

**GAARs – A Key Element of Tax Systems  
in the Post-BEPS Tax World**



notice in advance. The taxpayer may appeal to the higher-level tax authorities within seven days if it disagrees with the adjustment decision.

A notable feature of this GAAR Procedure Rule is that it specifically excludes its application to the offshore share transfer arrangements addressed in section 8.2.3. This does not mean that such an offshore share transfer will not fall within the scope of application of the GAAR. On the contrary, the SAT might strengthen its administration of offshore share transfers, either through continuing to apply Circular 698 (which already has a broad scope and has led to a great deal of criticism) or by enacting a stricter procedural rule specifically for offshore share transfers. But either way, offshore share transfer transactions are still within the scope of the GAAR, and they will most likely continue to be one of the key targets of China's GAAR application.

## Chapter 9

### Croatia

Nataša Žunić Kovačević, Stjepan Gadžo,  
Sabina Hodžić and Irena Klemenčić

#### 9.1. GAARs – An emerging trend in the tax landscape

The Croatian tax system lacks a coherent approach to tax avoidance.<sup>1</sup> This is not surprising, as a new tax system suitable for a market-oriented economy had to be created during the transition era of the 1990s.<sup>2</sup> In this context, tax evasion – rather than tax avoidance – was perceived as the more important tax policy issue. Admittedly, in the wake of the latest economic crisis and the resulting fiscal pressures, the necessity to confront some types of taxpayers' abusive behaviour was recognized. However – as will be expounded below – the chosen instruments, viewed in their entirety, are inadequate for the development of a coherent anti-avoidance framework.

Although multiple SAARs do exist, the Croatian tax system lacks a GAAR, as argued in several academic contributions.<sup>3</sup> Interestingly, the opposite opinion – that a GAAR is in fact in operation in Croatia – does exist.<sup>4</sup> It is assumed that this latter argument – misconceived in our view – is grounded in the interpretation of the “economic approach principle” provided for in

1. See R. Prebble, “Does Croatia Need a General Anti-Avoidance Rule? Recommended Changes to Croatia's Current Legislative Framework”, 29 *Financial Theory and Practice* 3 (2005).

2. See H. Arbutina et al., *Trends and Players in Tax Policy – National Report Croatia* (forthcoming).

3. See N. Žunić Kovačević, *A Comparative Look at Regulation of Corporate Income Tax Avoidance*, Chapter 5: Croatia (K.B. Brown ed, Springer, 2012), p. 127; R. Prebble, *supra* n. 1, p. 212; Z. Prebble et al., “Comparing the General Anti-Avoidance Rule on Income Tax Law with the Civil Law Doctrine of Abuse of Law”, 62 *Bulletin for International Taxation* 4 (2008), p. 154; T. Rogić Lugarić et al., *Pravni status poreznih izdataka: stanje i perspektive*, Zbornik radova s konferencije Skrivena javna potrošnja, Institut za javne financije, 2012, p. 190; and N. Žunić Kovačević and S. Gadžo, “Institut zakonskog poreznog jamstva nakon novele Općeg poreznog zakona 2012.: “Proboj pravne osobnosti” trgovačkih društava u slučaju zloporabe prava”, 34 *Zbornik Pravnog fakulteta u Rijeci* 1 (2013), p. 410.

4. See *Croatia Country Profile*, KPMG EU Tax Centre (2013). Available at <https://www.kpmg.com/Global/en/services/Tax/regional-tax-centers/european-union-tax-centre/Documents/eu-country-profiles/2013-croatia.pdf>.

Article 10(1) of the General Tax Act (hereinafter GTA).<sup>5</sup> Art. 10(1) GTA sets out that “[t]ax facts shall be determined according to their economic essence”. Furthermore, Art. 10(2) GTA provides that “[i]f the revenue, income, profit or other assessable benefit was acquired without a legal basis, the tax authority shall determine the tax liability in accordance with a special law regulating certain types of taxes”.<sup>6</sup> The intention of these provisions corresponds to those of a GAAR, but they are too vague and do not set out instructions or specific authorities that would enable the tax administration to take measures against tax avoidance. The economic approach principle in the GTA is essentially a codification of the substance over form approach taken in the process of classifying tax facts. It should be noted that the wording of the Croatian economic approach principle closely resembles that of *wirtschaftliche Betrachtungsweise* in Austrian tax law, as set out in Article 21 of the *Bundesabgabenordnung* (hereinafter BAO).<sup>7</sup> On the other hand, the Croatian GTA does not contain a provision comparable to Art. 22 BAO, which lays down a GAAR.<sup>8</sup> It may be assumed that it is precisely because an explicit GAAR exists in Austria that Art. 21 BAO is considered to be largely superfluous.<sup>9</sup>

The provisions on the economic approach principle have been in effect since 2001, when the GTA entered into force. However – possibly due to their vagueness – their potential as a powerful anti-avoidance tool was not recognized by the Tax Administration.

Art. 11 GTA sets out a mechanism aimed at preventing the abuse of legal form: “If a sham transaction conceals another legal transaction, the basis for the assessment of tax liability shall be that concealed legal transaction”. The rule on sham transactions is not specific to tax law only: it is also contained in Article 285 of the Civil Obligations Act.<sup>10</sup> While under civil law such a transaction is considered to be void, tax law is only concerned with its economic consequences. Art. 11 GTA allows the tax authorities

5. Official Gazette of the Republic of Croatia, Nos. 147/08, 18/11, 78/12, 136/12 and 73/13.

6. Translation by Croatian tax administration, available at [http://www.porezna-uprava.hr/en\\_propisi/\\_layouts/in2.vuk.sp.propisi.intranet/propisi.aspx#id=pro117](http://www.porezna-uprava.hr/en_propisi/_layouts/in2.vuk.sp.propisi.intranet/propisi.aspx#id=pro117).

7. Art. 21 BAO provides that, in order to evaluate tax matters according to the economic approach principle, the tax authority should evaluate actual economic meaning instead of the form of the legal transaction.

8. Art. 22 BAO provides that the abuse of form may not be used as a way to reduce a tax obligation. The abuse of law should result in setting the tax obligation as it would be set in the case of a legal form appropriate to economic events, facts and circumstances.

9. F. Zimmer, *Form and Substance in Tax Law – General Report*, in International Fiscal Association, *Cahiers de Droit Fiscal International*, vol. 87a. (Sdu Uitgevers, 2002), p. 27.

10. Official Gazette of the Republic of Croatia, Nos. 35/05, 41/08 and 125/11.

to “recharacterize” a transaction, i.e. the provision of the contract, and to neglect the form of the transaction chosen by the contracting parties and consider it to have been concluded in a form that corresponds to the real intention of the contracting parties.<sup>11</sup> According to Kapetanović,<sup>12</sup> this provision is seldom used in practice, with a tendency to use it more lately, especially with regard to real estate purchases via business shares sales.

The term “sham” typically applies to a situation where the actual intentions of the relevant parties do not match what they have recorded and, with respect to transactions, what they have reported to the tax authorities.<sup>13</sup> If a tax system allows a more favourable treatment for a certain type of contract, the parties might be tempted to recharacterize the contract as the one taxed at lower rates. Considering the fact that Croatia has legislation allowing the tax authorities to combat shams, a GAAR is not needed for combating sham transactions. Tax avoidance and shams are different concepts, and a GAAR applies when the sham doctrine is not strong enough. Sham transactions (simulations) and tax avoidance are in theory encompassed by the broader term “abuse of law” (*fraus legis*), allowing the tax authorities to reject certain behaviour if it is proven to be a sham or motivated exclusively by tax avoidance. Croatia, unlike France or Germany, does not regulate this matter through a GAAR but only through the provision intended to prevent fraudulent behaviour.<sup>14</sup>

In the Croatian tax system, there are some provisions which enable a legal reduction of taxes, introduced with the intent of the legislature to benefit certain areas<sup>15</sup> (e.g. the city of Vukovar, free zones, hill and mountain areas, and areas of special national concern – the last two having been in force until 2013), to encourage certain activities (e.g. business in areas of special national concern, corporations employing a certain number of employees, scientific activities, education and the training of employees) or to reduce tax obligations for a certain category of taxpayers (e.g. war veterans). Until 2001, the allowance for corporate equity (ACE) and the use of an accelerated depreciation allowance were employed as measures against tax avoidance.<sup>16</sup> After the new Corporate Income Tax Act (hereinafter: CITA)<sup>17</sup>

11. J. Šimović et al., *Hrvatski fiskalni sustav*, (Narodne novine, 2010), p. 233.

12. S. Kapetanović, “Prividni pravni poslovi”, *Porezni vjesnik (Tax News)* 3 (2010), pp. 40-42.

13. R. Prebble (2005), *supra* n. 1, p. 215.

14. T. Rogić Lugarić et al. (2012), *supra* n. 3, p. 190.

15. R. Prebble (2005), *supra* n. 1, p. 213.

16. N. Žunić Kovačević (2012), *supra* n. 3, p. 127.

17. Official Gazette of the Republic of Croatia, Nos. 177/04, 90/05, 57/06, 146/08, 80/10, 22/12 and 148/13.

entered into force in 2001, legal tax avoidance was possible through provisions on tax exemptions for investment in capital assets and allowances for the employment of new staff. This was abolished in 2006.<sup>18</sup> A number of special rules, i.e. SAARs, introduced with the aim of curbing tax avoidance, are found in the CITA *de lege lata* (see section 9.4.).

Although the approach to tax avoidance schemes with an international dimension is an important issue worldwide – especially considering the developments relating to the OECD BEPS Report – no discussion thereof has been noted in the Croatian tax community.

## 9.2. Requirements for the application of GAARs

The obligation to pay taxes stems from Article 51 of the Croatian Constitution,<sup>19</sup> which provides that everyone should participate in the defrayment of public expenses, in accordance with their economic capacity. The constitution goes on to stipulate that the tax system should be based upon the principles of equality and equity. Those general provisions are further elaborated on, inter alia, by Art. 9 GTA, which obliges the parties in the tax relationship to act in good faith, i.e. to conduct themselves conscientiously and fairly in accordance with the law.<sup>20</sup> Article 19 of the constitution sets out that the individual decisions of governmental agencies, the civil service and bodies vested with public authority should be grounded in law. The principle of legality is the key principle of the Croatian legal system, and therefore any action or procedure undertaken by the tax administration targeting tax avoidance behaviour should be based on the law and comply with the principle of legality.

## 9.3. Legal consequences of applying GAARs

Considering there is no GAAR in the Croatian tax system – or even a proposal on its introduction at the time this contribution was written – it is impossible to speculate about the legal consequences of its application. If policymakers opt for the introduction of such an anti-avoidance instrument,

18. N. Žunić Kovačević (2012), *supra* n. 3, p. 127.

19. Official Gazette of the Republic of Croatia, Nos. 56/90, 135/97, 8/98, 113/00, 124/00, 28/01, 41/01, 55/01, 76/10 and 85/10.

20. The principle of good faith conduct is further elaborated by the Ministry of Finance Ordinance (Official Gazette of the Republic of Croatia, No. 59/09).

it is likely that its elements and wording will take into account recent developments on the EU level (see section 9.7.).

## 9.4. GAARs and SAARs (specific anti-avoidance rules)

While Croatia does not have a GAAR, various SAARs have been adopted over the years. It may be inferred from the previous legislative activity in this area that the introduction of a GAAR was considered to be unnecessary and that the policy choice was to rely on SAARs as the cornerstones of anti-avoidance legislation. However, a more detailed analysis reveals that the special rules have often been adopted without a consistent underlying policy, leading to the conclusion that Croatian tax policymakers do not have a clear and coherent anti-avoidance approach. In our view, this approach can hardly be referred to as a policy; it is more a reflection of disorientation in the process of drafting and designing tax laws. This view is supported by the utter absence of debate among the stakeholders – including the Ministry of Finance as the key player in the development of tax policy – about the desirable anti-avoidance approach, i.e. about the GAAR – SAARs dilemma.

Moreover, some recent legislative interventions reveal a considerable degree of policymakers' attention to the important and controversial issue of the relationship between taxation and the abuse of rights principle. This is one of the general principles of Croatian private law, provided for under Article 6 of the Civil Obligations Act. Some tax procedure rules could be considered to be a reflection of this principle, even if the general rule prohibiting the abuse of rights, i.e. a GAAR, is lacking in the tax statutes. More specifically, amendments to the GTA in 2012<sup>21</sup> expanded the circle of legal guarantors for the tax liabilities of companies to the company shareholders, board members and executive directors and associated persons. The prerequisite for this piercing of the corporate veil – a concept originating in corporate law – is that it has been determined in a special tax procedure that these subjects have abused their rights or power, leading to the company's inability to pay the taxes due.<sup>22</sup>

SAARs are predominantly found in the corporate tax legislation. For example, the rules on the withholding tax – a tax that is levied on certain items of passive income paid by Croatian residents to non-residents, subject to

21. Official Gazette of the Republic of Croatia, No. 78/12.

22. For a more detailed analysis of these provisions, see N. Žunić Kovačević and S. Gadžo (2013), *supra* n. 3.

treaty restrictions – follow a pattern similar to other European countries, recognizing the existence of “low tax” jurisdictions. Specifically, Art. 31(10) CITA sets out that the withholding tax must be levied at a higher rate (20%) if the recipient of the pertinent income is resident in a tax haven country, i.e. resident in one of the 50 countries enumerated in the special list issued by the Ministry of Finance and published on its website.<sup>23</sup>

Another SAAR is targeted at the abuse of options to reduce the corporate tax base via reinvesting the company profits, i.e. increasing the capital of the company for investment and development purposes. While this special tax benefit – provided for under Art. 6(1)(6) CITA – was introduced in 2012 with the goal of helping the real economy in times of economic crisis,<sup>24</sup> the legislature recognized its possible use as a tax avoidance instrument.<sup>25</sup> Therefore, the taxpayer who uses this tax benefit must, within six months after the expiry of the deadline for the filing of a corporate income tax return, present to the competent local office of the tax administration evidence of the increase of registered capital effected by the profit earned in the tax period for which the reduced tax base has been declared. Moreover, the entitlement to reduce the corporate income tax will not be granted if it is obvious that the intention behind the increase of the company’s capital was tax fraud or tax evasion. The latter provision, provided for under Art. 6(7) CITA, is of special importance, because it is an explicit SAAR. Although the term “tax avoidance” is not defined in the CITA, it can be assumed that this provision targets not only illegal tax avoidance, i.e. tax fraud, but also activities aimed at the reduction of the tax burden that are not intended to produce a reinvestment effect.<sup>26</sup> As yet, it is difficult to make assumptions about the approach of the tax administration in determining the purpose of the capital increase.<sup>27</sup>

As in most civil law countries, the corporate income tax base in Croatia is calculated using the company’s financial accounts as the starting point. Art. 8 CITA contains a thin cap rule, providing that the taxpayer’s accounting profit/loss must be increased by the interest on shareholder loans. The

23. See [http://www.porezna-uprava.hr/hr\\_propisi/\\_layouts/in2.vuk.sp.propisi.intranet/propisi.aspx?id=pro22](http://www.porezna-uprava.hr/hr_propisi/_layouts/in2.vuk.sp.propisi.intranet/propisi.aspx?id=pro22).

24. K. Cipek et al., “Porezna olakšica za reinvestiranu dobit”, *Porezni vjesnik (Tax News)* 12 (2012), p. 53.

25. See Š. Jozipović, “Tendencies in Croatian Tax Law regarding CFC Legislation”, *European Tax Studies* 1 (2013), p. 6.

26. *Id.*, p. 10.

27. TPA Horwath, *Bez poreza na dobit – unos dobiti u temeljni kapital*, Newsletter 04/2013. Available at [http://www.tpa-horwath.hr/sites/default/files/newsletter/downloads/tpa\\_horwath\\_newsletter\\_04\\_-\\_2013\\_1.pdf](http://www.tpa-horwath.hr/sites/default/files/newsletter/downloads/tpa_horwath_newsletter_04_-_2013_1.pdf).

conditions are that the shareholder holds at least 25% in the taxpayer’s capital/voting rights and the loan exceeds four times the amount of his holding. For these purposes, the loans received by the company from third parties, guaranteed by the shareholder, are considered to be shareholder’s loans.

Since Croatia does not have a GAAR, it is hard to imagine what the relation between a GAAR and the above-mentioned SAARs would be. It is our standpoint that – in accordance with the *lex specialis* doctrine – where specific anti-avoidance rules coexist alongside a GAAR, the former should apply, excluding the application of a GAAR. Such an approach would be in accordance with legal certainty requirements.

## 9.5. GAARs and tax treaties

The relationship between GAARs and tax treaties has always been a controversial issue. Considering the absence of a GAAR in the Croatian tax system, it is only possible to give a hypothetical view that the application of a domestic GAAR should be recognized as a prerequisite, in line with paragraph 9.2 of the Commentary on Article 1 of the OECD Model. It should be emphasized that the situation is much clearer with regard to those tax treaties that expressly allow the application of domestic anti-avoidance rules. Such provisions can be found in the Croatian tax treaties with Israel (ratified in 2006) and Portugal (ratified in 2014).

## 9.6. GAARs and EU law requirements

Croatia is, as of 1 July 2013, the newest (28th) Member State of the European Union. On that date, the Accession Treaty (signed in 2011) entered into force, marking the realization of the long-standing paramount goal of Croatian foreign policy. Croatia had to harmonize large parts of its legal system with the *acquis communautaire*, and tax law was no exception. Taking into consideration the substantial efforts made in this area – particularly after the European Commission issued the screening report in 2006<sup>28</sup> – a broad assertion that Croatian tax law is aligned with the EU law requirements can be made. Admittedly, a genuine examination of specific tax provisions’ compatibility with EU law before the European Court of Justice (ECJ) is yet to be made.

28. Available at [http://ec.europa.eu/enlargement/pdf/croatia/screening\\_report\\_16\\_hr\\_internet\\_en.pdf](http://ec.europa.eu/enlargement/pdf/croatia/screening_report_16_hr_internet_en.pdf).

Against this backdrop, any future proposals for the reform of anti-avoidance legislation in Croatia should respect the limitations on its design and structure laid down in EU law. These limitations are the result of what is known as negative integration, i.e. they stem from the decisions of the ECJ.<sup>29</sup> This is a point that deserves special attention, as the influence of the ECJ's case law on national tax policy differs across EU Member States.<sup>30</sup> Since, at least at the time of writing, a comprehensive study on the matter of the compliance of Croatian tax legislation with ECJ case law is lacking, it is hard to envisage its influence on the future development of Croatian anti-avoidance policy.

The ECJ has not hitherto examined the compatibility of a national GAAR with the fundamental freedoms, but some insights can be drawn from the extensive case law dealing with various SAARs.<sup>31</sup> In fact, the anti-avoidance doctrine developed by the Court – putting aside the doubts about its uniformity in direct and indirect tax matters – shares remarkably similar features with the statutory GAARs existing in national tax systems.<sup>32</sup> More specifically, the decisive factors in its application are: (i) the purpose of the EU law relied upon by the economic operator (objective element); (ii) the intent of the economic operator of obtaining tax benefits via pertinent EU law abuse (subjective element); and (iii) the relative weight assigned to the “tax saving intent” and other, commercial (business) aims of the transaction(s) in question. We share the view that, when applying a national GAAR in the EU context, Member States must adhere to the tax avoidance concept delimited by the ECJ, even if the result is a narrowing of the GAAR's scope.<sup>33</sup>

Key ECJ decisions on the interaction between EU law and national anti-avoidance legislation seem to have passed largely unnoticed by the stakeholders in Croatia (with several academic contributions being notable

29. On the dichotomy between positive and negative integration of EU Member States' tax systems, see B. Terra and P. Wattel, *European Tax Law* (Kluwer Law International, 2012), pp. 36-39.

30. See C. Brokelind (ed.), *Towards a Homogeneous EC Direct Tax Law: Assessment of the Member States' Responses to ECJ's Case Law* (IBFD, 2007).

31. V. Ruiz Almendral, “Tax Avoidance, the “Balanced Allocation of Taxing Powers” and the Arm's Length Standard: An Odd Threesome in Need of Clarification”, in I. Richelle, W. Schön and E. Traversa (eds.), *Allocating Taxing Powers within the European Union* (Springer, 2013), p. 154.

32. For an overview of general features of GAARs see G. Cooper, “International Experience with General Anti-Avoidance Rules”, 54 *S.M.U. L. Rev.* (2001), pp. 83-130.

33. See S. de Monès et al. “Abuse of Tax Law across Europe, Part I”, *EC Tax Review* 2 (2010), pp. 95-96.

exceptions).<sup>34</sup> Most importantly, they have been virtually ignored by the Ministry of Finance, a key player in the shaping of Croatian tax policy.<sup>35</sup> Whether the dire straits of Croatian public finance – currently undergoing the surveillance process by the EU institutions – will provide an impetus for a more comprehensive approach to tax avoidance, including the introduction of a GAAR, remains to be seen.<sup>36</sup>

Croatia has, in various tax statutes and by-laws, implemented the provisions of the EU tax directives. Anti-abuse clauses of the direct tax directives have also been implemented, mostly by the provisions of the CITA and the Ordinance on Corporate Income Tax<sup>37</sup> (hereinafter: OCIT). The general part of the anti-abuse clause provided for in Article 15(1)(a) of the Merger Directive has been transposed by Art. 20(p) CITA. It follows that the tax benefits provided by the Merger Directive will be denied if it is obvious that the principal goal or one of the principal goals of the reorganization is tax evasion or tax avoidance. Interestingly, a very similar wording is found in Art. 31(e)(3) CITA, denying the benefits provided by the Parent-Subsidiary Directive, and in Art. 31(d)(3) CITA, denying the benefits provided by the Interest and Royalties Directive. This is the method of implementation of general anti abuse clauses, provided for in Article 1(2) of the Parent-Subsidiary Directive and in Article 5(1) of the Interest and Royalties Directive, chosen by the Croatian legislature, probably with the idea of pursuing a uniform anti-avoidance approach in the EU tax directives context. Consequently, some concerns about the application and interpretation of these provisions in practice have been raised. On the one hand, their wording is similar, but not identical. While the provisions relating to cases covered by the Merger Directive and Parent-Subsidiary Directive use the phrase “principal goal or one of the principal goals of the transaction”, the provision relating to cases covered by the Interest and Royalties Directive is silent on the question of the relative weight of evasion/avoidance intent. Moreover, the presumption of tax evasion/avoidance as a principal aim of the transaction in the absence of “valid commercial reasons” seems to apply only in cases covered by the Merger Directive, as set out in Art. 41(h)(6) OCIT. To our knowledge, there have not been any disputes related to the

34. See S. Gadžo and I. Klemenčić, „Time to Stop Avoiding the Tax Avoidance Issue in Croatia: A Proposal Based on the Recent Developments in the European Union”, 38 *Financial Theory and Practice* 3 (2014), pp. 277-302.

35. On tax policy in Croatia more generally, see H. Arbutina et al., *supra* n. 2.

36. This seems to have been one of the main reasons for anti-avoidance reforms in several crisis-stricken EU countries such as Greece and Portugal. See T. Lyons, “The Financial Crisis, Tax Avoidance and an EU GAAR”, *British Tax Review* 2 (2013), pp. 111-112.

37. Official Gazette of the Republic of Croatia, Nos. 95/05, 133/07, 156/08, 146/09, 123/10, 137/11, 61/12, 146/12, 160/13 and 12/14.

application of the direct tax directives in Croatia, and the tax administration has not released any (non-binding) opinions interpreting and clarifying the application of the aforementioned anti-abuse provisions.<sup>38</sup>

## 9.7. GAARS and recent European developments

In 2011, the European Commission published a proposal for the Council Directive on a Common Consolidated Corporate Tax Base (CCCTB).<sup>39</sup> The CCCTB Working Group – a group of experts that was heavily involved in the preparatory work leading up to the draft directive – confirmed the view on the legitimacy of tax planning in the internal market previously expressed by the ECJ.<sup>40</sup> More specifically, it was argued that “as a general rule, CCCTB taxpayers should be free to arrange their economic affairs in the manner they deem most beneficial for them”.<sup>41</sup> On the other hand, the need for harmonized anti-abuse rules, compatible with the requirements of primary law of the EU, was also recognized. The end result is that Chapter XIV of the draft directive contains various anti-abuse rules that form a two-level “anti-abuse shield”.<sup>42</sup> While SAARs – namely the rules providing for disallowance of interest deductions and the CFC rules – are laid down in Articles 81 to 83, a GAAR is provided for in Article 80 of the draft directive.

In our view, the overall structure of the anti-avoidance mechanism in the CCCTB context – a GAAR supported by more specific rules – is appropriate for achieving the envisaged goals of the draft directive. It must be noted that the very fact that legislators opt for the introduction of a GAAR indicates their awareness of the inherent unpredictability of taxpayers’ avoidance structures.<sup>43</sup> The Commission has clearly acknowledged this fact in designing the CCCTB anti-abuse mechanism.<sup>44</sup> In the highly unlikely case of the adoption of the CCCTB draft directive by the Council, corporate groups operating in the EU market (and beyond) would have manifold tax

38. On the role of the tax administration’s opinions in Croatia generally, see H. Arbutina et al., *supra* n. 2.

39. COM(2011) 121/4, 2011/0058 (CNS); SEC(2011) 316 final.

40. W. Schön, “Abuse of Rights and European Tax Law”, in *Comparative Perspectives on Revenue Law: Essays in Honour of John Tiley* (P. Harris and D. Oliver eds., Cambridge University Press, 2008), p. 98.

41. CCCTB/WP065, CCCTB WG: Anti-abuse rules p. 2 (14 and 15 Apr. 2008).

42. C. HJI Panayi, “The Anti-Abuse Rules of the CCCTB”, 66 *Bulletin for International Taxation* 4/5(2012), p. 258.

43. R. Prebble and J. Prebble, “Does the Use of General Anti-Avoidance Rules to Combat Tax Avoidance Breach Principles of the Rule of Law?”, 55 *Saint Louis University Law Journal* 1 (2010), p. 30.

44. CCCTB/WP065, *supra* n. 41, p. 3.

planning opportunities, a great number of which can hardly be foreseen at present. A GAAR can be a useful tool for combating those tax planning structures that are deemed to have crossed the line of “legitimate tax planning”. Whether the GAAR laid down in Article 80 of the CCCTB draft directive is well suited for this cause largely depends on its scope, a problem that deserves special attention.

Firstly, the draft directive remains silent on the hierarchy between the GAAR and SAARs. We support the interpretation that the GAAR can be applied only in cases not covered by the specific rules.<sup>45</sup> Moreover, the wording of the GAAR is the object of some criticism, as it – while obviously influenced by the case law of the ECJ and its “wholly artificial arrangements” doctrine – deviates from the court’s decisions in some important aspects.<sup>46</sup> Specifically, we point to the unnecessary narrowing down of the GAAR’s scope by its use of the “sole purpose test” in lieu of the “principal or main purpose test” employed in the anti-abuse rule of the Merger Directive and recognized in a number of anti-avoidance decisions of the ECJ.<sup>47</sup> This is highly relevant with regard to Croatian tax law. While Croatia does not have a GAAR and could relatively simply implement the anti-abuse rules of the CCCTB draft directive in its tax system, the Croatian legislature, as noted above, is developing a uniform anti-avoidance approach in the direct tax directive context. One of the features of this approach is the “principal purpose test”. Therefore, the introduction of the “sole purpose test” in a CCCTB context seems not only theoretically questionable, it could lead to practical problems as well.<sup>48</sup>

Another important anti-avoidance development in the European Union is the Commission Recommendation of 6 December 2012, which addresses aggressive tax planning in the area of direct taxation.<sup>49</sup> Aggressive tax planning is defined as “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”.<sup>50</sup> One of the suggested measures aimed at curtailing aggressive tax planning is the adoption of a uniform GAAR by the Member States, to be applied equally in purely domestic, intra-EU and third-country situations. This constitutes an effort to enhance legal security for enterprises doing

45. See C. HJI Panayi, *supra* n. 42, p. 258.

46. For an overview, see M. Lang, “The General Anti-Abuse Rule of Article 80 of the Draft Proposal for a Council Directive on a Common Consolidated Corporate Tax Base”, 51 *Bulletin for International Taxation* 6 (2011).

47. B. Terra and P. Wattel, *supra* n. 29, p. 919.

48. See M. Lang, *supra* n. 46, p. 225.

49. C(2012) 8806 final.

50. *Supra* n. 49, p. 2.



business in the internal market via codification of the main anti-avoidance doctrines developed by the ECJ. It seems that the recommendation has not influenced Croatian policymakers' approach to tax avoidance in any meaningful way. In contrast, if the introduction of a GAAR becomes a serious topic on the Croatian tax policy agenda, the main design elements set out in the recommendation cannot be ignored, because they closely follow the limitations on anti-avoidance rules laid down by the ECJ.

In November 2013, the European Commission published a proposal<sup>51</sup> for amendments to the Parent-Subsidiary Directive.<sup>52</sup> The proposal addresses double non-taxation arising from the use of hybrid loan arrangements by companies operating in the internal market. Double non-taxation occurs when the Member State of the subsidiary treats the pertinent payments as tax-deductible expenses, while the Member State of the parent company treats the payments as tax-exempt profit distributions. As this practice is contrary to the aims of the Parent-Subsidiary Directive, one of the proposed amendments ensures that the payment is taxable in the Member State of the parent company if it is treated as a tax-deductible debt repayment in the Member State of the subsidiary.<sup>53</sup> Moreover, the proposal introduces a new anti-abuse rule in the Parent-Subsidiary Directive, closely aligned with the GAAR design features contained in the above-mentioned Commission Recommendation on aggressive tax planning. The Member States are required to withdraw all of the Parent-Subsidiary Directive benefits where there are "artificial arrangements or an artificial series of arrangements which has been put into place for the essential purpose of obtaining an improper tax advantage and which defeats the object, spirit and purpose of the tax provisions invoked".<sup>54</sup> It is clear that this proposal is yet another reflection of Commission's desire to apply a uniform GAAR in the European Union via codification of the ECJ's anti-avoidance doctrines. As Croatia does not have a GAAR, it could implement the proposed anti-abuse rule relatively simply, by amending Article 31(e)(3) of the CITA. On the other hand, our view is that – in case the Parent-Subsidiary Directive amendments are adopted by the Council – the Croatian legislature should follow a more comprehensive anti-avoidance approach and finally introduce a GAAR, along the lines of the Commission Recommendation on aggressive tax planning.

51. COM(2013) 814 final, 2013/0400 (CNS).

52. Council Directive 2011/96/EU, L 345/8.

53. See Art. 1(3) of the Proposal COM(2013) 814 final.

54. See Art. 1(2) of the Proposal COM(2013) 814 final.

## 9.8. Alternatives to GAARs

In today's globalized economic environment, in which states are competing for foreign investment, the anti-avoidance strategy chosen by each tax jurisdiction can have a great impact on the entire economic system. Until now, Croatian policymakers have not opted for the introduction of a GAAR, but this cannot be ascribed to a coherent anti-avoidance strategy. One possible policy alternative to a GAAR is the application of the substance over form principle in determining the tax facts. Although Croatia has codified this principle in its General Tax Act, it has not been used by the tax administration as an anti-avoidance instrument. One of the probable reasons is the approach to the interpretation of the tax provisions practiced by the tax administration and the judiciary, which relies principally on the wording of the statute rather than its underlying purpose. Admittedly, in the absence of specialized tax courts, the reluctance of the Croatian judiciary to endeavour to find a purposive interpretation of the tax legislation does not come as a surprise. Excessive literalism in interpreting tax legislation – an approach mostly followed by the Croatian judiciary<sup>55</sup> – accompanied by excessive formalism as regards legal forms classified by the norms of private law constitutes one of the most important grounds for the proliferation of tax avoidance schemes.<sup>56</sup>

Against this backdrop, the introduction of a GAAR – particularly in view of the latest developments on the EU and international levels – should be recommended, as it implies taking a step away from interpretation and the analysis of the taxpayers' arrangements and the pertinent tax provisions as a whole.<sup>57</sup> It would serve as an appropriate interpretative guideline for the tax administration and the judiciary. Furthermore, we share the view that a GAAR – under certain conditions – can actually enhance legal certainty rather than work to its detriment. In a relatively new tax system like the Croatian one, it is imperative to avoid unnecessary complexity and "tax rule madness", introducing ever more SAARs as the legislature becomes aware of new avoidance techniques. In this regard, a GAAR can play the role of a fundamental tax principle, underpinned by specific rules (SAARs), thus creating a coherent legislative anti-avoidance framework.<sup>58</sup>

55. D. Aviani et al., "Uniformno tumačenje i primjena prava te jedinstvenost sudske prakse u upravnom sudovanju", 49 *Zbornik radova Pravne fakulteta u Splitu* 2 (2012), p. 371.

56. V. Ruiz Almendral, "Tax Avoidance and the European Court of Justice: What is at Stake for European General Anti-Avoidance Rules?", 33 *Intertax* 12 (2005), p. 565.

57. *Id.*, p. 566.

58. See J. Freedman, "Defining Taxpayer Responsibility: In Support of a General Anti-Avoidance Principle", *British Tax Review* 4 (2004), pp. 332-357.

## Chapter 10

### Czech Republic

Danuše Nerudová and Lukáš Moravec

#### 10.1. GAARs – An emerging trend in the tax landscape

Two basic GAARs are applied in the Czech Republic. The first rule can be found in Article 8(3) of the Tax Procedural Code.<sup>1</sup> It reads as follows: “The tax authority takes into account the actual content of the legal act or other facts relevant for tax administration”. This substance over form rule has been part of the legislation since 1993, when a new tax system was enacted in the Czech Republic. The rule allows the tax authorities to take into account the economic substance of a transaction and to disregard its formal structure.

In this context, it should be mentioned that the domestic substance over form rule has been applied by the Supreme Administrative Court<sup>2</sup> in a tax treaty situation. In the case at hand, a shareholder of a Czech company sold a part of his participation to a company resident in Cyprus in order to receive benefits under the Czech Republic-Cyprus tax treaty. The court ruled that, during the application of the substance over form rule by the tax authorities, the tax authorities do not investigate the will of the taxpayer to simulate the legal act, but the properly determined facts must clearly reflect the actual content of the resulting legal act. The court further stated that the purpose of a tax treaty is also to prevent tax avoidance and tax evasion. Therefore, tax treaty benefits should not be available in situations where the main purpose of the transaction was to secure a more favourable tax position and to obtain a more favourable tax treatment.

A second GAAR was developed by the Supreme Administrative Court as an abuse of law doctrine under the influence of the Court of Justice of the European Union<sup>3</sup> (ECJ) and the Constitutional Court. A definition of

1. Daňový řád [Tax Procedural Code] 2009, Art. 8 (amended 2014).

2. NSS, 2006, 5 Afs 42/2005-102.

3. ECJ, 21 Feb. 2006, Case C-255/02, *Halifax plc, Leeds Permanent Development Services Ltd, County Wide Property Investments Ltd v. Commissioners of Customs & Excise*, ECJ Case Law IBFD; ECJ, 12 Sept. 2006, Case C-196/04, *Cadbury Schweppes plc, Cadbury Schweppes Overseas Ltd v. Commissioners of Inland Revenue*, para. 48, ECJ Case Law IBFD; and others.