

ABUS DE DROIT: FURTHER THOUGHTS ON THE CLEANSING OF THE STABLES, AND THE COMMUNITY NOTION OF OWN RESOURCES

Peter Harris¹

Before UK Custom's recent success in the Tribunal case of *BUPA Hospitals Limited and Goldsborough Developments Limited* released on 25th February 2002,² it had been reported that Customs were citing the decision of the European Court in *Emsland-Stärke GmbH v Hauptzollamt Hamburg-Jonas*³ in support of its assertion that *abus de droit* is a general principle of Community law, and can therefore be applied in matters of VAT avoidance within the UK. Customs' arguments were summarised, with some apparent delight, by their anti-avoidance team in a recent issue of *The Tax Journal*.⁴ However, it might be unduly hasty to take Customs' position as read, despite the apparent victory in the *BUPA* case.

The case of *Emsland-Stärke* concerned an 'own resources' matter and the reference was made under Article 177 (now Article 234 EC) by the Bundesfinanzhof. In effect, the question related to the interpretation of the common detailed rules for

¹ R.P. Harris, 3 Temple Gardens Tax Chambers, Middle Temple Lane, London EC4Y 9AU; Tel: 00 44 207 353 7884; Fax: 00 44 207 583 2044; Email: pharris@taxcounsel.co.uk.

This article is a follow-up to earlier articles in the ECTJ – see ECTJ 4/3 [2000] at 141 and 153 and ECTJ 5/3 [2001] 187. The author wishes to thank Eamon McNicholas for drawing attention to the fact that Customs were making the argument discussed in this article and to Professor David Southern for his valued comments and help in the preparation of the article. (Both are colleagues of 3 Temple Gardens Tax Chambers.)

² Unreported case no. 17588 [LON/00/1089].

³ Case C-110/99 14th December 2000 unreported.

⁴ See Issue No. 639 of 8th April 2002 at page 5.

application of the system of export refunds on agricultural products - it was not a VAT matter. The refund procedure was laid down in a Regulation, not in a Directive, and was applicable in certain specific cases defined by EC customs procedural formality.

The facts in *Emsland-Stärke* were, in essence, that a German undertaking sold goods to a Swiss undertaking which in turn sold them on to an Italian undertaking, under an external Community transit procedure. An export refund had been given on the basis that the goods left the Community, which they did. Had the matter rested there, there would have been no further issue. The problem picked up by German Customs was that the goods were immediately shipped out to Italy, by the same means of transport, and were not placed on the Swiss internal market. There was a further issue raised as to the connections between certain of the parties involved.

The first point which must be made is that the Commission intervened in this case specifically to protect the Communities' own resources. This is the nub of the issue. The Commission proposed that although the provision in question, Article 10 of Regulation 2730/79, did not constitute a sufficient basis for demanding the repayment of the export refunds granted, in the light of the circumstances of the case in the main proceedings, the abuse of rights aspect of the matter had to be examined and here the issue becomes apposite.

The EU's own resources have been 'acquired' by Council Decision 70/234, and include the CAP levies, and a percentage of the VAT collected indirectly by Member States.

The Commission cited Article 4 (3) of Regulation 2988/95 on the protection of the European Communities' Financial Interests.⁵ According to this Article 'acts which are established to have as their purpose the obtaining of an advantage contrary to the objectives of the Community law applicable in the case by artificially creating the conditions required for obtaining that advantage shall result, as the case may be, either in failure to obtain the advantage, or in its withdrawal'.

The Commission considered that, although the Regulation was not applicable at the material time, the paragraph cited simply expressed a general principle of law already in force in the Community legal order. It is clear that this comment has been taken up by Customs who consider that it may be imported into VAT matters without further ado.

⁵ 18th December 1995 OJ 1995 L 312 p.1.

Paragraph 38 of the judgment in *Emsland-Stärke* which recalls one of the arguments presented to the ECJ, is quite explicit:

“It [the Commission] points out that this general legal principle of abuse of rights exists in almost all the Member States and has already been applied in the case law of the Court of Justice, although the Court has not expressly recognised it as a general principle of Community law.”

The Commission omitted to point out specifically that the concept certainly does not exist in either the UK or Ireland, where the civil law coupling with a written constitution does not exist. In the author's view, a written constitution prescribing the relationship between the individual and the state is a *sine qua non* for the existence of the concept of *abus de droit* in a domestic context.

The Commission cited the following cases in support of its contention in *Emsland-Stärke*:

Judgment	<i>Cremer v BALM</i> ⁶
Judgment	<i>Töpfer and others</i> ⁷
Judgment	<i>General Milk Products v Hauptzollamt Hamburg-Jonas</i> ⁸
Opinion	<i>Pafitis and Others v Trapeza Kentrikis Ellados</i> ⁹

It then set out the following contentions as to what would comprise an abuse of rights, which it surmised from these judgments, in the form of three elements:¹⁰

1. ‘An objective element; that is to say that the conditions for the grant of the benefit were created artificially, that is to say, that a commercial operation was not carried out for an economic purpose, but solely to obtain from the Community budget the financial aid which accompanies that operation. This requires analysis, on a case by case basis, both of the meaning and the

⁶ Case 125/76 [1977] ECR 1593.

⁷ Case 250/80 [1981] ECR 2465.

⁸ Case C-8/92 [1993] ECR I-799.

⁹ Case C-441/93 [1996] ECR I-1347.

¹⁰ See paragraph 39 of the judgment.

purpose of the Community rules at issue and of the conduct of a prudent trader who manages his affairs in accordance with the applicable rules of law and with current commercial and economic practices in the sector in question;'

2. 'A subjective element, namely the fact that the commercial operation was carried out essentially to obtain a financial advantage incompatible with the objective of the Community rules;' and
3. 'A procedural law element relating to the burden of proof.'

It would be easy to dismiss the application of this enunciation to VAT matters, given the wording of the first paragraph which virtually requires the demanding and the granting of a Community benefit in the form of a refund, rather than that of a right to deduct VAT, which is an integral part of the VAT system, and which the Court has consistently upheld. This analysis would be supported by the following extract from Special Report No 9/98 by the Court of Auditors:¹¹

'2.2. On 26th July 1995, because of various shortcomings and incompatibilities that were detrimental to the repression of fraud and to legal co-operation in criminal matters, the Member States subscribed to a Convention on the protection of the financial interests of the European Communities. The intention of this Convention was to create minimum criminal standards, starting with a single definition of fraud for both Community expenditure and revenue. In respect of revenue, it defined fraud as any intentional act or omission relating to:

- the use or presentation of false, inaccurate or incomplete statements or documents, which has as its effect the illegal diminution of the resources of the general budget of the European Communities or budgets managed by, or on behalf of, the European Communities,
- non-disclosure of information in violation of a specific obligation, with the same effect,
- misapplication of a legally obtained benefit, with the same effect.'

¹¹ Special Report concerning the protection of the financial interests of the European Union in the field of VAT on intra-Community trade together with the Commission's replies (Submitted pursuant to Article 188c(4)(2) EC Treaty – now Article 248) Official Journal C 356/1, 20/11/1998 p.1 - 17.

2.3. However, according to the explanatory report on the Convention adopted by the Council, VAT was excluded from its scope because it was not 'an own resource collected directly for the account of the Communities. Accordingly, unlike other Community fields, provision was not made for ensuring an identical level of protection in all the Member States, despite the fact that it accounts for almost half the Communities' budgetary resources'.

In other words, VAT is admitted by the Commission and in effect by the Council, and therefore by the Member States themselves, to have been excluded from the scope of the Regulation relied on by the Commission to support the argument in *Emsland-Stärke* on which UK Customs are also relying, as it is not 'an own resource collected directly for the account of the Communities'.

How can it be argued by UK Customs that such a supposed general principle of Community law, perhaps applicable within the scope of directly collected customs moneys, can be implemented by inference when it remains outside the declared formal scope of the Sixth Directive, limited as this Directive is to VAT? Whilst Customs raised the issue before the Tribunal in the *BUPA* case and the Chairman, Stephen Oliver QC, referred to the *Emsland-Stärke* case in paragraphs 121, 122 and 129 of his judgment, there was no mention made of the own resources point. However, at paragraph 136 Stephen Oliver QC takes the argument to the point of saying that he reads "Community Rules (for present purposes) [as] 'the VAT system as presented by the Sixth Directive'". This is conceptually inconsistent with the principle of the protection of 'own resources' recognised by both the Commission and the Council. Indeed, the VAT system would not appear to be a 'Community rule' in the sense of that given by the ECJ in paragraph 52 of its judgment in *Emsland-Stärke*.

It is clear that both the Report and the ECJ's decision in *Emsland-Stärke* support the conclusion that, in the context of a Community procedure such as claiming import or export refunds, there is scope for the concept of 'abuse'. At the risk of repetition, the notion of abuse or *abus* is not the same as *abus de droit*, or abuse of right. It is also clear that the request for the preliminary ruling in *Emsland-Stärke* came from a German Court, one of the jurisdictions in which a notion of *abus de droit* exists at a national level.

However, the ECJ was at pains to use the term abuse, and not that of *abus de droit* or abuse of right in its interpretative judgment. In fact, it only authorised the use of national procedural and evidential principles, which would infer in turn that in the UK, the only possibility for Customs and Excise would be to propose a concept of national law, for example that of sham or such similar UK concepts as were

capable of being adduced before the Tribunal in *Halifax*,¹² and in *BUPA*.

The wording that the ECJ employed in its judgment in *Emsland-Stärke* is as follows:¹³

“A finding that there is an abuse presupposes an intention on the part of the Community exporter to benefit from an advantage as a result of the application of the Community rules by artificially creating the conditions for obtaining it. Evidence of this must be placed before the national court in accordance with the rules of national law, for instance by establishing that there was collusion between that exporter and the importer of the goods into the non-member country.

The fact that before being re-imported into the Community, the product was sold by the purchaser established in the non-member country concerned to an undertaking with which he has personal and commercial links, is one of the facts that may be taken into account by the national court when ascertaining whether the conditions giving rise to an obligation to repay refunds are fulfilled.”

On a balanced reading of the judgment in its context, it is clear that it is only authoritative in relation to the application for an Export Refund under Community rules. It does not support a transfer by UK Customs of the idea to VAT, which is not a question of a claim for a Community benefit, but is a Community right, which the ECJ has consistently and unequivocally maintained and supported. Customs cannot claim that it is simply a question of the protection of own resources, as the Commission has clearly stated in the Report cited above that VAT is not ‘an own resource collected directly for the account of the Communities’.¹⁴ Neither does it *a fortiori* support an extension of the concept to subsume that of *abus de droit* or abuse of right in the context of what is purely a domestic procedural matter: ‘Accordingly, unlike other Community fields, provision was not made for ensuring an identical level of protection in all the Member States, despite the fact that it [VAT] accounts for almost half the Community’s budgetary resources’.¹⁵

¹² *Halifax plc and Others v CCE* [2002] STC 402.

¹³ See paragraph 59 of the judgment.

¹⁴ Special Report concerning the protection of the financial interests of the European Union in the field of VAT on intra-Community trade together with the Commission’s replies (Submitted pursuant to Article 188c(4)(2) EC Treaty – now Article 248) Official Journal C 356/1, 20/11/1998 p.1 – 17 at paragraph 2.3.

¹⁵ *Idem*.

There is no mention of the concept of *abus de droit*, or abuse of right, as a community concept in the *Emsland-Stärke* judgment. The ECJ refers uniquely to abuse and to national procedures, and therefore does not support Customs' argument. Let us bear in mind that the ECJ has found in *Metropol Treuhand and Stadler*¹⁶ that:

‘according to the fundamental principle which underlines the VAT system which follows from Article 2 of the First and Sixth Directives, VAT applies to each transaction by way of production or distribution after deduction has been made of the VAT which has been levied directly on transactions relating to inputs. It is settled case law that the right of deduction provided for in Article 17 et seq. of the Sixth Directive is an integral part of the VAT scheme and in principle may not be limited. That right must be exercised immediately in respect of all of the taxes charged on input transactions. Any limitation on the right to deduct VAT affects the level of the tax burden and must be applied in a similar manner in all Member States.’

In other words, the right to deduction is not a matter that can be limited in principle by the Member States, whether by law or by procedure, otherwise than to the extent permitted by the Sixth Directive. This does not include the concept of *abus de droit* where this concept does not form part of the domestic law and procedure of the Member State concerned.

Whilst the Commission is more directly implicated in the defence of the Communities own resources, it is clear that the reference made to Regulation 2988/95¹⁷ does not concern VAT matters, but those of CAP customs duty and excise questions within other schemes.

The ECJ in its judgment in *Emsland-Stärke* did not expressly recognise the concept of *abus de droit* or abuse of right as a general principle of Community Law. It in fact forbore from following the Commission's argument. Do UK Customs still wish to assert the contrary in matters of VAT?

The conclusion is that there is a very clear and fundamental distinction between the structure of VAT, as being collected by Member States on an indirect basis, and the other Community resources, referred to as 'own resources'. This is borne out in the different procedural and legal treatment given to each type of issue. VAT avoidance is left to the legislation of Member States. Own resources evasion and abuse is dealt

¹⁶ (Case 409/99) at paragraph 42.

¹⁷ 18th December 1995 OJ 1995 L 312 p.1.

with under Community principles, as these questions are in effect regulated by regulation, and not indirect Community legislation such as directives.

The *Emsland-Stärke* case does not settle the question of whether *abus de droit* remains a concept of national law prevalent in several Member States, or whether it can be considered to be of more general application as a general principle of national law, foreign as it is to British domestic law and practice, or whether it is actually a general principle of Community law which could be termed abuse of right. The concept of *abus de droit* may indeed have application in areas of 'own resources', but the ECJ did not actually state this, preferring to retain the term 'abuse'.

The aim of this article has been to show that procedural initiatives taken under Customs refund procedures are not automatically transposable to the matters of deductibility of VAT under the Sixth Directive.

It is here that the historic attribution of VAT to Customs rather than to the Inland Revenue displays all the trademarks and imperfections of a pragmatic solution. Not only are interpretative concepts of direct taxation borrowed by Customs from colleagues at the Inland Revenue, but their considerable talent in matters of Customs refund procedures is now being brought to bear on tax matters which, in the author's opinion, and apparently that of the Commission and the Council of the Communities, remain clearly outside the scope of the protection accorded to the Communities' own resources.