The Anti-abuse Rule and Related Tax Administration Principles Written in the Tax Code

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Abstract
The tendency to increasingly apply the principle of prohibition of abuse of tax law is clear in the domestic, European and international context. This paper deals with the principle of the prohibition of the abuse of tax law in terms of principles that are specified directly in the Tax Code (Act No. 280/2009 Sb.). This year, the general anti-abuse rule should become a part of the Tax Code.

Keywords
the anti-abuse rule; tax administration principles; the Tax Code

1 Introduction

In the following paper, I have asked myself to what other tax administration principles is the anti-abuse rule of tax law connected with and I attempted to answer them. The anti-abuse rule of tax law is manifested in the field of domestic jurisprudence, international and European law. It is a very up-to-date and important topic. I have used case law, expert papers and articles, and internet resources for this paper.

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2 The Principle of Legality and Its Relation to the Anti-abuse Rule

The principle of legality is undoubtedly one of the main tax administration principles and we can also say that it is the leading principle superior to the other principles. This is also evidenced by its systematic introduction in the first place among the basic tax administration principles in the Tax Code. The principle of legality is implemented in the whole area of tax administration and it cannot be related only to a particular procedure or act of a tax administrator. It cannot be subject to the other principles, for example, to the principle of urgency, and "give way" to them.

The principle of legality is regulated in Sec. (§) 5 Subsec. 1 of the Tax Code as follows: *"A tax administrator carries out the administration of taxes in accordance with the law and other legal regulations (hereinafter referred to as "legal regulations"). For the purposes of this Act, law also means an international treaty that is a part of the legal order."*

The principle of legality according to the Tax Code is related to all the activities of a tax administrator bound generally by the legal order and its constitutional foundations can be found in Art. 2 Subpar. 2 of the Charter of Fundamental Rights and Freedoms (Resolution of the Czech National Council No. 2/1993 Sb. as amended) and Art. 2 Subpar. 3 of the Constitution allowing to exercise public authority only in the cases, and within the framework of the limits and methods stipulated by law (Baxa et al., 2011: 34).

As stated in the explanatory memorandum to the Tax Code and some commentaries (Kobík and Kohoutková, 2010: 31), the principle of legality is also an expression of the constitutional principle under Art. 11, Subpar. 5 of the Charter of Fundamental Rights and Freedoms, according to which taxes and fees can be imposed only if stipulated by law.

However, the principle of legality according to the Tax Code has a much wider overlap and impact than the mentioned constitutional principle under Art. 11 Subsec. 5 of the Charter of Fundamental Rights and Freedoms, which "only" excludes the assessment of taxes and fees by the executive power (Resolution of the Constitutional Court of 21 April 2009, file no. Pl. ÚS 29/08). In compliance with the principle of legality, tax administrators are required, in addition to the laws, to comply with the administrative rules, such as directives, decrees or legal regulations of the territorial self-government. A tax administrator is not empowered to assess compliance of a legal regulation of a lower legal force with the one of a higher legal force because of the lack of legal authorisation. While administering taxes, tax administrators should therefore resolve any case of conflict of legal regulations in favour of the taxpayer in accordance with the principle of "in dubio mitius" – more leniently in case of doubt, regardless of the fact that in some cases priority is to be given to a legal regulation of lower legal force. The International and Community Law mentioned below are an exception in this aspect (Matyášová and Grossová, 2011: 21). Similarly, the Constitutional Court judged in accordance with the principle of *in dubio mitius,* as it can be inferred from

its finding that where the law allows for a dual interpretation, it cannot be overlooked that in the field of public law, the state authorities can only do what they are expressly allowed to do according to the law (unlike citizens who can do anything not prohibited by law – Art. 2 Subpar. 3 and 4 of the Constitution). From this maxim follows that when imposing and collecting taxes according to the law, public authorities are required to act within the meaning of Art. 4 Subpar. 4 of the Charter of Fundamental Rights and Freedoms less strictly respecting the essence and meaning of fundamental rights and freedoms – more leniently in the case of doubt (Nález Ústavního soudu, ÚS 666/02). It is the possible conflict or identification of the boundaries between the above-mentioned principle "in dubio mitius" and the constitutional principles in Art. 2 Subpar. 2 of the Charter of Fundamental Rights and Freedoms and Art. 2 Subpar. 3 of the Constitution allowing to exercise public authority only in the cases and in the framework of limits and methods stipulated by law and the anti-abuse rule can be perceived as a fundamental issue.

2.1 Compliance with international treaties

The principle of legality is designed in the Tax Code in the way that an international treaty that is part of the legal order is considered to be a law, as well. According to Art. 10 of the Constitution, such international treaties are the declared international treaties the ratification of which was approved by the Parliament and which are binding for the Czech Republic. These international treaties become a part of the legislative reduced term "legal regulation" implemented in the Tax Code and tax administrators shall proceed in compliance with them. The above-mentioned Article of the Constitution also introduces the application priority of an international treaty in the case the international treaty regulates something else than law. In accordance with the Constitution, tax administrators shall always give priority to an international treaty over law, however, it can only be mistakenly inferred from the language interpretation of the Tax Code that an international treaty deemed to be law is equal to it even in terms of its application.

In the area of tax administration, I would like to mention the double taxation conventions as an example of international treaties in compliance with which tax administrators are obliged to proceed. The strengthening of anti-abuse rules and measures against aggressive tax planning was one of the motives for the creation of the BEPS project. These international double taxation conventions will be significantly affected by the BEPS project, i.e. the Base Erosion and Profit Shifting project in the foreseeable future. The OECD has even classified the BEPS project as the most fundamental change in the international tax rules in the past 100 years. On 8 October 2015 in Lima, ministers of finance of the G20 countries approved the final package of measures for comprehensive, coherent and coordinated reforms of the international tax rules. The Organization for Economic Cooperation and Development (OECD) launched this project in 2013.

The BEPS Action Plan, as a joint initiative of the OECD and G20, contains 15 key actions:

1. Tax challenges in the digital economy.
2. Neutralization of effects of hybrid non-transparent instruments and entities.
3. Strengthening rules for taxation of controlled foreign corporations.
4. Limiting base erosion involving interest deductions and other financial payments.
5. Countering harmful tax practices more effectively, taking into account transparency and substance.
6. Preventing the granting of treaty benefits in inappropriate circumstances.
7. Preventing the artificial avoidance of permanent establishment status.

8–10. Aligning transfer pricing outcomes with value creation.

11. Creating methodologies to collect and analyse the data on BEPS and the actions to address it.
12. Recommendations regarding the design of mandatory disclosure rules for aggressive tax planning schemes.
13. Transfer pricing documentation.
14. Making dispute resolution mechanisms more effective.
15. Development of a multilateral instrument.

Preventing the granting of treaty benefits in inappropriate circumstances and treaty abuse is the task of the BEPS action number 6. This action has already been elaborated in the final report available in the online version entitled *Preventing the Granting of Contractual Benefits in Inappropriate Circumstances, Action 6 – 2015 Final Report.* This report includes changes to the OECD Model Tax Convention to prevent treaty abuse. It first addresses treaty shopping through alternative provisions that form part of a minimum standard that all countries participating in the BEPS Project have agreed to implement. It also includes specific treaty rules to address other forms of treaty abuse and ensures that tax treaties do not inadvertently prevent the application of domestic anti-abuse rules. The report finally includes changes to the OECD Model Tax Convention that clarify that tax treaties are not intended to create opportunities for non-taxation or reduced taxation through tax evasion or avoidance (including through treaty-shopping) and to identify the tax policy considerations that countries should consider before deciding to enter into a tax treaty with another country (OECD, 2015).

Perhaps the most well-known and fundamental consequence of the BEPS project is the *Multilateral Convention to Implement Tax Related Measures to Prevent Base Erosion and Profit Shifting* (shortened as Multilateral Instrument – MLI) in relation to tax treaties. This Convention was solemnly signed on 7 June 2017 in Paris by 68 states and one of these countries was also the Czech Republic. The MLI modifies the application of thousands of bilateral tax treaties concluded to eliminate double taxation. The MLI is part of the rules against aggressive tax planning schemes using gaps and inconsistencies in the tax rules of the state and artificial profit shifting to low or zero tax jurisdictions resulting in minimum or no tax paid, primarily corporate tax of multinational groups.

Because of the international element of these structures, isolated local solutions at the national level do not work. Already before the cases of Google, Apple and Microsoft, the issue of cross-border tax optimisation, which is, of course, legal and legitimate in many cases had become a political issue. The MLI is flexible enough to respect the right to individual tax policies of the contracting states while ensuring the implementation of the relevant BEPS actions. Individual jurisdictions have the ability to implement only the minimum standards and at the same time, they have the possibility to implement optional provisions. Minimum standards include the above-mentioned rule against the abuse of bilateral treaties (Action 6 – Preventing the Granting of Treaty Benefits in Inappropriate Circumstances) and the rules of more effective dispute resolution mechanisms (Action 14 – More Effective Dispute Resolution Mechanisms). The Czech Republic has only been implementing the mandatory minimum standards for MLI. Therefore, the expected impacts can be rather limited. The most significant change is the tightening of the anti-abuse rule (Frelich, 2017).

2.2 Compliance with Community Law

With respect to our membership in the European Union (hereinafter: EU), Art. 10a of the Constitution, according to which certain powers of the Czech authorities may be transferred to an international organisation or institution upon an international treaty, is also essential. In accordance with the ruling of the Constitutional Court of 21 February 2014, file no. Pl. ÚS 19/04, from 1 May 2004, each public authority is obliged to apply Community Law taking precedence over the Czech law if the Czech law is contrary to Community Law.

The so-called primary law of the European Union, including the attached addendums, annexes and protocols and subsequent amendments and changes are considered the founding treaties of the European Union. These founding treaties, as well as their amendments and changes, in particular the Maastricht Treaty, the Treaty of Amsterdam, the Treaty of Nice and the Treaty of Lisbon, as well as the individual Accession Treaties, contain basic provisions on the objectives, organisation, functioning of the EU and partially also economic law. This establishes the constitutional conditions of the functioning of the EU, which are subsequently performed in the interest of the Union by its authorities, which are equipped with legislative and administrative powers for this purpose (Borchardt, 2011: 81).

The Treaty on the Functioning of the European Union,[2] which is the source of primary law, contains the following articles that are directly related to taxes: *Art. 110, Art. 111, Art. 112, Art. 113* (The Treaty on the Functioning of the European Union).

[2] For the sake of clarity, I would like to mention that the Treaty on the European Union and the Treaty on the Functioning of the European Union have the same legal force. The European Union replaced the European Community becoming its successor. Due to the Treaty of Lisbon, the European Union

The Articles above provide the basis for the harmonisation of indirect taxes. Approximation in the area of direct taxation is introduced on the basis of *Art. 115 (ex Art. 94 TEC)* mentioned below. As it concerns direct taxation, all the directives in this area shall be adopted by the Council unanimously.

It can be stated that the Treaty of Lisbon, which changed the title *Treaty establishing the European Community* to the *Treaty on the Functioning of the European Union* merely transposing the tax provision into other provisions, while their basic meaning remained the same. In addition to the above-mentioned article of the Treaty on the Functioning of the European Union, I would like to put stress on *Art. 18* (ex Art. 12 TEC) and *Art. 115* (ex Art. 94 TEC), according to which *"the Council shall, acting unanimously in accordance with a special legislative procedure and after consulting the European Parliament and the Economic and Social Committee, issue directives for the approximation of such laws, regulations or administrative provisions of the Member States as directly affect the establishment or functioning of the internal market"*. I would also like to mention *Art. 192 (ex Art. 175 TEC),*[3] *Art. 223 (ex Art. 190 Subsec. 5 TEC)*[4] *and provisions relating to freedom of movement for goods in Arts. 28–44 (ex Arts. 23–38 TEC), persons in Arts. 45–55 (ex Arts. 39–48 TEC), services in Arts. 56–62 (ex Arts. 49–55 TEC) and capital in Arts. 63–66 (ex Arts. 56–60 TEC)* (Skalická, 2010).

The principle of legality under the Tax Code, however, provides for a tax administrator to act not only in accordance with the primary law, but also with the secondary law,[5] i.e. the rules published in the Official Journal of the European Union in the case of their immediate binding character – typically European Union regulations. Regulations are undoubtedly legal acts upon which the Union authorities may intervene into the national legislation in the most effective way. However, directives, the effects of which can be divided into direct and indirect effects, are important for tax administrators, as well.

The principle of the indirect effect of the directives was first formulated by the European Court of Justice in the Case *Von Colson and Kaman (C-14/83)*. This Judgment became the basis of the doctrine of the indirect effect and it was subsequently cited and extended many times (e.g. C-106/89 in the Case Marleasing, C-80/86 in the Case Kolpinghuis, C-334/92 in the Case Wagner Merit). The doctrine of

gained a legal personality. The Treaty of Lisbon also changed the name of the European Court of Justice to the Court of Justice of the European Union.

3 By way of derogation from the decision-making procedure stipulated in Art. 192, Subsec. 1, without prejudice to Art. 114, in accordance with a special legislative procedure and upon consultation with the European Parliament, the European Economic and Social Committee and the Committee of the Regions, the Council shall adopt the regulations of mainly fiscal character.

4 Upon its own initiative, the European Parliament shall, in the form of a special legislative procedure determine the regulations and general conditions governing the performance of the duties of its members upon consulting it with the Commission and approval of the Council. All the rules and conditions regarding the tax treatment of the existing or former members require unanimity in the Council.

5 A secondary law can be defined as the law arising from performance of powers entrusted to the EU authorities.

indirect effect requires the national law to be interpreted in a certain way, while keeping the condition that a national rule is capable of such an interpretation when the indirect effect is to be used. If the national interpretative techniques allow for the interpretation of the national provision in several ways, the administrative authority and the court shall use the interpretation which is the closest to the meaning and purpose of the corresponding Community Provision. If a provision of law is unclear, vague or it is not defined, it cannot be determined whether it is contrary to a certain directive or not. Consequently, the principle of the indirect effect of Community Law can never be *contra legem*. This may also be to the detriment of a taxpayer though. The obligation to interpret the national law in accordance with a directive is a priori conditional upon the existence of the national provision which is ambiguous, allowing for several interpretations, while at least one of the possible interpretations of the law is in accordance with the Directive (Rozsudek Nejvyššího správních soudu, 5 Afs 68/2009). It can be said that European Union law and the case law of the Court of Justice of the European Union constitute a mandatory explanatory guide for the application of the Czech law, which was adopted to implement the law of the Union not only in the case of the administrative courts, but also the administrative authorities.

I would like to mention one of the most discussed directives regulating tax-abuse, in particular Directive (EU) 2016/1164 adopted by the Council laying down rules against anti-tax avoidance (the Anti-Tax Avoidance Directive, ATAD).

Art. 6 of this directive sets out the general anti-abuse rule (GAAR). Under this rule, the transactions which are not real are not taken into account for the purpose of calculating tax liability, as the main reason or one of the main reasons for their realisation is obtaining a tax advantage which hampers the object or purpose of the relevant tax law. Despite all the efforts to cut down aggressive tax planning schemes, companies can be expected to continue finding out ways to achieve tax advantage by profit shifting through artificial transactions without economic substance. Therefore, the directive introduces the general anti-abuse rule providing a tax administrator with the possibility of not taking such an artificial transactions into account.[6]

The Directive is to be transposed by EU Member States by the end of 2018. The need of the explicit anti-abuse rule in the legal order of the Czech Republic is based on the requirement of the European Union to prove the fulfilment of the obligations imposed by the European Union law when it comes to the implementation of European Union legislation by the Czech Republic. In the case of maintaining the existing legal situation where the general anti-abuse rule is not explicitly enacted in the tax legislation, although it can be considered an implicit part of it, there would be a conflict with the formal requirements for the proper implementation of EU law and it would mean a breach of the obligations of the Czech Republic arising from EU law. It can be stated that the legal implementation of this rule is necessary.

[6] Implementace směrnice EU proti vyhýbání se daňovým povinnostem do českého právního řádu, 2017.

Specifically regarding the abuse of right within the framework of the case law of the Court of Justice of the European Union, the Judgment in Case C-255/02 Halifax is of fundamental importance for the interpretation and application of provisions of the EU law. Without wishing to define in detail other relevant case law in the chosen area, it is obvious that the Supreme Administrative Court (hereinafter: SAC) and subsequently the Constitutional Court of the Czech Republic had been "inspired" while applying the abuse of tax law, especially by the jurisprudence of the Court of Justice of the European Union.

From the older decisions of the SAC in which it confirmed the abuse of tax law in the given cases, I would like to mention, for example, Judgment No. 5 Afs 53/2008-70 and 7 Afs 45/2008-44. Cases of abuse of tax law concerned both the income tax and value added tax, but the SAC made statements also concerning abuse of rights in the area of the Tax Code (e.g. Judgment No. 8 Aps 2/2007-6, 1 Afs 50/2007-06 and 2 Afs 101/2007-49). In some older cases, the SAC adjudged the conduct as a dissimulated legal act under Sec. (§) 2, Subsec. 7 of Act No. 337/1992 Sb. as a circumvention of law (Šefl, 2009).

Following the last mention of the so-called dissimulated legal act, I would like to continue with the next tax administration principle, which is worth mentioning in the context of abuse of rights, i.e. the very principle of the so-called material truth.

3 The Principle of Material Truth

This principle is expressed in Sec. (§) 8 Subsec. 3 of the Tax Code as follows:

> *"A tax administrator shall follow the actual content of the legal act or other facts decisive for tax administration."*

According to this principle, the actual content of a legal act shall always be a priority for a tax administrator. In connection with this principle, the burden of proof thereof shall be borne fully by a tax administrator, who has to prove that a legal act is a dissimulated legal act.

As stated in the explanatory memorandum of the Tax Code, in addition to the formal concealment of a specific legal act, the scope of this principle affects even the cases where it is necessary to examine the actual content of the given fact decisive for tax administration. It is assumed that the economically justifiable behaviour, from which individual facts and legal acts result, is defined in individual substantive laws as the subject of tax (The Explanatory Memorandum of the Tax Code: 21).

The definition of the principle of material truth in the Tax Code as opposed to its original amendment according to the Act regulating Administration of Taxes and Fees (hereinafter: AATF) (Act No. 337/1992 Sb., as amended) has changed at first glance. For the sake of clarity, the diction of the principle in both legal regulations follows:

Principle of Material Truth Sec. (§) 8 Subsec. 3 of the Tax Code:

> *"A tax administrator shall follow the actual content of a legal act or other fact decisive for tax administration."*

Principle of Material Truth Sec. (§) 2 Subsec. 7 AATF:

> *"In the application of tax laws within tax management, the actual content of the legal act or other matter decisive for the determination or collection of a tax shall always be taken into account if it is obscured by a formal legal condition and it is distinct from it."*

The first change we can notice is the impact of this principle under the AATF only on tax management. Extension of this principle to tax administration in general, not just to tax proceedings is a positive change. The changes made in the text of this principle in the Tax Code is without doubt a more pregnant expression of this important tax administration principle.

Both during the period of effectiveness of the AATF and at present, it has not been possible to apply this principle to cases of the so-called circumvention of law. During the period of effectiveness of the CPSA, the SAC judged that the principle of material truth cannot affect the cases in which the manifestation and will are in agreement, i.e. the participants have a real interest in making a legal act, but they do so in order to circumvent the law. An examination of the relationship between will and manifestation of will of the parties to the legal relationship is therefore decisive for the application of this principle (Usnesení Nejvyššího správního soudu, 1 Afs 73/2004).

The relationship between this expressed principle and abuse of tax law, respectively, the application to a particular case used to be much more ambiguous. It may be noticed in one of the most well-known cases when the SAC established the concept of abuse of law in tax matters (Rozsudek Nejvyššího správního soudu, Afs 107/2004 – 48). This Judgment has been known as the *Divers.* By coincidence, it was reassessed by another senate of the same court and in the same case the court did not assess it as the abuse of rights, but a violation of the principle of material truth interpreting it more broadly than the SAC had done in the previous decision.

If the principle of material truth is interpreted more broadly as an act of concealing the essence of a transaction as such, it will not be necessary to discuss the abuse of tax law and use the existing principle enshrined in the Tax Code. However, in the above-mentioned ruling of 2007, the SAC identified a clear boundary between a dissimulated legal act and circumvention of law and it did not accept the wider interpretation of the principle of material truth.

4 Conclusion

The SAC in the mentioned Case *Divers* adjudged that the institute of prohibition of abuse of individual rights is a material corrective of the formal concept of law through which the issue of equity is brought into the legal order. An Act, which is by its very nature general, cannot conceptually mention all the conceivable life situations that can occur during the period of its effect. As a result, it may happen that from the formal point of view certain behaviour, however, only ostensibly corresponds with the rule of law but is also felt to be manifestly unfair because, contrary to certain fundamental values and rational organisation of social relations, it causes harm to the others.

However, I see many points worth reflecting in the above-mentioned view of the abuse of rights and its application into tax law. The first one of them is the very aspect of equity or morals brought into the field of tax law. Its use can be contrary to the principle that everyone can do what is not prohibited by law. Due to the abuse of tax law, tax planning of taxpayers, which is directly permitted by law in many situations, has occurred in situations where a taxpayer often cannot be sure how the particular case would be subsequently judged by the court. The corrective of abuse of tax law on the part of the court and its use is not very foreseeable. It may therefore get into conflict with the principle of legal certainty and the principle of legitimate expectations, which is one of the principles expressly set out in the Tax Code.

According to the author, despite some controversial issues, it has been proved above that the adoption of the general anti-abuse rule is a necessary step, resulting from the latest developments in European legislation, in particular the ATAD Directive. It confirms the current administrative practice in the Czech Republic and it is in accordance with the recent legislative development in other EU countries, which have already adopted this rule into national legal orders. At the time of submitting this contribution, a concrete anti-abuse principle as a part of the Tax Code has been already discussed within the approval process.

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