

Burden of proof in tax law: current topics

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Burden of proof – theory and practice

- Burden of proof rules in strict meaning
 - taking decisions when there is no absolute certainty on facts
 - facilitates rational and legitimate decision-making in the domain of procedural truth
- Burden of proof rules in wider meaning
 - shows which party must be active in seeking and presenting evidence
 - connects to standards of proof: probable, more likely than not, beyond reasonable doubt etc.
 - connects to reasoning: it is possible to explain the evidence or lack of it thoroughly or in more general terms
- Important for theories on rational decision-making: cornerstone of any systematic description of what courts do
 - at least in Finland, the legal decision-making is currently seen as a weighing and balancing of legal principles and other factors – this is not very analytical view
 - this may have reduced the "demand" of exact burden of proof rules
 - however, BEPS/ EU/TP developments point to different direction

Burden of proof – who needs it and why it is needed?

- Guides parties of the process
- Helps courts to reach consistent decisions
- May have somewhat different functions in different fields of law
 - criminal law cases
 - civil law cases
 - domestic tax law cases
 - EU tax cases
- The rules make sense only if they lead to better decisions?
- The rules fulfill their function only if they are transparent enough?
- Different kinds of rules may function well in different jurisdictions?

Burden of proof in tax cases – something different?

- Written proceedings
- Complicated factual basis
- Decisions are usually not based on isolated "brute facts", but more extensive fact patterns
- Overlaps in objective and subjective criteria, especially in tax avoidance cases
- Courts' style of reasoning is typically "all things considered" and building on interpretation of norms, as opposed to style where individual facts would be named and compared (pro et contra style) under simple syllogism

OECD TPG 1.60 – 6 steps in identifying risks

- 1) Identify economically **significant** risks
- 2) Determine how specific, economically significant risks are **contractually assumed** by the associated enterprises
- 3) Determine through a functional analysis how the associated enterprises that are parties to the transaction **operate in relation to assumption of risks**, and which enterprise perform control functions and risk mitigation functions,
- 4) Steps 2-3 will have identified information relating to the assumption and management of risks in the controlled transaction. The next step is **to interpret the information and determine whether the contractual assumption of risk is consistent with the conduct of the associated enterprises** and other facts of the case by analysing (i) whether the associated enterprises follow the contractual terms under the principles of Section D.1.1; and (ii) whether the party assuming risk exercises control over the risk and has the financial capacity to assume the risk.
- 5) Where the party assuming risk under steps 1-4(i) **does not control the risk or does not have the financial capacity to assume the risk**, apply the guidance on allocating risk (see Section D.1.2.1.5).
- 6) The actual transaction as accurately delineated by considering **the evidence of all the economically relevant characteristics of the transaction** as set out in the guidance in Section D.1, should then be priced taking into account the financial and other consequences of risk assumption, as appropriately allocated, and appropriately compensating risk management functions (see Section D.1.2.1.6).

Recent developments in tax law – new context for evidence?

- BEPS
- OECD TPG 2017 – DEMPE
- BEPS MLI – principal purpose test (PPT)
- EU Anti-Tax Avoidance Directive

→ Changes in domestic tax systems

- New EU tax policy, new objectives of EU direct tax law

→ Changes in ECJ's previously established interpretations

Burden of proof – current challenges

- Tax administration
 - enforcement focus is shifting away from tax litigations to e.g. pre-emptive discussions
 - “judicial feedback” comes typically long time after tax administration has decided to go for certain interpretation
 - many of the precedents that come out now are “old cases”
- Taxpayers
 - need to adapt to post-BEPS proof/documentation requirements
 - burden of proof in new contexts, like PPT
- Administrative courts
 - readiness to deal with new types of evidence, e.g. valuations and value chain analyses
 - recognizing the difference between strong and weak evidence in new contexts
 - upholding fair and reasonable division of burden of proof in new contexts

ECJ on burden of proof – preliminary remarks

- The ECJ's general approach is (of course) that the burden of proof is shared between taxpayers and tax authorities: there are procedural requirements to both parties
- For ECJ, the burden of proof has relevance primarily in order to guarantee that EU citizens are not deprived of their rights/effective legal protection, or so that objectives of EU law are not compromised
 - primacy of EU law, principle of proportionality
- Burden of proof has been discussed especially in abuse of law/tax avoidance cases

“It is not for the Court to assess the facts in the main proceedings. However, when giving a preliminary ruling, the Court may, if appropriate, specify indicia in order to guide the national court in the assessment of the cases that it has to decide.”

- Court's roles:
 - ECJ – uniform interpretation of EU law, protecting functions of the preliminary ruling procedure
 - National courts – evaluation of facts, taking the final decision, de facto decision of when to request for a preliminary ruling

- To what extent can ECJ (realistically) be expected to steer national courts' evaluation of evidence?
- Is it possible that too much ECJ case regarding this topic would create problems for national courts, e.g. by creating tensions between established MS approach and the approach that must be followed in EU law cases?
- Is there only one EU (tax) law concept of burden of proof, or more?
 - EU economic freedoms vs. EU directives
 - Income tax cases vs. VAT cases
- While reading & interpreting ECJ cases, should we presume that the ECJ:
 - A) always makes coherent decisions based on interpretations that are constant over time
 - B) sometimes makes inconsistent decisions and sometimes changes its views

C-196/04 Cadbury Schweppes

61 The legislation on CFCs contains a number of exceptions where taxation of the resident company on the profits of CFCs does not apply. Some of those exceptions exempt the resident company in situations in which the existence of a wholly artificial arrangement solely for tax purposes appears to be excluded. Thus, the distribution by a CFC of almost the whole of its profits to a resident company reflects the absence of an intention by the latter to escape United Kingdom income tax. The performance by the CFC of trading activities excludes, for its part, the existence of an artificial arrangement which has no real economic link with the host Member State.

62 If none of those exceptions applies, the taxation provided for by the **CFC legislation may not apply if the establishment and the activities of the CFC satisfy the motive test**. That requires, essentially, that **the resident company show**, first, that the considerable reduction in United Kingdom tax resulting from the transactions routed between that company and the CFC was not the main purpose or one of the main purposes of those transactions and, secondly, that the achievement of a reduction in that tax by a diversion of profits within the meaning of that legislation was not the main reason, or one of the main reasons, for incorporating the CFC.

65 In order for the legislation on CFCs to comply with Community law, the taxation provided for by that legislation must be excluded where, **despite the existence of tax motives**, the incorporation of a CFC reflects economic reality.

70 The resident company, which is best placed for that purpose, **must be given an opportunity to produce evidence** that the CFC is actually established and that its activities are genuine.

C-504/16 & C-613/16 Deister Holding

- Was it against EU law to collect withholding taxes on dividends that were paid to foreign parent companies?
- Relevant German domestic tax law provisions were as follows:

A foreign company has no entitlement to complete or partial relief under subparagraphs 1 or 2 to the extent that persons have holdings in it who would not be entitled to the refund or exemption if they earned the income directly, and

- (1) **there are no economic or other substantial reasons for the involvement of the foreign company or**
- (2) **the foreign company does not earn more than 10% of its entire gross income for the financial year in question from its own economic activity or**
- (3) **the foreign company does not take part in general economic commerce with a business establishment suitably equipped for its business purpose.**

The circumstances of the foreign company shall be the sole decisive factor; organisational, economic or other substantial features of undertakings that are affiliated with the foreign company (Paragraph 1(2) of the Außensteuergesetz (Foreign Transaction Tax Law)) shall not be considered. A foreign company does not have its own economic activity if it earns its gross income from the management of assets or assigns its main business activities to third parties.'

C-504/16 & C-613/16 Deister Holding

69 In that regard, the Court notes, first, that, by subjecting the grant of that exemption to such a requirement, without the tax authorities being required to provide *prima facie* evidence of the absence of economic reasons or of fraud or abuse, the legislation introduces, as is clear from paragraph 62 above, a general presumption of fraud or abuse and thus undermines the objective pursued by the Parent-Subsidiary Directive, in particular Article 5(1) thereof, to prevent double taxation of dividends distributed by a resident subsidiary to its non-resident parent company by the Member State of that subsidiary's residence, in order to facilitate the cooperation and grouping together of companies at EU level.

70 Second, in so far as that legislation, where one of the conditions laid down by it is satisfied, **does not allow a non-resident parent company to provide evidence** demonstrating the existence of economic reasons, it also establishes an irrebuttable presumption of fraud or abuse.

73 The fact that the economic activity of a non-resident parent company consists in the management of its subsidiaries' assets or that the income of that company results only from such management **cannot per se indicate the existence of a wholly artificial arrangement** which does not reflect economic reality. In that context, the fact that the management of assets is not considered to constitute an economic activity for the purposes of value-added tax is irrelevant, since the tax at issue in the main proceedings and value-added tax are governed by distinct legal regimes, each pursuing different objectives.

74 In addition, contrary to what the legislation at issue in the main proceedings provides, the finding of such an arrangement requires that, on a case-by-case basis, an **overall assessment of the relevant situation be conducted**, based on factors including the organisational, economic or other substantial features of the group of companies to which the parent company in question belongs and the structures and strategies of that group.

C-311/08 SGI

73 According to the Belgian Government, **the burden of proof as to the existence of an 'unusual' or 'gratuitous' advantage within the meaning of the legislation at issue in the main proceeding rests with the national tax authorities**. It states that when those authorities apply that legislation, **the taxpayer is given an opportunity to provide evidence of any commercial justification that there may have been for the transaction in question**. The taxpayer has a month, a period which may be extended, within which to establish that no unusual or gratuitous advantage is involved, having regard to the circumstances in which the transaction was effected. If, however, those authorities persist in their intention of issuing a revised assessment and do not accept the taxpayer's arguments, the latter can challenge the assessment to tax before the national courts.

74 The Belgian Government adds that, where the legislation at issue in the main proceedings is applied, only the unusual or gratuitous part of the advantage in question is added back to the profits of the company which granted it.

75 In those circumstances, subject to verification to be carried out by the referring court as regards the last two points, which concern the interpretation and application of Belgian law, it must be concluded that, in the light of the foregoing, **national legislation such as that at issue in the main proceedings is proportionate to the set of objectives pursued by it**.

C-650/16 Bevola

61 In this respect, it must show that the losses in question satisfy the requirements set out by the Court in paragraph 55 of the judgment of 13 December 2005, *Marks & Spencer* (C-446/03, EU:C:2005:763), to which the referring court rightly refers in its question.

62 Thus, in paragraph 55 of that judgment, the Court held that a restriction of freedom of establishment imposed by the legislation of a Member State is disproportionate in a situation in which, first, the non-resident subsidiary has exhausted the possibilities available in its State of residence of having the losses taken into account for the accounting period concerned by the claim for relief and also for previous accounting periods and, second, **there is no possibility of the losses being taken into account in its State of residence for future periods either by the subsidiary itself or by a third party, in particular where the subsidiary has been sold to that third party.**

C-101/16 SC Paper Consult

- Rom Packaging provided services to Paper Consult, transaction date 3 Jan 2011
- Tax authorities had removed Rom Packaging from VAT register as from 1 Nov 2010
 - the company was declared inactive taxpayer due to its failure to give tax declarations
- Tax authorities denied Paper Consult's VAT deductions
- Romanian tax authority's website contained information where it was possible to check whether a company was declared as inactive taxpayer
- Was it against EU law to deny VAT deduction? Was this proportional?

54 The **only obligation imposed on the taxable person is, in fact**, to consult the list of taxpayers declared inactive displayed at the NAFA's headquarters and published on its website, such a verification being, in addition, straightforward to carry out.

55 It thus appears that, by obliging the taxable person to carry out that verification, the national legislation pursues an objective that is legitimate and even imposed by EU law, namely that of ensuring the proper collection of VAT and the prevention of VAT evasion, and that such a verification can reasonably be required of an economic operator. It is, however, necessary to determine whether that legislation does not go beyond what is necessary to achieve the objective pursued.

56 While the failure to file tax declarations laid down by law may be regarded as indicative of evasion, **it does not prove irrefutably that VAT evasion has occurred**. Furthermore, it is apparent from the material submitted to the Court that, subject to the checks to be carried out by the referring court, even if the taxpayer has regularised its situation and succeeded in being removed from the list of taxpayers registered as inactive, the penalty laid down in Article 11(1²) of the Tax Code would remain, with the result that the purchaser of the goods or service cannot recover the right to deduct VAT. By contrast, Article 11(1¹) of the Tax Code provides that the 're-activated' taxpayer is authorised, after its 're-activation', to recover the VAT in respect of which it has been refused a right of deduction during the period of inactivity.

60 However, **the impossibility, for the taxable person, to demonstrate that the transactions concluded with the trader declared inactive meet the conditions laid down by Directive 2006/12 and, in particular, that the VAT has been paid into the public purse by that trader, goes beyond what is necessary to attain the legitimate objective pursued by that directive.**

C-159/17 Dobre

- Dobre was in VAT register between July 2011 – July 2012, then removed from the register due to failure in submitting VAT returns
- Dobre continued invoicing with VAT until July 2013 without submitting VAT returns
- Based on tax audit, Dobre was required to pay unreported VAT on sales
- Dobre made a "counterclaim" on VAT deductions to be made on corresponding purchases

39 In that regard, it must be noted that, under Article 168(a) of Directive 2006/112, in order to have a right to deduct, first, the **interested party must be a ‘taxable person’** within the meaning of that directive and, second, the goods or services relied on to give entitlement to that right must be used by the taxable person for the purposes of his own taxed output transactions, and that, as inputs, those goods or services must be supplied by another taxable person (see, to that effect, *inter alia*, judgments of 22 October 2015, *PPUH Stehcemp*, C-277/14, EU:C:2015:719, paragraph 28, and of 19 October 2017, *Paper Consult*, C-101/16, EU:C:2017:775, paragraph 39).

40 In any event, the Court has held that, even if infringements of those formal obligations do not prevent the production of conclusive evidence that the substantive requirements giving rise to the right to deduct input VAT have been satisfied, **such circumstances may establish the simplest case of tax evasion, in which the taxable person deliberately fails to fulfil the formal obligations** incumbent upon him with the aim of evading payment of the tax (judgment of 28 July 2016, *Astone*, C-332/15, EU:C:2016:614, paragraph 55).

41 In particular, **failure to file a VAT return that would allow VAT to be applied and monitored by the tax authorities is liable to prevent the correct collection of the tax and, therefore, to compromise the proper functioning of the common system of VAT**. Therefore, EU law does not prevent such infringements from being considered to amount to tax fraud and the right to deduct being refused in such a case (judgment of 28 July 2016, *Astone*, C-332/15, EU:C:2016:614, paragraph 56).

C-664/16 Vadan

- Mr. Vadan undertook construction project (16 buildings and 90 apartments) and carried out real estate transactions between 2006 and 2009
- Due to volume of the transactions, the VAT exemption threshold was exceeded and Mr. Vadan had to register from 1 August 2006
- In 2011, tax authorities levied VAT payable for the period between August 2006 and December 2009
- The case is about whether Mr. Vadan is allowed to make VAT deductions for purchases in that period, although he is not able to present original invoices
- The available document was court-commissioned expert report on how much VAT is deductible on the basis of work for the construction of the buildings that Mr. Vadan had sold

45 That evidence may include, inter alia, documents held by the suppliers or service providers from whom the taxable person has acquired the goods or services in respect of which he has paid VAT. An assessment based on an expert report commissioned by a national court may, if necessary, supplement that evidence or reinforce its credibility, but may not replace it.

46 In the present case, it is apparent from the information in the order for reference that, **as he was unable to produce the invoices, Mr Vädan submitted other documents which are, however, illegible and, according to the referring court, are not sufficient to determine the existence and scope of the right of deduction.**

47 As regards the evidence by way of a court-commissioned expert report, such as that at issue in the main proceedings, that court states that the expert would have the task of assessing how much VAT is deductible on the basis of the amount of work carried out or the labour used by that taxable person that were necessary for the construction of the buildings which he has sold. In that regard, it must, however, be noted that such an expert report would not be able to establish that Mr Vädan actually paid that tax in respect of the input transactions carried out for the purposes of constructing those buildings.

48 (--)a taxable person who is **unable to provide evidence** of the amount of input tax he has paid, by producing invoices or any other document, cannot benefit from a right to deduct VAT solely on the basis of an assessment resulting from an expert report commissioned by a national court.

C-648/16 Fontana

- In 2014, Ms. Fontana was subject to tax adjustment procedure for year 2010
- The amount of VAT payable was calculated, in the absence of other reliable documents, on the basis of sector study of typical turnovers
- Ms. Fontana contested the tax bill by claiming that the tax authorities had wrongly applied the sector study that is relating to accountants and tax consultants, instead of the study relating to human resources management advisers, which Ms. Fontana considers to be her main activity
- The case is about whether it is allowed under EU law to use extrapolated turnover to calculate VAT

42 As regards the principle of proportionality, that principle does not preclude national legislation which provides that only significant differences between the amount of turnover declared by the taxable person and the amount calculated by extrapolation, taking account of the turnover achieved by persons carrying out the same activity as that taxable person, can bring into operation the procedure leading to an adjustment. **The sector studies used in order to calculate that turnover by extrapolation must be correct, reliable and up to date.** Such a difference can give rise only to a rebuttable presumption, **which may be rebutted by the taxable person, on the basis of evidence to the contrary.**

43 In that context, it should be noted that, throughout the tax adjustment procedure, **the taxable person's rights of defence must be guaranteed**, which means in particular that, before adopting a measure which will adversely affect a taxable person, he must be placed in a position in which he can effectively make known his views as regards the information on which the authorities intend to base their decision (judgment of 3 July 2014, *Kamino International Logistics and Datema Hellmann Worldwide Logistics*, C-129/13 and C-130/13, EU:C:2014:2041, paragraph 30).

44 Thus, the taxable person must, **first, be able to challenge both the accuracy of the sector study at issue and/or the relevance of that study for the purposes of the assessment of his specific situation.** Second, the taxable person must be in a position to explain why the declared turnover, although lower than the turnover calculated by extrapolation, reflects the actual facts of his activity during the relevant period. **In so far as the application of a sector study means that that taxable person must prove, where necessary, negative facts, the principle of proportionality requires that the necessary standard of proof is not excessively high.**

45 In those circumstances, it must be held that the mechanism at issue in the main proceedings, by its design, structure and the specific provisions governing it, does not appear to infringe the principle of proportionality, which, however, it is for the national court to verify.

Joined cases C-116/16 and C-117/16

- Beneficial owner concept under Parent-Subsidiary Directive
 - [Another stream with similar outcome is C-115/16, C-118/16, C-119/16 and C-299/16, regarding payments under Interest and Royalty Directive]
- Danish companies paid dividends to their immediate parent companies that were resident in Luxembourg and Cyprus. Ultimate parent companies were resident outside the EU
- The companies in Luxembourg and Cyprus functioned more or less as intermediaries or flow-through entities
- Danish tax authorities denied the tax benefits of Parent-Subsidiary Directive and levied withholding taxes, because recipient companies were not regarded as beneficial owners of the dividends
- ECJ found that EU law requires that the MS's deny withholding tax exemption in cases of fraudulent and abusive practices
- ECJ's interpretation departures from previous case law and there are many references to burden of proof and evidence

“it is in principle for **the companies** which seek entitlement to the exemption from withholding tax on dividends that is provided for in Article 5 of Directive 90/435 to establish that they fulfil the objective conditions imposed by the directive”

“where a tax authority of the source Member State seeks (--) to refuse to grant the exemption (--) to a company that has paid dividends to a company established in another Member State, it has the task of establishing the existence of elements constituting such an abusive practice while **taking account of all the relevant factors**, in particular the fact that the company to which the dividends have been paid is not their beneficial owner.”

“Such an authority has the task not of identifying the beneficial owners of those dividends but of establishing that the supposed beneficial owner is merely a conduit company through which an abuse of rights has been committed. Indeed, **identification of that kind may prove impossible**, in particular because the potential beneficial owners are unknown. Given the complexity of certain financial arrangements and the possibility that the intermediary companies involved in the arrangements are established outside the European Union, the national tax authority does not necessarily have information enabling it to identify those owners. **That authority cannot be required to furnish evidence that would be impossible for it to provide.**”

“in order to refuse to accord a company the status of beneficial owner of dividends, or to establish the existence of an abuse of rights, **a national authority is not required to identify the entity or entities** which it regards as being the beneficial owner(s) of those dividends.”

“when examining the structure of the group it is immaterial that some of the beneficial owners of the dividends paid by the conduit company are resident for tax purposes in a third State which has concluded a double taxation convention with the source Member State. **The existence of such a convention cannot in itself rule out an abuse of rights.**”

“it is an indication of the existence of an arrangement intended to obtain improper entitlement to the exemption provided for in Article 5 of Directive 90/435 that all or almost all of the aforesaid dividends are, **very soon after their receipt, passed on** by the company that has received them”

“the artificiality of an arrangement is capable of being borne out **by the fact that the relevant group of companies is structured in such a way** that the company which receives the dividends paid by the debtor company must itself pass those dividends on to a third company which does not fulfil the conditions for the application of Directive 90/435, with the consequence that it makes only an insignificant taxable profit when it acts as a conduit company in order to enable the flow of funds from the debtor company to the entity which is the beneficial owner of the sums paid.”

“The fact that a company acts as a conduit company may be established where its sole activity is the receipt of dividends and their transmission to the beneficial owner or to other conduit companies. The absence of actual economic activity must, in the light of the specific features of the economic activity in question, **be inferred from an analysis of all the relevant factors relating, in particular, to the management of the company, to its balance sheet, to the structure of its costs and to expenditure actually incurred, to the staff that it employs and to the premises and equipment that it has.**”

“Indications of an artificial arrangement **may also be constituted by the various contracts** existing between the companies involved in the financial transactions at issue, giving rise to intragroup flows of funds, by the way in which the transactions are financed, by the valuation of the intermediary companies' equity and **by the conduit companies' inability to have economic use of the dividends received.**”

Conclusions

- In most cases, ECJ's burden of proof rules should be read and understood in light of the underlying objectives of EU law
 - Direct tax cases: requirement for close case-by-case and all-things-considered factual analysis in order to limit restrictions of free movement to those individual cases where they are absolutely necessary
 - VAT cases: prevention of VAT fraud is a key objective, may lead to interpretations that are rather harsh for non-compliant taxpayers
 - Possible new path in recent beneficial owner cases: still highlighting all-things-considered approach, but shifting the overall balance in favor of tax authorities
- It is a challenging task for the ECJ to strike a functioning balance between legal certainty and tailor-made burden of proof rules
 - too vague rules may lead to inconsistent application of EU law; ATAD and post-BEPS environment require new approaches
 - too intrusive rules may lead to confusion and create tensions between purely domestic procedures and EU related procedures