

## COUNTERING THE CORPORATE TAX AVOIDANCE IN THE COURT OF JUSTICE OF THE EUROPEAN UNION PRACTICE

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The article contains the analysis of extensive CJEU practice regarding the issues of countering corporate tax avoidance, and legal framework, mostly the provisions of the Treaty on the Functioning of the European Union and Directives.

The purpose of this paper is to conduct a comprehensive research of the issues of countering the corporate tax avoidance in the CJEU practice. For this reason the authors set the following tasks: (1) to consider the concept of abuse of law, developed by the CJEU practice, with respect to corporate tax avoidance; (2) to identify the interaction between national anti-avoidance rules and fundamental freedoms of the internal market as established by the CJEU practice; (3) to study the CJEU practice concerning the implementation of tax directives and the application of anti-avoidance measures; (4) to identify the main features of the Directives "Anti-Tax Avoidance Directive" (ATAD) in terms of their potential impact on the development of the CJEU practice.

The research methodology includes the application of both general methods of formal logic (including analysis, synthesis, deduction and induction) and special legal methodology (formal legal and comparative legal methods).

The main results of the study. The CJEU has repeatedly considered the problem of conflict of national anti-avoidance rules with the fundamental freedoms of the EU internal market. The conflict between these rules is resolved in different ways depending on the type of anti-avoidance rules: (1) national rules aimed at countering the abuse of law, and (2) national rules developed to counter tax avoidance, which are strictly applied according to formal criteria, without any requirement to prove abuse of law in a particular situation. The application of national anti-avoidance rules may provide for the exemptions from the regime of fundamental freedoms of the internal market. Where national anti-avoidance rules are not aimed at combating wholly artificial arrangements, but are applied mechanically, due to formal criteria, such rules should apply subject to the legal regime of fundamental freedoms. The CJEU held that the concept of beneficial owner should be applied not only to interest and royalties, but also to the distribution of profits, despite the fact that the provisions of the Parent-Subsidiary Directive do not contain such a concept. EU law prohibits the granting of state aid. National anti-avoidance rules and law enforcement practice may be subject to such a prohibition in cases where they create positive discrimination.

Conclusions. When implementing the provisions of the ATAD 1-2, the EU Member States committed numerous breaches of the EU law. It therefore can be expected that the CJEU practice regarding the proper implementation of the Directives may appear in the near future. The general prohibition of abuse of EU law shall apply, even in cases where the EU Member State has not implemented the anti-avoidance mechanisms of tax directives into its national law. The general prohibition of abuse of EU law shall apply despite the principle of legal certainty, which precludes directives from being able by themselves to create obligations for individuals, so the directives cannot be relied upon per se by the Member State as against individuals.

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## 1. Introduction

The significance of the study is determined by an increasing number of initiatives around the world aimed at combating tax abuse. The practices of the EU institutions in countering corporate income tax avoidance are often referenced in the Russian tax law doctrine. In addition, the experience of a regional integration organization such as the EU can be used in further developing the Eurasian integration project in which Russia actively participates, i.e. the Eurasian Economic Union [1-4].

G. P. Tolstopyatenko notes that the CJEU is the main institution of the EU that carries out "negative integration". "Negative integration" is understood as achieving the goals of the integration tax policy through "prohibitions" on provisions of national law that conflict with EU law [5, p.27].

The key rules of a regional integration organization may significantly hinder the ability to counter tax avoidance and to protect the fiscal base of its member states.

The creation of an internal market and its proper functioning is the most important goal of economic integration, which can be achieved only under the condition that individuals are provided with proper guarantees.

In that sense, the economic foundation of the EU is its internal market, which serves as the basis for the EU's legal system [6, p.167].

In turn, the functioning of the internal market is based on four fundamental freedoms. The Treaty on the Functioning of the EU<sup>1</sup> (hereinafter - TFEU) provides for:

1. free movement of goods (Article 34);
2. free movement of persons (which, in turn, includes free movement of citizens (Article 21), workers (Article 45) and freedom of establishment (Article 49));
3. freedom to provide services (Article 56);

4. free movement of capital (as well as payments - Article 63).

These freedoms are self-executing and national law should never prevent the exercise of these four fundamental freedoms. Even a decrease in an EU Member State's tax revenues cannot justify restricting the fundamental freedoms specified in the TFEU. Each one of the four freedoms that is provided in the internal market serves as a basic principle, the violation of which is qualified as discrimination (i.e. a barrier) hindering the economic relations necessary to the proper functioning of the EU's internal market.

The mechanisms for countering tax discrimination and barriers involve compliance assessment and control over national tax policies and practices by EU institutions, namely the European Commission (hereinafter - the Commission) and the CJEU. These mechanisms apply to such national constructions or national tax policies and practices that affect the relations involving a foreign element (also referred to as cross-border relations)<sup>2</sup>. In turn, those national rules and practices applicable to relations without a foreign element – so-called "purely internal situations" – are not controlled on the basis of these four freedoms.

Freedoms of movement of persons, of goods and of services apply to those cross-border relations where the foreign element is associated with another EU Member State and do not apply to cross-border relations where the foreign element relates to a third-party jurisdiction. A different approach is used when it comes to free movement of capital, as it also applies to foreign elements associated with third-party jurisdictions.

Still, the goal of ensuring the effective application of legal mechanisms aimed at countering tax avoidance (tax avoidance measures) will, in some circumstances, prevail over the goal of ensuring the internal market's fundamental

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<sup>1</sup> Consolidated version of the Treaty on the Functioning of the European Union. OJ C 202. 2016.

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<sup>2</sup> Order of the ECJ of 12 October 2017. C-192/16. Peter Fisher and Others v Commissioners for Her Majesty's Revenue & Customs. Para 34.

freedoms; this requires exemptions to the ordinary regime of fundamental freedoms. Tax avoidance measures can also be set forth at the level of integration law, which is a specific level of legal regulation that combines features of both international and national law [7]. From the taxation point of view, all these measures may apply to overly aggressive tax planning and tax avoidance schemes that are based on so-called "wholly artificial arrangements"<sup>3</sup> with the aim of obtaining tax benefits in EU Member States.

In turn, in situations where no exemption to the regime of fundamental freedoms is granted, tax avoidance measures must be developed by the national legislator and applied by domestic tax authorities and courts in full compliance with the fundamental freedoms [8].

The existence of conflicting interests in ensuring the protection of fundamental freedoms versus ensuring the protection of EU Member States' fiscal basis makes it difficult for the CJEU to find the correct balance between these interests.

In addition, another conflict of interests must be pointed out: the conflict between EU Member States that are committed to protecting their fiscal interests and those EU Member States that actively participate in international tax competition by creating more favorable tax regimes [9, p.42]. In some cases, participation in tax competition leads some EU Member States to fostering cross-border tax avoidance schemes.

The objective of EU institutions becomes to counter tax avoidance in situations where the EU Member State itself does not take the necessary actions to do so or actively encourages tax avoidance, usually in order to attract investment.

The CJEU began forming its initial practices in implementing tax avoidance measures in the field of direct corporate taxation in the early 2000s. Subsequently, a significant part of these practices were taken into consideration when developing tax avoidance mechanisms set forth in EU tax Directives. The relationship between the CJEU's

case law and these constructions will be discussed further in the article.

The prompt implementation of these directives' tax avoidance measures has had a direct impact on the development of EU law; we will also consider this further from the perspective of CJEU practices.

The purpose of the study is to set out a comprehensive analysis of the issues related to countering the avoidance of corporate income tax in the EU judicial practice. To this end, it was necessary to set and perform the following tasks:

1) Considering the concept of abuse of law as applied by the CJEU in the context of corporate income tax avoidance;

2) Identifying the correlation established by CJEU's practices between national tax avoidance measures and the internal market fundamental freedoms and the mechanisms for countering state aid;

3) Studying the CJEU's practices when implementing tax Directives and tax avoidance measures.

This study is based on extensive normative, scientific and analytical materials. The research methodology includes the use of both general methods of formal logic (including analysis, synthesis, deduction and induction) and specific legal methods (the formal legal method and the comparative legal method).

## **2. Tax avoidance: the concept and related phenomena**

The problem of tax avoidance is directly related to the limits of tax planning, when determining the permissible means of reducing the taxpayer's liabilities. This is a matter of polemic discussions in the tax law doctrine. Thus, it is necessary to define the terminology used in this study so as to distinguish clearly between tax evasion, tax compliance, tax planning, aggressive tax planning, tax avoidance and the taxpayer's abuse of a subjective right (tax abuse).

The IBFD Explanatory Dictionary of International Taxation Terms states [10] that tax evasion is the intentional misconduct of a person or conduct that directly violates the tax legislation for the purpose of non-payment of tax.

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<sup>3</sup> Judgment of the ECJ of 12 September 2006. Case C-196/04. Cadbury Schweppes Plc, Cadbury Schweppes Overseas Ltd. v Commissioners of Inland Revenue. Para. 55.

Opposite concepts include tax compliance and tax planning, which are lawful behaviors of a taxpayer. Thus, tax compliance is understood as the taxpayer's good faith and lawful behavior involving a series of measures aimed, on the one hand, at preventing the commission of tax offenses and abuse of law, and, on the other hand, at assessing and managing tax risks [11, p.6]. In turn, tax planning is a purposeful lawful activity by individuals to reduce their tax liability [12]. In the context of international taxation, tax planning is considered not only as a lawful conduct, but also as an activity that is compatible with the fundamental freedoms of EU law, even if it is aimed at reducing the taxpayer's overall tax burden [13].

Next, we need to consider the concept of aggressive tax planning, the essence of which is to use the features of the tax system or inconsistencies between two or more tax systems in order to reduce tax liabilities<sup>4</sup>.

Aggressive tax planning is currently condemned by the international community [14, p. 370], as this practice essentially involves transnational corporations [15] that significantly erode the tax bases of states by taking advantage of globalization and differences between different tax systems, creating a competitive advantage over entities operating exclusively within the national economic space.

Aggressive tax planning can be implemented in various forms and can result in double deduction of expenses and double non-taxation.

At the same time, some tax studies [13] have said that aggressive tax planning is not a distinct legal category. Therefore, the qualification of any event as aggressive tax planning does not in itself give rise automatically to the adoption of an administrative or judicial act re-qualifying the legal form of the underlying transaction or of the taxpayer's legal arrangement for tax purposes. In this regard, the response of States can be coordinated action to help develop and improve the norms aimed at countering tax avoidance, as well as the adoption of appropriate acts both

within the EU and at the national level in order to eliminate gaps and inconsistencies in the law [13] and to tighten national enforcement practices.

We now turn to the term "tax avoidance" – it refers to an event that is somewhere between tax evasion and tax compliance. Tax avoidance can be considered an "acceptable form of taxpayer behavior"[16], such as tax planning or abstaining from consumption. However, most often tax avoidance is considered as an "unacceptable" or "illegitimate", but legal behavior. In that sense, the taxpayer's behavior, which is aimed at reducing its tax liability, is compliant with the letter of the law, but is inconsistent with its spirit – for example, the situation whereby the taxpayer provides for a fictitious legal arrangement [16].

In the Russian tax law doctrine, the concept of "tax avoidance" is described in a similar way: as a model of taxpayer behavior that can be both legal and illegal [17, p. 747; 18, p. 16]. However, the term itself is often translated as "tax evasion" [19], meaning that a prevalent negative connotation is given to this type of taxpayer's behavior.

Thus, tax avoidance occupies an intermediate place on the "scale of legality" of taxpayer's behavior – situated somewhere between completely illegal tax evasion and the lawful behavior of tax compliance.

Most problematic is distinguishing between tax avoidance and tax planning: there is a thin line to cross for tax planning to be considered as tax avoidance. Based on which criteria can we differentiate these concepts? As a result of case law evolution, the approach to determining the limits of tax planning has moved from the Westminster approach [20, p. 102], which stipulated the taxpayer's right to reduce its tax liabilities by any formally permitted means, to the Ramsay principle [21], which limits the possibility of obtaining tax benefits by creating artificial civil law arrangements, as the assessment of the taxpayer's behavior must also take into account the purpose of the law.

Thus, the term "tax avoidance" is most often used to describe fully artificial structures (wholly artificial arrangements) [22] of the taxpayer that do not coincide with the economic substance of the relationship and pursue the only goal of obtaining tax benefits [23, p.155-156]. Only if these two

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<sup>4</sup> 2012/772/EU: Commission Recommendation of 6 December 2012 on aggressive tax planning. OJ L 338.2012.

criteria are met does it become possible to apply a rule aimed at countering tax avoidance.

However, in some cases, there is actual tax avoidance without reverting to completely artificial structures. For example, such a situation may occur when applying the rules on controlled foreign companies: the establishment of a company in a foreign jurisdiction may not have any features of artificiality, but such a structure leads to a reduction in tax liabilities in the state of residence of the controlling person – this is tax avoidance in the broad sense. In order to protect the fiscal framework, States established rules for controlled foreign companies (hereinafter - CFC), but under EU law, if a controlled foreign company is established in another EU Member State, the CFC rules may conflict with the principle of freedom of establishment<sup>5</sup>.

Thus, tax avoidance consists of two patterns of taxpayer's behavior: 1) the taxpayer's behavior does not distort the economic substance of the relationship, but achieves a reduction in its tax liability, which may lead to a response by states to establish special rules against tax avoidance to protect their national tax base, for example, the CFC or thin capitalization rules; 2) the taxpayer creates completely artificial structures that distort the true nature of the economic relations at hand, in order to reduce its tax liability. To counteract such behavior, States adopt general rules against tax avoidance. This type of behavior is also called abuse or qualified tax avoidance, as it is carried out deliberately through completely artificial structures used specifically for tax evasion [24].

The abuse of law in tax relations is understood as the creation of an artificial private-law form of economic relation, which allows the taxpayer to obtain tax implications that were not intended by the legislator. The mechanisms for countering abuse of law allows us to set aside artificial arrangements for tax purposes and replace them with those qualifications that correspond to the actual nature of the economic

relation.

In summary of our analysis, we can draw the main conclusion that identifying tax avoidance schemes is the most difficult part when assessing the taxpayer's behavior, as it can include both the abuse of a taxpayer's subjective right, as well as actions by the taxpayer that lead to a reduction of tax liability, but without distorting the true nature of the underlying economic relation. As a rule, States seek to restrict as much as possible the taxpayer's behavior when it takes the form of abuse of subjective rights, including by applying general rules against tax abuse. In turn, tax avoidance, which does not fall under the concept of abuse, may be subject to special rules to protect the fiscal interests of States.

### **3. Correlation of national anti-avoidance mechanisms and basic freedoms**

Legal concepts aimed at countering the avoidance of income tax in the EU were developed by the decisions of the CJEU in the second half of the 2000s in the context of realization of basic freedoms.

The context for the development of these approaches was, in particular, the holding of the Court on the question of VAT collection (2006). At that time, the CJEU noted that Community law could not be relied on for abusive or fraudulent ends<sup>6</sup>. In another case concerning a corporate legal issue, the CJEU held that a member State of an integration association was entitled to take measures designed to prevent certain of its nationals from attempting, under cover of the rights created by the Treaty, improperly to circumvent their national legislation or to prevent individuals from improperly or fraudulently taking advantage of provisions of Community law<sup>7</sup>.

In the 2006 Cadbury Schweppes case, the CJEU

<sup>5</sup> Council Resolution of 8 June 2010 on coordination of the Controlled Foreign Corporation (CFC) and thin capitalization rules within the European Union. OJ C 156. 2010.

<sup>6</sup> Judgment of the ECJ of 21 February 2006. Case C-255/02. Halifax plc, Leeds Permanent Development Services Ltd and County Wide Property Investments Ltd v Commissioners of Customs & Excise. Para. 68.

<sup>7</sup> Judgment of the ECJ of 9 March 1999. Case C-212/97. Centros Ltd v Erhvervs- og Selskabsstyrelsen. Para. 24.

explicitly stated that the possibility of restricting the freedom of establishment guaranteed in the internal market of an integration association arises when the purpose of such a restriction is “prevention of abusive practices, the specific objective of such a restriction must be to prevent conduct involving the creation of wholly artificial arrangements which do not reflect economic reality, with a view to escaping the tax normally due on the profits generated by activities carried out on national territory”<sup>8</sup>.

Wholly artificial arrangements, in turn, are arrangements that lack any economic reality and that have the purpose of avoiding taxes [23, p.156].

To identify such constructions, two tests are used: objective and subjective [25]. Objective test implies that “despite formal observance of the conditions laid down by the Community rules, the purpose of those rules has not been achieved”. A subjective element consists in the sole intention to obtain a tax benefit (or advantage from the Community rules) to which a person would not otherwise be entitled to<sup>9</sup>.

EU law has consistently developed law enforcement practice aimed at combating completely artificial structures. In 2007 the CJEU tried a case concerning the application of national thin capitalization rules, where the court argued that restrictive laws may be justified when they specifically target fictitious arrangements made solely to evade the tax legislation in the Member State in question. The court found that the thin capitalization rules were specifically intended to prevent such behaviour. Therefore, the need to prevent tax avoidance was found to justify the restriction of the basic freedom of the internal market [26, p.297]. At the same time, national anti-

avoidance rules should be proportional to their goal [27, p.119-120].

Thus, when applying national legal mechanisms to counteract the abuse of law in the tax sphere, those tax issues that fall under the scope of such mechanisms can be withdrawn from the regime of fundamental freedoms guaranteed within the EU internal market, which, in turn, ensures the elimination of a legal conflict between the norms that protect the fiscal base of an EU member state and the norms of EU law that allow non-discriminatory participation in cross-border economic relations within the internal market.

Tax avoidance itself does not always take place as a result of the taxpayer's intentional behaviour aimed at reducing the amount of tax due. Tax avoidance may also occur in the absence of a subjective criterion: through the relocation of a permanent establishment of an organization from one jurisdiction to another one, through hybrid loans, or when establishing a controlled foreign company abroad without any intention of tax evasion, etc. In other words, not every actual tax benefit is the result of a taxpayer's undue behavior. The EU approaches to the possibility of applying measures aimed at combating tax avoidance in such cases are very different, as the CJEU tries to balance national legislative provisions of Member States and the fundamental freedoms of the internal market.

Firstly, in Marks & Spencer case<sup>10</sup> regarding the issue of compatibility of the UK's cross-border group relief rules with EU law, the CJEU held that it was possible to deduct from taxable profits losses incurred by a subsidiary in another Member State when that subsidiary had exhausted all possibilities to deduct losses in its State of residence. The Court also held that such an approach contributed to best allocation of taxing powers among Member States and helped not to deduct losses twice – in the state of residence of a parent company and in the state where the losses had been incurred [28].

Secondly, in the previously mentioned Cadbury Schweppes case regarding the possibility of application the CFC rules, the CJEU concluded that in

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<sup>8</sup> Judgment of the ECJ of 12 September 2006. Case C-196/04. Cadbury Schweppes Plc, Cadbury Schweppes Overseas Ltd. v Commissioners of Inland Revenue. Para. 55. In this case the application of CFC rules was justified by the existence of a wholly artificial arrangement.

<sup>9</sup> Judgment of the ECJ of 14 December 2000. Case C-110/99. Emsland-Stärke. Paras 52-53.  
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<sup>10</sup> Judgment of the ECJ of 13 December 2005. Case C-446/03. Marks & Spencer plc v David Halsey (Her Majesty's Inspector of Taxes).

the absence of a wholly artificial arrangement, the application of the CFC rules could not be justified solely by a more favorable tax regime in the State of residence of the CFC, and the alleged tax losses incurred by the State of residence of the controlling person could not themselves serve as a justification for the application of the CFC rules.

With the adoption of Council Directive (EU) 2016/1164 of July 12, 2016 laying down rules against tax avoidance practices that directly affect the functioning of the internal market (ATAD), the implementation of the CFC rules was prescribed to all EU Member States. It is important to emphasize that when developing the CFC rules of this directive, the positions of the CJEU concerning wholly artificial arrangements were taken into account: ATAD rules contain exceptions for CFCs that may demonstrate the absence of artificiality, and these exceptions are applied only to situations when a CFC is a resident of or situated in EU Member State or a third country of the European Economic Area (hereinafter – the EEA).

Thirdly, the issue of compliance with the EU law of the exit tax has also been examined by the CJEU. Exit taxation concerns the taxation of unrealized capital gains at the time a taxpayer relocates its residence, a business or certain assets from one Member State (i.e., Departure State) to another Member State or to a third country (i.e. the Destination State) [29]. At the same time, exit tax is not levied when an enterprise moves within one state, which creates different tax consequences for cross-border and domestic situations.

In 2011, in the *National Grid Indus* case<sup>11</sup>, the CJEU stated that a restriction of freedom of establishment was permissible only if it was justified by overriding reasons in the public interest. The CJEU recognized the necessity to ensure the balanced allocation of powers of taxation between the Member States. The Court also held that in the absence of any unifying or harmonising measures in the EU, the Member

States retain the power to define, by treaty or unilaterally, the criteria for allocating their powers of taxation. The transfer of the place of effective management of a company of one Member State to another Member State cannot mean that the Member State of origin has to abandon its right to tax a capital gain which arose within the ambit of its powers of taxation before the transfer<sup>12</sup>.

In 2014, in the *DMC* case<sup>13</sup>, also regarding the exit taxation issue, the CJEU pointed out the possibility of restricting free movement of capital on the basis of the same prevailing goal of the balanced allocation of the power to impose taxes, noting the previously developed position on the right of a Member State to tax the economic value generated by an unrealized capital gain in its territory even if the gain concerned had not yet actually been realized<sup>14</sup>.

While analyzing the abidance by the principle of proportionality, the Court held that this principle corresponded to giving the taxpayer the right to choose between an immediate payment of the amount of exit tax assessed or a deferred payment of the amount of tax by paying it in instalments over five years, possibly together with interest and a guarantee. The possibility to choose an immediate payment or an installment plan (which implies an administrative burden associated with reporting to the authorities of the respective Member State on the assets in question), according to the Court's reasoning, allows limitations of the basic freedom of the internal market to be less tough.

In case of an installment plan, a Member State is entitled to require a taxpayer to provide a guarantee as the risks of non-recovery can increase over the time. Still the guarantee should not be claimed automatically and in each and every situation – such a claim should be based on a demonstrable and actual risk of non-recovery.

K.A.Ponomareva notes that the CJEU established a tax regime for exiting jurisdiction for those Member States that had already introduced

<sup>11</sup> Judgment of the ECJ of 29 November 2011. Case C-371/10. *National Grid Indus BV v Inspecteur van de Belastingdienst Rijnmond/kantoor Rotterdam*. Para. 42.

<sup>12</sup> Ibid. Para. 46.

<sup>13</sup> Judgment of the ECJ of 23 January 2014. Case C-164/12. *DMC Beteiligungsgesellschaft mbH v Finanzamt Hamburg-Mitte*.

<sup>14</sup> Ibid. Paras 44, 46-47, 52.

exit taxation regime, but the CJEU could not oblige the Member States to establish exit tax itself [30, p. 41].

For these reasons it is necessary to outline that exit taxation regime was later introduced by ATAD. Part 2, Art. 5 of ATAD provides for an installment plan where (in case of exiting the jurisdiction) the Destination country is an EU Member State or a third country – a Member of the European Economic Area. Moreover, ATAD rule regarding the requirement to provide a bank guarantee is compatible with the CJEU holding, expressed in the decision in the DMC case: an EU Member State may claim the guarantee only if there is a demonstrable actual risk of tax non-recovery.

Moreover, ATAD provisions do not allow EU Member State to claim a guarantee, even where such a risk of non-recovery exists, if there is another company of the same corporate group which is a tax resident of the Departure State, and if the legislation of the Departure State allows the collection of the amount of tax from such a company.

Thus, it should be noted that in practice, it is the CJEU that, by hearing cases, determines the scope of the national norms aimed at combating tax avoidance; and the positions developed by the Court are subsequently taken into account when developing the norms of directives. In fact, EU Member States can apply national legislation and combat tax avoidance not only in cases affecting wholly artificial arrangements, but the possibility of application of national legislation should always be assessed subject to existing fundamental freedoms.

The limitations on tax planning and the real possibilities of applying measures aimed at combating tax avoidance and protecting the fiscal sovereignty of EU Member States, in our opinion, have yet to be determined by the CJEU.

#### **4. Implementation and application of tax directives through the CJEU practice**

##### **4.1. Anti-tax avoidance mechanisms of directives on the common systems of taxation**

In this section of the study, we will pay special

attention to the law enforcement practice of the CJEU regarding anti-tax avoidance mechanisms contained in three directives, which we generically refer to as directives on the common systems of taxation:

Parent-Subsidiary Directive<sup>15</sup>;

Council Directive 2003/49/EC of 3 June 2003 on a common system of taxation applicable to interest and royalty payments made between associated companies of different Member States<sup>16</sup> (hereinafter – the Interest and Royalties Directive);

Council Directive 2009/133/EC of 19 October 2009 on the common system of taxation applicable to mergers, divisions, partial divisions, transfers of assets and exchanges of shares concerning companies of different Member States and to the transfer of the registered office of an SE or SCE between Member States <sup>17</sup> (hereinafter – the Merger Directive [31, p.100]).

The previous Parent-Subsidiary Directive, adopted in 1990, as well as the previous version of the current Parent-Subsidiary Directive, which was in force until 2015, did not contain their own general anti-avoidance rule, but provided for a blanket rule on the possibility of introduction of anti-tax avoidance norms into national legislation and read as follows: "This Directive shall not preclude the application of domestic or agreement-based provisions required for the prevention of

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<sup>15</sup> Council Directive 2011/96/EU of 30 November 2011 on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States. OJ L 345. 2011.

<sup>16</sup> Council Directive 2003/49/EC of 3 June 2003 on a common system of taxation applicable to interest and royalty payments made between associated companies of different Member States. OJ L 157. 2003.

<sup>17</sup> Council Directive 2009/133/EC of 19 October 2009 on the common system of taxation applicable to mergers, divisions, partial divisions, transfers of assets and exchanges of shares concerning companies of different Member States and to the transfer of the registered office of an SE or SCE between Member States. OJ L 310. 2009.

fraud or abuse"<sup>18</sup>. This blanket rule did not oblige the EU Member States to refuse to provide benefits under the directive and did not contain its own anti-avoidance mechanism. Thus, if there was no anti-avoidance norm at the level of international agreements or national legislation, then in fact that specific norm of the directive was not applied.

At the same time, European researchers [23, p.199], with reference to the position of the CJEU<sup>19</sup>, note that this rule reflects an important legal principle, according to which no one can receive benefits provided for by EU law in case of fraudulent actions and abuse of law. Advocate General J. Kokott also used similar arguments<sup>20</sup> with reference to the Kofoed case [32].

Meanwhile, this case concerned the application of the provisions of the Merger Directive 1990, which at that time contained a fundamentally different anti-avoidance mechanism, which raises doubts about such arguments of the Advocate General. The Merger Directive initially contained not a blanket rule, like the Parent-Subsidiary Directive, but its own anti-avoidance mechanism. Those two directives had one characteristic in common: each of them contained only a permission to (not an obligation of) the EU Member States to combat the abuse of law.

In 2015, the Parent-Subsidiary Directive was amended by a general anti-avoidance rule (GAAR),

which established the obligation of EU Member States not to provide the benefits of the Directive to an arrangement or a series of arrangements which had been put into place for the main purpose or one of the main purposes of obtaining a tax advantage that defeated the object or purpose of this Directive, and which were not genuine having regard to all relevant facts and circumstances<sup>21</sup>.

At the same time, tax avoidance provisions must always meet the requirements of proportionality and should not be more burdensome than necessary [23]: if there is a conflict and the actions of the Member States to prevent abuse appear excessive (*ultra vires*), the CJEU should make an explanatory decision [33, p.209].

An important aspect of the application of the Parent-Subsidiary Directive is that in practice it is possible to use the concept of the beneficial owner of income in order to tax dividends at source, although the Directive itself does not explicitly contain such a rule<sup>22</sup>. If the recipient of the dividends acts as a conduit and transfers all (or almost all) the funds to another person immediately (or soon) after receiving them, such a structure may be considered as an artificial one, and therefore the tax benefit claim under the Parent-Subsidiary Directive should be denied<sup>23</sup>.

On February 26, 2019, the CJEU ruled on six Danish cases concerning the cross-border payment of dividends and interest, which were called "Danish beneficial ownership cases"<sup>24</sup>. It should be noted

<sup>18</sup> Council Directive 2011/96/EU of 30 November 2011 on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States. OJ L 345. 2011. Art. 1(2).

<sup>19</sup> Judgment of the ECJ of 7 September 2017. Case C-6/16. *Eqiom SAS, formerly Holcim France SAS and Enka SA v Ministre des Finances et des Comptes publics*. Para. 26.

<sup>20</sup> Judgment of the ECJ of 5 July 2007. Case C-321/05. *Hans Markus Kofoed v Skatteministeriet*. In this case (Para. 38), concerning the exchange of shares under Danish law, it was stated that individuals must not improperly or fraudulently take advantage of provisions of Community law [32].

<sup>21</sup> Council Directive 2011/96/EU of 30 November 2011 on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States. OJ L 345. 2011. Art. 1(2),(3).

<sup>22</sup> Judgment of the ECJ of 26 February 2019. Joined Cases C-116/16 and C-117/16. *Skatteministeriet v T Danmark and Y Danmark Aps*. Paras 97-114.

<sup>23</sup> Judgment of the ECJ of 26 February 2019. Joined Cases C-115/16, C-118/16, C-119/16 and C-299/16. *N Luxembourg 1 and Others v Skatteministeriet*. Paras. 88-89, 128-132.

<sup>24</sup> Judgment of the ECJ of 26 February 2019. Joined Cases C-116/16 and C-117/16.

that one of the decisions was even considered in a letter of the Russian fiscal authority [34, p. 538].

In all these cases, the Danish tax authorities challenged the beneficial owner status of the direct recipient of interest and dividends in accordance with the applicable international agreement on elimination of double taxation, the Parent-Subsidiary Directive and the Interest and Royalties Directive. According to the taxpayer, in the audited periods, there was no obligation to withhold tax at source when paying dividends, since at that time the Parent – Subsidiary Directive did not contain rules governing the beneficial owner status, moreover, the anti-avoidance mechanisms of both directives were not implemented into the national legislation of Denmark. The national Danish legislation and judicial approaches also did not contain the concept of a beneficial owner or other anti-abuse measures that would prescribe ignoring for tax purposes a legal entity established for the purpose of obtaining tax advantages in these circumstances [35, p.9].

The CJEU faced a number of issues that needed to be resolved, in particular the question of correlation between respective Directives and Danish tax legislation and the issue of which source of law should apply – Directives, international tax agreements or national anti-abuse norms and judicial approaches, as well as the concept of beneficial owner.

By then the CJEU had already held that there was a general principle of prohibition of abuse of law in EU law (e.g., see the previously mentioned decision on Kofoed case, where this conclusion was made by construction and interpretation of the Merger Directive).

The Danish cases were rather special, because Denmark had not implemented anti-avoidance rules into national legislation, which, in turn, posed substantial difficulties for the Court to justify their application.

Earlier, the CJEU in the decision on Kofoed

case in 2007 held that the principle of legal certainty precluded directives from being able by themselves to create obligations for individuals, and directives could not therefore be relied upon per se by the Member State as against individuals<sup>25</sup>.

Nevertheless, despite the above mentioned position, the CJEU in 2019, in the decisions on the Danish beneficial ownership cases, held that the ban on the abuse of EU law had a direct effect and did not require the implementation of directives into national legislation.

Additional questions arose regarding the application of the concept of beneficial owner, since the Parent-Subsidiary Directive did not contain such a criterion in respect of the recipient of income while the Interest and Royalties Directive did. Accordingly, through the interpretation of the Interest and Royalties Directive and the Commentaries to the OECD Model Tax Convention, the CJEU held that the concept of beneficial owner should have an autonomous meaning in EU law notwithstanding similar concepts in national legislation of EU Member States, and the CJEU reduced it to the concept of abuse of law.

The CJEU also pointed out that wholly artificial arrangements do not reflect economic reality, therefore, when hearing cases, an economic analysis of the taxpayer's activities is required, including an analysis of functions performed, risks assumed and assets owned.

Now we would briefly analyze the dissenting opinion of the Advocate General J. Kokott regarding the Danish beneficial ownership cases. With reference to the principle of legal certainty, she pointed out the impossibility of tax reclassification of the taxpayer's actions on the basis either of the principle of direct effect of EU directives or of the general principle on the prohibition of abuse of law. As a possible option, it was proposed to apply the national norms on substance over form, which would allow ignoring some structures in case of abuse. At the same time, to determine the abuse, J. Kokott referred to ATAD, which has not yet entered into force. Thus, the behavior of a taxpayer shall be

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Skatteministeriet v T Danmark and Y Denmark Aps; Judgment of the ECJ of 26 February 2019. Joined Cases C-115/16, C-118/16, C-119/16 and C-299/16. N Luxembourg 1 and Others v Skatteministeriet.

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<sup>25</sup> Judgment of the ECJ of 5 July 2007. Case C-321/05. Hans Markus Kofoed v Skatteministeriet. Para. 42.

deemed abusive if there are non-genuine constructions, and their main or one of the main goals is to obtain tax advantages that contradict the objectives of the applicable tax laws. Additionally, J. Kokott recommended giving the concept of beneficial ownership an autonomous meaning within EU law, different from the OECD one, since subsequent amendments to the OECD Model Tax Convention could possibly pose difficulties in the interpretation and application of the respective norms [36].

Thus, these decisions establish a new approach to determining what kind of behavior is considered as abusive for the purposes of direct taxation in the EU and establish four basic principles: 1) the principle of direct effect of the norms developed against tax abuse in the field of direct taxation in the EU; 2) the differentiation of abuse from real economic activity is carried out through economic, not legal, analysis; 3) there should be a special definition of the beneficial owner for the purposes of EU tax law; 4) EU Member States are obliged not to provide tax benefits in case of abuse.

When applying the Interest and Royalties Directive, the following should be taken into account. Firstly, Article 5 of the Directive contains a rule that the Directive shall not preclude the application of domestic or agreement-based provisions required for the prevention of fraud or abuse. Article 5 also states that Member States may, in the case of transactions for which the principal motive or one of the principal motives is tax evasion, tax avoidance or abuse, withdraw the benefits of this Directive or refuse to apply this Directive.

In practice, this means that the Member State cannot provide a benefit in the case of the formation of an artificial structure, but the burden of proving improper behavior of the taxpayer should be on the tax authority. Anti-avoidance measures of this directive are carried out not only on the basis of the specified norms of Article 5 of the directive; Article 1 of the directive explicitly states that there is no withholding tax only if the recipient of interest / royalties is the beneficial owner of such income.

#### **4.2. Implementation and application of the Anti-Tax Avoidance Directives**

Transposition of the 2016/1164 EU Anti-Tax Avoidance Directive (ATAD 1) and 2017/952 EU Anti-Tax Avoidance Directive<sup>26</sup> (ATAD 2) may be subject to judicial control.

Although at the moment there are no judgments of the CJEU concerning these directives, such decisions may appear in the future.

The Commission checks the implementation of the Directives process. Certain EU Member States violate the deadlines for the transposing of the provisions, and may also implement them improperly. Pieces of national legislation implementing a directive may actually violate its explicit mandatory prescriptions or create the obstacles to the achievement of both their explicit or implied objectives.

The Commission assesses how the discretion of a EU Member State is used and abused. In case the EU Member State violates the EU law, the Commission prescribes to the EU Member State to remedy the breach of the supranational law.

In 2020, the Commission submitted the Report to the Parliament and the Council on the progress of the implementation of the two directives at hand. This report contains a table indicating a significant number of detected violations committed by the EU Member States during the implementation of the Directives<sup>27</sup>.

If the violation is not remedied properly and in

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<sup>26</sup> Council Directive (EU) 2017/952 of 29 May 2017 amending Directive (EU) 2016/1164 as regards hybrid mismatches with third countries. OJ L 144. 2017.

<sup>27</sup> Report of 19 August 2020 from the Commission to the European Parliament and the Council on the implementation of Council Directive (EU) 2016/1164 of 12 July 2016 laying down rules against tax avoidance practices that directly affect the functioning of the internal market as amended by Council Directive (EU) 2017/952 of 29 May 2017 amending Directive (EU) 2016/1164 as regards hybrid mismatches with third countries. COM/2020/383 final. P. 10.

a timely manner, the Commission is entitled to apply to the CJEU.

Moreover, in cases where a particular provision of implementing national law does not directly stem from the directives, such legislation is considered unharmonised and thus it can be evaluated in terms of compliance with fundamental freedoms (negative discrimination) and prohibition of state aid (positive discrimination).

#### **5. General principle of prohibition of abuse of the EU law**

As a principle of the EU law, the prohibition of abuse developed significantly through the case law of the CJEU. Currently it covers taxation and specifically granting the benefits provided for under the tax directives. This principle fills the legal gap that arises, if the EU Member State refrains from implementing anti-avoidance measures. Effectively, the principle concerned may serve as a legal basis to deny tax advantage provided for by the EU law, which was confirmed by the CJEU in 2019 in judgments on 'Danish' cases on beneficial ownership<sup>28</sup>. For more information, see Section 4.1.

#### **6. State aid prohibition and countering corporate tax avoidance**

According to Art. 107(1) TFEU, incompatible with the internal market is "any aid granted by a Member State or through State resources in any form whatsoever which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods shall, in so far as it affects trade between Member States, be incompatible with the internal market."<sup>29</sup>

<sup>28</sup> Judgment of the ECJ of 26 February 2019. Joined Cases C-116/16 and C-117/16. *Skatteministeriet v T Danmark and Y Denmark Aps*; Judgment of the ECJ of 26 February 2019. Joined Cases C-115/16, C-118/16, C-119/16 and C-299/16. *N Luxembourg 1 and Others v Skatteministeriet*.

<sup>29</sup> Art. 107 (1). Consolidated version of the Treaty on the Functioning of the European Union. OJ C 202. 2016.

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The legal mechanism of countering state aid affects, in particular, the taxation and specifically the tax sovereignty of the EU Member States. In fact, the prohibition concerned precludes positive discrimination in tax sphere, i.e. the provision of tax advantage to certain entity or group of entities, if such tax advantage is not granted to other entities under the similar economic and legal conditions, provided that it hinders competition and trade within the EU internal market.

Exceptions to anti-avoidance measures or their misapplication by tax authority may constitute positive discrimination, which falls under the state aid prohibition.

At the same time, we emphasize that in cases where the norms of national law are implementing pieces of legislation which follow strictly the provisions of a tax directive, such norms generally cannot constitute state aid. State aid may arise by virtue of the national law of the EU Member State, but it cannot stem from the EU law itself.<sup>30</sup>

Therefore, only such national legal provisions fall under the scope of state aid control, which were not harmonised by the EU primary or secondary legislation (e.g. thin capitalization rules, which remain unharmonised), or those arose as a result of a gap in a tax directive or those within the discretion of the EU Member State (e.g. exceptions to anti-avoidance measures not expressly provided for by the directive). The application of law by national executive agencies (e.g. non-application of anti-avoidance rules with respect to certain entities) is also covered by the scope.

Nonetheless, control over state aid will not affect the very anti-avoidance provisions of tax directives, or their exact reproduction in national law.

In addition, the prohibition of state aid paved the ground for the Commission application of the arm's length principle in order to establish whether there is a selective tax advantage provided under tax rulings, in a situation where the national legislation of the EU Member State did not contain the arm's

<sup>30</sup> Judgment of the General Court of 5 April 2006. Case T-351/02. *Deutsche Bahn v Commission*. Para. 101.

length principle<sup>31</sup>. Thus, in the decision of 15 July 2020 of the General Court, which is the first instance of the CJEU, in the combined cases T-778/16 and T-892/16 (Ireland and others v. the Commission) the General Court pointed out the arm's length principle may be applied by virtue of Art. 107(1) of the TFEU<sup>32</sup>, despite the fact that this norm does not contain any explicit indication of the use of the arm's length principle, but only in most general form the criteria to establish if the state aid exists.

## 7. Conclusion

As the result of the analysis carried out, the authors come to the following conclusions concerning the CJEU role in countering the corporate tax avoidance.

1. The CJEU has repeatedly considered the problem of clashes between national anti-avoidance rules and the fundamental freedoms of the EU internal market. There is a legal conflict between these norms, which is resolved in different ways for two types of anti-avoidance rules - national rules against abuse of law, and such legal mechanisms that address corporate tax avoidance through the application of formal criteria without identifying abuse of law in a specific case.

2. The application of national measures against the abuse of law allows for exceptions to the regime of fundamental freedoms of the internal market. The CJEU thus allows the priority of protecting the fiscal base in the case where the EU Member State counteracts the abuse of law.

3. In cases where the national anti-avoidance rules are not aimed at identifying non-genuine arrangements in specific cases, but are applied mechanically, due to formal criteria, such rules should be adapted to the legal regime of fundamental freedoms.

4. The reasoning developed by the CJEU concerning the reconciliation of national anti-avoidance rules with the legal regime of fundamental freedoms was considered within the ATAD, and significantly affected the general anti-abuse rule provided for under the directive. In addition, the reasoning of the CJEU was taken into account in the form of special exceptions within the legal

mechanisms of the CFC rules and the exit tax, where cross-border relationships concern either the EU or third EEA State.

5. When implementing the provisions of the ATAD, the EU Member States breached the EU law intensively which was established by the Commission. In the future, the CJEU may be concerned in its judgments in the process of transposition as well as the application of ATAD.

6. The general prohibition of abuse of EU law is applied within the framework of tax directives even in cases where the EU Member State does not transpose the anti-avoidance mechanisms of such directives into the national law nor its national legislation contains any other anti-avoidance rules. The general prohibition of abuse of EU law applies despite the principle of legal certainty, which generally does not allow for the direct effect of the directives, if it creates the burden of obligations for the taxpayer and the EU Member State did not transpose it.

7. The CJEU allows for the application of the concept of beneficial ownership not only to interest and royalties, but also to the distribution of profits, despite the fact that Parent-Subsidiary Directive does not contain such a concept. For the application of this concept, the CJEU considers a general prohibition of abuse of the EU law to be sufficient.

8. EU law prohibits the provision of state aid. Such a prohibition may cover national anti-avoidance rules and application of law by national executive agencies of the EU Member State, provided that they create positive discrimination. At the same time, state aid cannot stem from the EU law itself, neither from anti-avoidance provisions of the directives, nor from the judgments of the CJEU, nor from the national legislative measures in case they are transposed and applied in strict accordance with the letter and spirit of the directives.

9. Within the framework of prohibition of state aid the CJEU (i.e. the General Court), allowed for the application of the arm's length principle by virtue of Article 107(1) of the TFEU in cases where the law of an EU Member State does not contain such a legal mechanism.

<sup>31</sup> Judgment of the General Court of 15 July 2020. Cases T-778/16 and T-892/16. Ireland and Others v European Commission. Para. 170.

<sup>32</sup> Id. Para. 214.

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