[102] See TERRA, B. J. M. – WATTE, P. J., *Negative Integration of Direct Taxes; the ECJ Case Law on Taxation and Free movement*, in *European Tax Law*, Kluwer Law International, 2008, p. 779.
[103] See case C-294/97, *Eurowings Luftverkehrs;* case C-524/04, *Test Claimants in the Thin Cap Group Litigation;* case C-105/07, *NV Lammers & Van Cleeff;* case C-425/06, *Part Service Srl*.
[104] See LAMPREAVE, P., *An Assessment of the Anti-Tax Avoidance Doctrines in the United States and the European Union*, in *Bullettin for International Taxation*, IBFD, 2012.
[105] Swiss Federal Court, 10 July 1987, ATF, 1987, 113 Ib, 197; Federal Court, 22 November 1986, ATF, 1994, I, 659.
[106] Austrian Supreme Administrative Court, 26 July 2000, 2 ITLR, 2002, 884.

the absence of specific anti avoidance provisions in tax treaties, a State has the right to protect itself against an unjustified exploitation of the tax benefit provided for in the treaty. The absence of specific anti avoidance provisions in the treaty does not justify a conclusion that the treaty permits the use of nominee arrangements or the abuse of forms and institutions of civil law."

71. Applying the principle to the interpretation of the tax treaty between Europalia and Globalco, following *i.e.* the literal tax treaty interpretation approach adopted by the Czech Supreme Administrative Court in its jurisprudence, we can note that the application of the anti-abuse rule contained in ETC comply with the obligation deriving from the tax treaty. In fact, in the text of the 1980 Cyprus–former Czechoslovakia tax treaty, nothing indicates that domestic GAAR can be applied for tax treaty purposes. According to scholar,[107] "the predominant factor in interpreting treaties is the purpose of the treaty itself, as explicitly expressed in the title [...]". The title of the 1980 Cyprus–former Czechoslovakia tax treaty suggests that the purpose of the treaty is (1) the avoidance of double taxation and (2) prevention of fiscal evasion. It can, therefore, be argued that the term "tax evasion" is meant to also include "tax avoidance" and that, in light of art. 31(1) of the Vienna Convention, the application of the domestic substance-over-form rule is justified by the purpose of the treaty.[108]

72. Other Courts in Finland, Austria, Switzerland and USA see no difficulty in applying such measures to perceive abuses of tax treaties. In some of those decisions Courts have made it clear that they have come to such conclusion to prevent the frustration of the object and purpose of the treaty provisions that were allegedly abused.[109]

73. Tax treaty between Europalia and Cheeseland is silent on the application of GAAR in the treaty context. Some jurisdictions, and a wide range of scholars,[110] take the view that a principle prohibiting treaty abuse is inherent in tax treaties. The existence of this principle is frequently linked to the general principles recognized by civilized nations according to art. 38(1) of the Statute of the International Court of Justice. Moreover in a bilateral dimension, the OECD Commentary also flirts with that idea.[111]

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[107] See VAN BRUNSCHOT, F., *The Judiciary and the OECD Model Tax Convention and its Commentaries*, in *Bulletin for International Fiscal Documentation*, 2005, p. 5.
[108] See MKRTCHYAN, T., *Supreme Administrative Court Gives First Decision on Application of Domestic Substanceover- Form Rule in Tax Treaty Context*, in *European Taxation*, 2007.
[109] See DE BROE, L., *Application of domestic antiavoidance rules to tax treaties: Position of the OECD and analysis of case law*, in *International Tax Planning and Prevention of Abuse*, IBFD, 2007.
[110] See WARD, D. A., *Ward´s Tax Treaties*, Toronto, Carswell, 1996, p. 61; VOGEL, K., *Klaus Vogel on Double Taxation Conventions*, London, Kluwer Law International, 1997, p. 125.
[111] See §9.1 and 9.2 of OECD Model Commentary on Article 1.

74. Some authors call upon art. 31(3)(c) VCLT to justify the strong influence OECD Model and Commentary have on tax treaty interpretation.[112] The "relevant rules of international law applicable in the relations between the parties", as required by art. 31(3)(c), are both the OECD Model and the OECD Commentary.[113]

75. Finally, OECD takes the position that the interposition of a holding company to own the real estate with a view to sell the shares of the company rather than the real estate, is an abuse of the treaty (art. 13(1) OECD MC).[114]

76. Globalco group, that has interposed Globalco Cheeseland to own the real estate with a view to sell the shares of Transfero, rather than the real estate, only because in Cheeseland there is the PEX regime, has abused of the tax treaty to reach an unlawful tax relief.

5. TREATY SHOPPING

77. In this section we will demonstrate that the whole operation is a case of treaty-shopping. In fact, without the existence of PEX regime in Cheeseland, there would have been no tax relief from the interposition of Transfero, joined with the shifting of the taxation of profits from one company (Globalco Europalia – subject to tax in Europalia) to the associated company participating in the SPV (Globalco Cheeseland – not subject to tax in Europalia).

78. "Treaty shopping" connotes a premeditated effort to take advantage of the international tax treaty network and a careful selection of the most favourable tax treaty for a specific purpose.[115]

79. In 2004, in a treaty-shopping case-law,[116] Austrian Administrative Supreme Court stated that:

    (i) the absence of specific anti-avoidance provisions in the treaty does not mean that a taxpayer can abuse the treaty by using legal structures with international ramifications, i.e. the setting up of an investment company in a lowtax jurisdiction,

    (ii) such defeats the object and the purpose of the tax treaty and a State has the right to protect itself against an unjustified exploitation of its treaties and

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[112] See VOGEL, K. – PROKISCH, R., *Interpretation of Double Taxation Conventions (General Report),* in *Cahiers de Droit Fiscal International*, 1993, p. 26.

[113] See REIMER, E., *Interpretation of Tax Treaties*, in *European Taxation*, 1999, p. 458.

[114] See DE BROE, L., *Application of domestic antiavoidance rules to tax treaties: Position of the OECD and analysis of case law*, in *International Tax Planning and Prevention of Abuse*, 2007, p. 398.

[115] ROSENBLOOM, H.D., *Tax Treaty Abuse: Problems and Issues, 15 Law and Policy*, in *International Business*, 1983, 766.

[116] Austrian Supreme Administrative Court, 9 December 2004.

(iii) the Austrian approach is consistent with the practice of other States.

80. In line with the OECD's position, US courts see no objection to apply US judicially developed anti avoidance doctrines to cases where US tax treaties have allegedly been abused.[117]

81. The paradox of the tax treaty system is that tax treaties have become the vehicle for tax avoidance techniques – such as treaty shopping – even though one of the purposes of tax treaties is to counter tax avoidance. Treaty shopping occurs when a multinational enterprise operates through a subsidiary incorporated in a foreign country specifically for the purpose of gaining access to the benefits of that country's tax treaties. Such treaty benefits would not be available to the multinational enterprise if it operated in a more straightforward method by investing directly in the other country.[118]

82. In the Globalco case, the aim was to exploit the Europalia-Cheeseland treaty by using a company resident in Europalia because the treaty allocated the taxing rights over the gains to the Cheeseland. It also appears that the gains were not assessable under Cheeseland domestic tax law. This type of treaty shopping is easy because a taxpayer only has to use a company incorporated in a jurisdiction to gain access to that country's treaty network and the benefits it provides.

83. In fact, if Globalco Cheeseland had directly purchased the real estate property without the interposition of Transfero, the conditions of special provision no. (4) of ETC were have not been fulfilled, with reference to the right to sell immovable property at a consideration equal to the book value.

84. In any case, the not proportional share-out of Transfero shares is a tangible clue that the economic substance of real estate transaction between Globalco Europalia and Transfero - before selling the Transfero's shares to a third party - was made at fair value instead of a book value. The difference between the "fair value" of the property sold and its "book value" consists in the not proportional share-out of Transfero's shares.

85. There was no objective business reason, less than obtaining tax benefit, for using a special purpose vehicle, participated by a non-resident company, in that real estate transaction.

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[117] See DE BROE, L., *Application of domestic antiavoidance rules to tax treaties: Position of the OECD and analysis of case law*, in *International Tax Planning and Prevention of Abuse*, 2007.

[118] *Double Taxation Conventions and the Use of Conduit Companies*, Para. 1 (1986), reproduced in *Model Tax Convention on Income and on Capital,* Vol. II at R(6)-1, OECD, 2003. In this sense see also KOBETSKY, M., *The Aftermath of the Lamesa Case: Australia's Tax Treaty Override*, in *Bulletin-Tax Treaty Monitor*, 2005.

86. After the re-characterisation of Globalco Europalia's income, to the extent that the application of the rule referred to abuse of law, the provisions of the Convention will be applied taking into account these changes, that in any case haven't any impact on the Globalco Cheeseland fiscal situation.[119]

6. ARTICLE 13 (4) OECD MODEL IN THE CONTEXT OF DOUBLE TAXATION CONVENTION

87. The absence, in the double taxation convention between Europalia and Cheeseland, of the GAAR referred to art. 13(4) of the OECD Model does not preclude the application of the domestic GAAR.

88. Accordingly, we will proceed to demonstrate that the parties could not insert the provisions of art. 13(4) (OECD model) in the double taxation convention signed by them, as his insertion would have been superfluous. In this way it prefers the application of the static interpretation of International Treaties, where the parties have decided not to establish a legal situation that is already established by the domestic legislation.

6.1. NATURE AND PURPOSE OF ART. 13 (4), OECD MODEL (C.D. *SITUS PRICIPLE*)

89. The 2003 version of the OECD Model Tax Convention on Income and on Capital added an entirely new paragraph, art. 13(4), to art. 13 (Capital gains), which deals with the alienation of shares deriving more than 50% of their value from immovable property situated in a contracting state. The new paragraph remains unchanged in the 2005 version of the OECD Model[120].

90. In this article, companies whose shares derive more than 50% of their value directly or indirectly from immovable property are referred to as "immovable property companies". Art. 13(4) allocates primary taxing rights to the source (*situs*) State regarding gains on the alienation of shares deriving more than 50% of their value from immovable property situated in that State. The allocation of taxing rights in art. 13(4) is not connected in any way to the existence of an immovable property company provision in the *situs* State of the immovable property. As a consequence, the States that tax capital gains accruing to non-residents on the alienation of shares in companies (for whatever reason) are no longer prevented from taxing such gains under the residual catchall provision in art. 13.5 if the alienated shares derive more

[119] In this sense see, also, paragraph 22.1 on Commentary on Article 1 of OECD Model.
[120] Unless other specified, references to the OECD Model and Commentary are to the 2010 version, released in July 2010.

than 50% of their value from immovable property situated in their territory. Thus, art. 13(4) clearly goes beyond the mere solution of a possible conflict of interpretation in the case of domestic anti-abuse sourcing rules. Accordingly, the OECD Commentary on art. 13 no longer refers to the domestic laws of the contracting States.

91. The purpose of art. 13(4) is equality in the treaty regimes for the direct and indirect alienation of immovable property. In other words, art. 13(4) is designed to apply the same regime to gains on the alienation of shares in an immovable property company as the regime that would apply if the underlying immovable property were disposed of. Para. 28.3 of the Commentary on art. 13 points out:[121] "*By providing that gains from the alienation of shares deriving more than 50 per cent of their value directly or indirectly from immovable property situated in a Contracting State may be taxed in that State, paragraph 4 provides that gains from the alienation of such shares and gains from the alienation of the underlying immovable property, which are covered by paragraph 1, are equally taxable in that State*".

92. Art. 13(4) stems from the domestic sourcing provisions in force in several States and from the related treaty practice, which is also reflected in several MCs. In every case, immovable property company provisions are characterized as having an anti-abuse aim.[122] Indeed, Art. 13(4) undoubtedly has an anti- abuse purpose, namely, to prevent rule shopping through the use of legal entities that are interposed as the owners of immovable property. The 1989 *OECD Report on Tax Treaty Overrides*, in commenting on similar (domestic) provisions, confirmed this by stating (Para. 32): "*the overriding measure is clearly designed to put an end to the improper use of its tax treaties*".

93. The anti-abuse nature of a similar provision endorsed by the UN Model (Art. 13(4)) is underscored in the 2003 UN Manual:[123] "*Paragraph 4 of Article 13 ... is designed to prevent avoidance of taxes on the gains from the sale of immovable property through the use of real-estate holding companies and similar devices. Taxing the gain derived from the sale of an interest in such an entity is necessary, due to the ease with which taxpayers otherwise would avoid tax on the sale of immovable property*".

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[121] See also paragraph 23 of the Commentary on Art. 13.

[122] See VANN, R. J., *International Aspects of Income Tax*, in *Thurony, V.* (ed.), *Tax Law Design and Drafting* (Washington, D.C.: International Monetary Fund, 1998), 718-743, commenting on immovable property company provisions on a comparative basis; see ARNOLD, B. J. – McINTYRE, M. J., *International Tax Primer* (Boston, The Hague, London, 1995), 113; see also MARTIN JIMÈNEZ, A. J., *Domestic Anti-Abuse Rules and Double Taxation Treaties: a Spanish Perspective – Part II*, in *Bulletin for International Fiscal Documentation*, 12, 2002, 620.

[123] United Nations, *Manual for the Negotiation of Bilateral Tax Treaties between Developed and Developing Countries* (New York, 2003), Observations on Art. 13.

94. Therefore, art. 13(4) applies – and thus the same treaty regime applies to direct and indirect alienations of immovable property – if the shares being alienated derive more than 50% of their value from immovable property situated in a contracting state. Art. 13(4) postulates the following: if a company derives its value mainly from immovable property situated in a certain state, then:

   i) the alienation of the company's shares de facto amounts to the alienation of the underlying property;

   ii) and the gains on the alienation are attributable mainly to the immovable property situated in that state.

95. As a consequence, art. 13(4) allocates the taxing rights on gains from the alienation of shares to the state in which the relevant immovable property is situated (since art. 13(4) considers that the gains are sourced there). It is thus necessary to ascertain whether "*deriving value*" is a proper economic indicator to achieve the aim of art. 13(4). Whether the "*deriving value*" test is consistent with the purpose of art. 13(4) must be analysed at two different levels: requirements for applying the test and allocation of taxing rights.

6.2. THE IRRELEVANCE OF THE NON-PROVISION OF ART. 13 (4) OECD MODEL IN THE DOUBLE TAXATION CONVENTION BETWEEN EUROPALIA END CHEESELAND: THE DOMESTIC GAAR'S APPLICATION

96. In order to demonstrate the above, it should be noted that the real intention of the parties was strongly influenced by the existence of the domestic anti-abuse rule that should govern the matter.

97. The interpretation of Convention in fact is based on the circumstances and insights at the time the treaty was concluded.[124] So a treaty is an agreement between two parties, and its interpretation, therefore, has to be based on the insights and intentions of those parties at the time their agreement was concluded.[125]

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[124] See VAN RAAD, K., *Five fundamental rules in applying tax treaties*, in *Liber amicorum Luc Hinnekens*, (Brussels: Bruylant, 2002), pp. 589-590.

[125] Among all, see HUGH AULT, J., *The Role of the OECD Commentaries in the Interpretation of Tax Treaties*, in *Intertax*, 1994, p. 145; VAN RAAD, C., *Interpretation and Application of Tax Treaties by Tax Courts*, in *European Taxation*, 1996, p. 4; LANG, M., *Later Commentaries of the OECD Committee on Fiscal Affairs not to Affect the Interpretation of Previously Concluded Tax Treaties*, in *Intertax*, 1997, Vol. 25, issue 1, p. 7; RUSSEL YOUNG, R., *The Use of Extrinsic Aids in the Interpretation of Tax Treaties*, in *Tax Management International Journal*, 1999, p. 468; REIMIER, E., *Interpretation of Tax Treaties*, in *European Taxation*, 1999, p. 468; VOGEL, K., *The Influence of the*

(continued...)

98. Based on the treaty text and the circumstances at the time the treaty text was agreed, taxpayers should be able to obtain certainty about their future tax obligations, and it should not be possible to change those obligations to their disadvantage unless that change is accorded the same democratic legitimacy as the treaty itself .[126]

99. In reality, therefore, the Convention is indispensable for the interpretation of the real intention of the parties. In this sense, the inclusion in the domestic discipline of anti-abuse rule, however, previous to the same Convention, allows itself to demonstrate the real intention of the parties intended to admit sufficient the domestic GAAR. Consequently, the OECD discipline referred to in 13(4) was not voluntarily recalled in the double taxation convention because the same principle has already been mandated by the domestic legislation. Then, the conventional vacuum does not represent the impossibility of applying the OECD GAAR, but allows us to understand the possible irrelevance of the recall in the light of previous domestic legislation aimed at regulating the same case with a special GAAR.

100. In fact, although nothing has been planned in order to insert the OECD GAAR in the agreement in question, the domestic GAAR will find ample space, in the light of the above considerations, since it appears sufficient to resolve disputes in subject to capital gains. In addition, therefore, the rule in question, in accordance with the general rules of interpretation of treaties, since before the Convention provides the legal deadline to resume taxation the amounts detected.

101. Moreover, the possibility to insert in the agreement between two States a clause similar to that laid down in art. 13 of the OECD model would also have led to the inapplicability of the Partecipation exemption in the Cheeseland State. Therefore, in this way the convention would create enormous discrimination to foreign investors (in this sense refer to the stated concerning freedom of establishment).

102. In conclusion, there are no reasons to uphold that the assessment issued to Globalco Europalia breaches domestic, European and international law.

103. The Europalia tax provisions do not discriminate the partecipation of a foreign company, that belongs to the same group, in a cross-border transaction neither there is a restriction of

OECD Commentaries on Treaty Interpretation, in *Bulletin for International Fiscal Documentation*, 2000, p. 614.

[126] See, WATTEL, P. J. – MARRES, O., *The Legal Status of the OECD Commentary and Static or Ambulatory Interpretation of Tax Treaties*, in *European Taxation*, 2003, p. 222.

the EU freedoms. Anyway, any asserted restriction would be justified under the ECJ rule of reason.

104. Rather, the Globalco Group has abused of the EU freedoms carrying out a transaction without any business purpose, with the only aim to achieve a tax relief.

105. However, with reference to the treaty interpretation, the domestic GAAR is sufficient to resolve the dispute in question because the possible inclusion of a provision similar to art. 13(4) OECD Model in the double taxation convention between Europalia and Cheeseland would have been superfluous and harmful to the Cheeseland's PEX regime applicability and, in general, to the foreign investment.

106. The case at issue is a typical treaty-shopping case where the benefit of the Double Taxation Convention was used to breach ETC.

VI. TABLE OF ABBREVIATIONS

Art.	Article
DTCs	Double Taxation Conventions
ECJ	European Court of Justice
ETC	Europalia Tax Code
EU	European Union
EU law	European Union Law
GAAR	General Anti-Avoidance Rule
MC	Model Convention
MS	Member States
OECD	Organization for Economic Co-operation and Development
PEX	Participation exemption
SPV	Special purpose vehicle
TEU	Treaty on European Union
TFEU	Treaty on the Functioning of the European Union
UN	United Nations
VCLT	Vienna Convention on the Law of Treaties