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Series Editor: Michael Lang

Editors: Michael Lang / Jeffrey Owens / Pasquale Pistone /
Alexander Rust / Josef Schuch / Claus Staringer

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

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

Why this book?

General anti-avoidance rules (GAARs) have been a topic of great relevance in practice as well as in academia for decades. In a post-BEPS tax world, with national legislators introducing or tightening GAARs, and with the European Union and OECD suggesting implementation of such rules, the topic seems more important than ever. The aim of this book is to give tax policymakers, tax authorities, tax courts and tax practitioners an idea of the various understandings of and approaches towards tax avoidance in 39 countries.

In order to do so, 39 national reports from countries across the globe have been compiled and are published in this volume. More than 100 experts, including the authors of the national reports, convened for a joint conference on “General Anti-Avoidance Rules (GAARs) – A Key Element of Tax Systems in the Post-BEPS Tax World?” in Rust (Austria) from 3-5 July 2014. The national reports focus on the requirements for the application of the GAARs and on the legal consequences of applying a GAAR. Moreover, the relationship between GAARs and SAARs, as well as tax treaties and EU law requirements, are given much attention. A further objective of this book is to shed light on recent European developments and on alternatives to GAARs.

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Telephone: 31-20-554 0100
Fax: 31-20-622 8658
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Chapter 1

General Report: GAARs

Richard Krever

1.1. Introduction

While they are very recent additions to some countries' tax laws, GAARs have played a central role in other tax systems for well over a century.[1] Quite possibly no other feature of tax law provides a better insight into a nation's tax psyche than its anti-avoidance rules. The intersection of general anti-avoidance rules (GAARs) – as well as their ancillary specific anti-avoidance rules (SAARs) – with operative provisions of tax law reveals much about all aspects of a country's tax system: citizens' tax morale; judicial perspectives on taxation and legal interpretation; drafters' inclinations towards technical or principled drafting; and legislators' willingness to confront politically sensitive issues or their tendency to delegate the tough decisions to administrators and courts. A comparative analysis of the role of GAARs (or the lack of any GAAR) in tax systems such as that found in this volume can thus offer unique perspectives on tax law across jurisdictions.[2]

At the same time, comparative study of GAARs raises challenges rarely encountered in other areas of tax law. While some tax concepts – transfer pricing, thin capitalization and permanent establishment, for example – have common meanings across jurisdictions and tax systems, even if the details vary at the margins, there appears to be no universal understanding of what constitutes a GAAR or, for that matter, what constitutes "tax avoidance", the notional target of a GAAR. At one end of the spectrum, the avoidance label is limited to convoluted and, at best, quasi-legal transactions verging on evasion;[3] at the other, legitimate choices between alternatives yielding different tax outcomes can amount to avoidance in some circumstances.

There is an equally wide spectrum of definitions of a GAAR. In most countries, the GAAR takes the form of a statutory rule, albeit with an extremely

1. See, for example, New Zealand, which has had a GAAR for 139 years.
2. This general report analysis refers to chapters in this volume on specific jurisdictions by use of the name of the country covered in the chapter.
3. Russian jurisprudence, for example, merges avoidance and evasion into a single issue; see Russia.

large range of constructions. This is not always the case, however. In a jurisdiction lacking a statutory rule, a doctrinal approach based only on judicial interpretation might be considered a GAAR.[4]

There is similarly a divergence of views on the merits of, or drawbacks to, reliance on a GAAR as a tool to safeguard the integrity of a tax system. The most commonly cited drawbacks are uncertainty for taxpayers and unfairness resulting from selective application. The two perceived problems are related. Because a GAAR is only applied after the fact, taxpayers cannot make investments predicting particular after-tax rates of return – a key expectation essential to the efficient allocation of capital in any market economy – as they cannot know with certainty what the tax consequences of their intended actions will be after possible application of a GAAR.[5] For the same reason, the law will apply differently to different taxpayers in the same circumstances. Unlike a substantive tax rule, which sets out general rules for all taxpayers in a particular situation, a GAAR applies to each case separately, and its elements, including the taxpayer's purpose (to the extent this is incorporated into the rule), must be considered separately for each case.[6] Only a portion of the pool of taxpayers who may have entered into similar transactions are subject to audit and only some of those transactions might be identified as transactions to which the GAAR might apply, with the rule applied successfully only to a portion of this subset. Equal application to all taxpayers of a rule that looks at the totality of circumstances in each case – including, as it does in most instances, the motives of each particular taxpayer – is not possible.

Commentators sympathetic to the use of GAARs view these concerns as exaggerated. While they may have some legitimacy prior to the first GAAR cases being heard, proponents of GAARs argue, once the outcomes of attempts to apply the GAAR are known, the rule can act as a supplement to substantive measures by showing how particular types of arrangements are likely to be treated under the rule, inhibiting behaviour similar to that known to be caught. To the extent that the concerns of critics are valid, supporters might further argue, the rule is nevertheless necessary to protect the integrity of the tax law, given the inherent limitations on drafters' ability to anticipate every possible alternative transaction open to taxpayers.[7] The

4. See, for example, Norway and Russia.
5. See, for example, Poland. It has been suggested that the latitude afforded tax authorities by a GAAR is fundamentally incompatible with the certainty that Adam Smith saw as a cornerstone of legitimate taxation; see Ireland.
6. See Germany.
7. See Finland.

most realistic of supporters concede that there is inherent uncertainty arising from a GAAR but argue that this is a price that has to be paid in the interest of the larger goal of protecting the integrity of the tax base.

Whatever their merits or flaws, there is no doubt that the lack of precise borders in a GAAR transfers great power and responsibility to the adjudicators. Supporters of a GAAR have to hope that the judges will exercise those powers, in the words of a minister who oversaw the introduction of a GAAR in the Netherlands, "as good men".[8]

While GAARs have proliferated in modern times, they are not universal and proposals to introduce GAARs sometimes flounder in the face of resolute opposition, including that of the legislature.[9] Jurisdictions reluctant to adopt GAARs delegate to the courts the task of identifying cases where the taxpayer's characterization of transactions could or should be rejected[10] or rely on specific legislative responses where the courts decline to look beyond legal form even where transactions were carried out in a particular form with the clear objective of tax avoidance.[11] In the rarest cases, there is no effective remedy in the absence of a GAAR.[12]

Somewhat ironically, the absence of a GAAR in a jurisdiction may be interpreted by courts as a sign that the legislature is willing to tolerate avoidance when other jurisdictions with similar legal backgrounds have adopted GAARs. In these cases, it may be an implicit judicial invitation that prompts enactment of a GAAR.[13] Also, ironically, adoption of a GAAR may have the opposite effect: there is a risk that adoption of a statutory GAAR will inhibit courts from adopting more robust interpretation doctrines to reduce opportunities for avoidance on the assumption that the legislature has fully occupied the anti-avoidance field.[14]

1.2. Models

While the forms of GAARs vary widely, they generally fall into four groups.

8. See the Netherlands.
9. See, for example, Mexico and, initially, the United Kingdom (the UK position has since reversed, and a GAAR was adopted in 2013).
10. See, for example, Brazil. Croatia has an "economic substance" provision, but some argue this does not amount to a GAAR.
11. See, for example, Denmark.
12. See, for example, Mexico.
13. See, for example, Ireland.
14. See Australia.

One group, the "acts and benefits" group, comprises rules that allow the tax authorities to identify a transaction or series of transactions that had the purpose or (more rarely) effect of providing a tax benefit and then recompute the taxpayer's liability on the basis of a hypothetical transaction that the tax authorities surmise would have been the one used had the taxpayer not followed the tax-effective path it did. GAARs in this group look at acts carried out and benefits realized, without the need to identify an economic substance.[15]

A second group, usually with a statutory base but on occasion derived solely from judicial practice,[16] sets out rules that mandate an interpretation and application of tax law to the economic substance of a transaction (or series of transactions) rather than the legal form.[17] The rule will normally allow the tax authorities to reassess the taxpayer on the basis of a hypothetical legal transaction that better reflects the underlying economic substance. While almost all jurisdictions with a statutory substance over form rule regard the rule as a GAAR,[18] this characterization of the rule is not universal.[19] Nor is the view that a judicial substance over form rule (or variations such as the "true import" of an arrangement) amounts to a GAAR.[20]

A possible third model, it is argued by some, is a judicial "GAAR" based on the adoption by the courts of a broad abuse of law doctrine.[21]

A fourth model is a statutory abuse of law model that applies where a taxpayer adopts a fictitious arrangement or one that is valid in law but used to defeat the intention of the tax legislation.[22]

Whether a GAAR takes the form of the classic tax benefit identification rule or an economic substance or abuse of law rule, it can only be effective if it allows a reassessment on the basis of a hypothetical alternative transaction different from the legal form chosen by the taxpayer to minimize tax. In

15. The "acts and benefits" GAARs are mostly found in Anglo jurisdictions such as Australia, Canada, India, New Zealand, South Africa and the United Kingdom, although some other GAARs, including China's and the current (but not the proposed replacement) Italian GAAR, also satisfy this definition.
16. In one case, the judicial substance over form test was subsequently codified; see United States.
17. In the case of Turkey, this is labelled the "real" substance; see Turkey.
18. See, for example, Switzerland.
19. See, for example, the debate in Korea.
20. See, for example, Sweden, where the true import alternative is considered quite distinct from the GAAR.
21. See, for example, the Czech Republic.
22. See, for example, France.

the case of an explicit reconstruction rule, the tax authorities are allowed to substitute an appropriate arrangement for the one used by the taxpayer. An economic substance rule, in contrast, opens the door to assessment on the basis of applying the tax law directly but interpreting the circumstances to fit into the law.

The difference between the two can be illustrated with the example of a taxpayer entering into a complex set of arrangements to avoid a loan having the form of a debt. Under the explicit reconstruction rule, the tax authorities would be allowed to substitute a fictional transaction (a direct loan) for the arrangements used by the taxpayer. Under the economic substance approach, the tax authorities can look at the totality of the arrangements and find that there actually is a loan, albeit by a somewhat complex route, and apply the tax law for debt directly. Commonly, the power of the tax authorities to reassess on the basis of an alternative hypothetical transaction is clear, whether it is based on an explicit or an implicit construction of the GAAR. In some rarer cases, however, there is debate over how the GAAR operates in this respect.[23]

1.3. When is the GAAR used?

While GAARs differ significantly in form and language, there are some remarkable similarities between the types of cases in which tax authorities have sought (not always successfully) to invoke the GAAR. These appear to fall into three broad categories.

The most common situation is where the tax law offers, on its face, alternative tax outcomes depending on the form or structure of a transaction, and taxpayers have arranged affairs to enjoy the reduced (or nil) taxation available with one alternative rather than adopt the version, preferred by the tax authorities, that would incur a higher tax liability. These are not cases where the law offers a concession and the taxpayer has, in response to the government subsidy for targeted activities, invested or acted as the government sought. Nor are they cases where the law provides a tax advantage to achieve a tax policy outcome such as avoiding double taxation[24] or features structural asymmetries such as providing lower capital gains tax rates for taxpayers who hold assets for longer periods or providing different tax rates

23. For example, in Austria, one school of thought sees the GAAR as having an independent reconstruction power, while another sees it as authorizing interpretation on the basis of an economic substance approach.
24. See, for example, Norway.

for taxpayers who choose to operate through different types of companies.[25] Rather, they are cases where a taxpayer changes the form of a transaction to shift from one tax rule to another.

To achieve the shift, the taxpayer often substitutes a multi-step and multi-party arrangement for the simple transaction that attracts a higher tax burden. For example, rather than lend money directly to a borrower, a lender might interpose a company and convert what would have been taxable interest paid to the lender into tax-free inter-corporate dividends from the interposed company.[26] Similarly, rather than buy immovable property or shares directly, a taxpayer may use an intermediary company to acquire the property or shares and sell interests in the intermediary company rather than the underlying assets if capital gains on the sale of interests in an intermediary company fall outside the scope of the tax law.[27] Other examples include the interposition of entities between a service provider and clients so the income can be diverted to related individuals facing lower marginal tax rates,[28] the use of an interposed entity to avoid social security taxes otherwise payable in respect of employees[29] and the creation of an interposed entity between partners and clients to provide a vehicle for distribution of tax-free benefits (by way of interest-free loans) to the former partners.[30] A further example is the creation of intellectual property, such as a copyright, to convert remuneration for personal labour services to property rights that can then be transferred to an interposed entity so the income it generates is diverted to related persons in lower tax brackets.[31]

In the second group of tax avoidance cases to which a GAAR is sometimes applied, the taxpayer seeks to shift a transaction from one tax rule to another not by establishing alternative structures and arrangements but simply by relabelling a transaction in a different form. For example, if lower tax liabilities apply when a person providing labour services is a contractor than if the person is an employee, the parties might agree to substitute a contract calling the person an independent contractor rather than an employee, without any change to the actual working conditions.[32] Similarly, an investor may fund a company by way of what is described on paper as debt but which is in fact equity with a variable "interest" rate that is actually based on the profits

25. See, for example, Portugal.
26. See, for example, Canada and Portugal.
27. See, for example, China and Croatia.
28. See, for example, New Zealand.
29. See, for example, Russia.
30. See, for example, South Africa.
31. See, for example, South Africa.
32. See, for example, Hungary.

of the so-called borrower.[33] In theory, the arrangements could be attacked under the civil law – tax authorities could show that what seemed to be a loan was in fact an equity investment or could have a purported contractor agreement declared a sham. The problem with this approach is that it lacks any reconstruction rule that could be used as the basis for reassessment by reference to a substitute arrangement. Relying on a recharacterization of the transaction, the tax authorities could alter the assessment of the taxpayer in respect of the issue in dispute. It may be much more difficult, however, to extend that characterization to all the consequential issues that would follow in respect of the taxpayer and all other parties to the transaction. From the tax authorities' perspective, a GAAR with a provision to deal with the consequences of recharacterization is the preferable tool for attacking the arrangement.

A third category of cases in which a GAAR can be used is where taxpayers seek to exploit literal interpretations of rules accepted by courts that are inconsistent with the purpose of those rules. For example, all tax laws allow deductions for expenses incurred to derive income so only net gains are subject to tax. Consistent with this goal, dual-purpose expenses incurred only in part to derive income and in part to achieve a tax goal unrelated to derivation of income only partially meet the threshold for deductibility. A GAAR could be used to overcome an interpretation of the law that ignored the aim of the deduction section and instead allowed a deduction for expenses that deliberately exceed expected income to achieve other tax goals.[34]

1.4. Taxpayer's purpose

GAARs cannot be used by tax authorities to substitute alternative hypothetical arrangements simply because a higher tax alternative exists. The trigger for application of a GAAR is almost always a subjective test – an impugned transaction or arrangement will be subject to the GAAR if the taxpayer's purpose in using the transaction or arrangement under attack was to avoid tax. While the GAAR may set out objective indicators to be used in determining the taxpayer's purpose[35] or an objective limb may be tacked onto the GAAR,[36] at the end of the day, the taxpayer's purpose usually needs

33. See, for example, India.
34. See, for example, Germany.
35. See, for example, Australia.
36. See, for example, the Netherlands.

to be proved or disproved.[37] Although the concept of a "purpose" sounds inherently subjective, it can be fashioned in a more objective manner by, for example, adopting an objective test such as whether it is reasonable to conclude the taxpayer's main purpose was to obtain a tax benefit.[38]

The requirement for a tax reduction purpose before the GAAR can be applied seems to be present even in cases where the law makes no mention of purpose and even in a non-statutory GAAR based on judicial substance over form doctrines.[39] For example, if the GAAR is triggered whenever the form used by the taxpayer does not conform to the ultimate economic substance of the transaction, read literally, the GAAR would apply even to cases where the taxpayer mistakenly adopted a form with no intention of reducing a tax liability. A provision of this sort will nevertheless commonly be read down and interpreted as requiring an intention to reduce tax before it is applied.[40] The argument that tax law should be wholly objective in nature, with no room for subjective intent in a GAAR,[41] has not found traction in practice.

Among other things, the taxpayer's purpose will depend on how broadly the impugned transaction is defined. The ultimate purpose of most transactions is commercial, apart from a limited group of avoidance schemes that generate after-tax profits when they would yield real-world economic losses. Taxpayers can almost always show that the ultimate goal of the arrangements was an economic outcome – a purchase, a sale, an investment, etc. The primary tactic of tax administrators, therefore, is to look not at the commercial goal of the entire scheme but rather to assert that there is no valid commercial explanation for a subsidiary step or series of steps undertaken for tax minimization reasons.[42] The distinction is between the aim of achieving a commercial outcome and the goal of minimizing tax by pursuing a particular path to achieve the broader outcome.[43]

There is wide variation in the threshold level of the avoidance "purpose" necessary to trigger a GAAR. Relatively rare, but not unknown, are

37. In one case, there is no explicit or implicit reference to purpose in a GAAR, only an authorization for the tax authorities to recharacterize a transaction in accordance with its real substance; see Turkey. In practice, however, the "will of the taxpayer" becomes an element in the application of the GAAR.
38. See, for example, the United Kingdom.
39. See, for example, Norway.
40. See, for example, Finland.
41. See, for example, Germany.
42. See, for example, Spain.
43. See, for example, France.

thresholds that trigger the application of a GAAR only in cases that have no plausible rationales other than obtaining a tax benefit, that is, where this is "essentially" the purpose of a transaction[44] or the "sole" purpose of the arrangements[45] or the "decisive" (the only or by far the most important) reason for the transactions.[46] An alternative high threshold construction can state that the GAAR applies only to transactions that have "no valid commercial reasons".[47]

The need for a very high or exclusive tax avoidance motive could also be stated in a negative fashion: the GAAR will not apply if there is a business purpose as well, even if it is a limited business purpose.[48] The original version of the EU's GAAR included in the CCCTB proposal, since modified, adopted a "sole" purpose tax avoidance test for application of the GAAR.[49] However, the norm is for the GAAR to apply if obtaining a tax benefit was the "main" or "primary" or "greater" purpose of a taxpayer.[50]

In some cases, it may be necessary to read the purpose test for triggering the GAAR in the context of the entire GAAR to ascertain the true threshold. For example, the apparently high threshold of a main or sole purpose test can be mitigated if the GAAR is constructed in such a way that it assumes the threshold is met using objective indicators and shifts the onus onto the taxpayer to prove otherwise.[51]

In some cases, the purpose element of the GAAR is implicit rather than explicit, with the provision applying, for example, where there is no reasonable business purpose for the form taken.[52] In others, the level of unacceptable purpose is unstated – the law simply refers to the purpose of avoiding tax – but this is interpreted as meaning the main purpose of the taxpayer.[53] There are, in addition, cases where the law is silent and "the jury is still

44. See, for example, Lichtenstein and Italy. The latter is being changed from "solely" to "essentially".
45. See, for example, France.
46. See, for example, the Netherlands.
47. See, for example, Italy. The current rule is to be replaced. However, the replacement GAAR may be interpreted as enjoying an equally high trigger threshold, applying to transactions that lack any economic substance.
48. See Norway.
49. The proposal has since been changed to the "main" purpose.
50. The Portuguese requirement of "wholly or mainly" implies a possibly higher standard than simply "mainly" in that jurisdiction; see Portugal.
51. See, for example, South Africa.
52. See, for example, China.
53. See, for example, Finland.

out" on what level of avoidance purpose the courts will need to recognize for the GAAR to apply.[54]

While GAARS usually turn on a single explicit or implicit purpose test, one of the most recent GAARs adopted utilizes a two-pronged test with both a positive purpose limb and a second, tainted element, negative limb. To invoke the GAAR, the tax authorities have to show, first, that the main purpose of the targeted transaction is to obtain a tax benefit and, second, that the arrangement fits into one of four categories of tainted transactions.[55] It remains too early to know how this approach will operate in practice compared to more traditional approaches.

The fact that purpose is central to the operation of even a non-statutory GAAR developed by the courts in the form of interpretation doctrines[56] illustrates the importance of purpose in almost all GAAR systems and the assumption in most systems that GAARs should only be invoked where it can be shown that transactions or arrangements were adopted mostly or exclusively for the purpose of reducing tax rather than for a commercial or private reason.

The most significant deviation from the general rule that GAARs are implicitly or explicitly triggered by the taxpayer's tax saving purpose in adopting a particular course of action or a particular set of arrangements is found in a very small number of GAARs that may be triggered both by *purpose* and *effect*. These GAARs look to the purpose behind the arrangements under attack and also, as an alternative, whether the effect of the transactions was obtaining a tax benefit, whatever the taxpayer's motivation might have been.[57] On their face, the "effect" tests look to be easier to apply from the perspective of the tax authorities, as there is no need to rely on evidence of the taxpayer's subjective intent or objective factors that could point towards particular motives.

However, the application of the "effect" test confronts the same problem raised by the purpose test in terms of how narrowly the inquiry needs to be focused. Apart from the rare cases where taxpayers turn economic losses into after-tax gains through mismatches (for example, non-recognition of some income and full recognition of related expenses), most schemes subject to GAARs are based on actual commercial transactions. The end goal

54. See, for example, Serbia.
55. See India.
56. See Norway.
57. See, for example, New Zealand and, in respect of the GST, Australia.

is legitimate – a takeover, an investment, a sale, etc. – and the only issue is whether the steps taken to secure the outcome were deliberately chosen to reduce taxes. A GAAR that relies on purpose can only be invoked if it is restricted to some tax-driven elements of the overall plan. Similarly, the overall *effect* of the transaction will be a commercial outcome – the taxpayer will have acquired the target entity, divested the assets it wanted to sell, shifted ownership from one entity to another, and so on. A GAAR that relies on effect will also only be effective if it is possible to isolate particular transactions or arrangements and find that the effect of those elements, viewed in isolation, was a reduction in tax liability, even though the effect of the entire arrangement was a commercial outcome.

1.5. Counterfactual

The importance of a counterfactual to the success of a GAAR cannot be understated. There is no tax recouped simply by striking down a tax-motivated transaction or arrangement on the authority of a GAAR. Tax can only be recovered if the tax authorities are allowed to develop a counterfactual to the tax-motivated events that actually took place and assess on the basis of that hypothetical transaction. This is equally true for classic GAARs that look for transactions that were used to generate a tax benefit and "substance over form" GAARs that recharacterize the transactions actually used as another transaction that yields the same economic outcome. Tax can only be assessed on the basis of a specific transaction, be it a hypothetical alternative or a recharacterized transaction that achieves the same economic outcome as the steps in fact taken. A fully effective GAAR must also envisage a hypothetical "nil transaction" – the fiction that the taxpayer would not have entered into any transaction if the actual one undertaken is disregarded for tax purposes.[58]

GAARs differ dramatically in terms of the leeway they grant authorities for developing the counterfactual transaction to be taxed. The trend has been to enhance the power of tax authorities to use counterfactuals as the basis for assessment. Thus, for example, under the GAAR formerly used in Belgium, taxpayers were able to defeat counterfactuals by showing that they had legitimate commercial aims in achieving particular legal outcomes that are not replicated in any hypothetical arrangement. Recent amendments have shifted the balance of power to the tax authorities, who can now "presume"

58. See Ireland.

alternatives for tax-motivated transactions, with the onus on the taxpayer to show its choice of arrangements was not tax motivated.

In every case, however, the question remains whether the alternative hypothetical transaction that the tax authorities seek to substitute for the one that took place in legal form at least is the most appropriate alternative.[59] Taxpayers may wish to argue that, if they had known the tax benefits from the transaction they entered into would be cancelled, they would have engaged in a transaction or series of transactions different from that postulated by the tax authorities. To address this problem, the laws are interpreted in most cases to shift the onus onto the taxpayer to show the tax authorities' counterfactual is not the one that would have been used to realize the economic outcome that was achieved. In the event of doubt, this priority of the tax authorities' hypothetical may be legislated.[60]

1.6. Abuse of the anti-abuse rule

GAARs are adopted as a means of stymying arrangements made by taxpayers that abuse the form, intent or structure of tax laws to reduce their tax liability. GAARs are subject to the same interpretative issues as other parts of tax law, however, and just as taxpayers have found ways of avoiding tax through weaknesses in the substantive tax law, tax authorities could try to find ways to abuse the GAAR and apply it to increase tax liability beyond the level envisaged in the substantive law.[61] A GAAR intended to apply where taxpayers have real net profits and no taxable income thanks to tax avoidance, for example, has been used by tax authorities to assess a taxpayer with large gross proceeds but no net profit as a result of poor business judgments.[62] Assessing on the basis of cash movements rather than actual profits might be considered an abuse of the anti-abuse rule.

59. The Liechtenstein law explicitly refers to the "appropriate" counterfactual as the one mandated by law.
60. See, for example, Australia and New Zealand.
61. Note the warning of the Finance Minister in India.
62. See, for example, Hungary.

1.7. GAARs and SAARs

All tax jurisdictions have SAARs that can operate alongside a GAAR.[63] GAARs and SAARs appear to be quite compatible – there are no reported conflicts between the two. Where a SAAR applies to the particular facts of an arrangement, it will be used in preference to the GAAR as a matter of practice and, in one case,[64] legislative fiat. On the other hand, tax authorities might be inclined to rely on the GAAR in cases where taxpayers have deliberately structured a transaction to circumvent a SAAR.[65]

One reason for the apparent compatibility of GAARs and SAARs is the fundamentally different goals and modi operandi of the two types of rules. A GAAR dismantles, for tax purposes, arrangements or agreements that can continue to be effective for civil law purposes and substitutes hypothetical arrangements and agreements in their place to recompute tax liability. A SAAR, in contrast, generally accepts the legitimacy of transactions constructed for tax purposes but negates the tax benefits from aspects of the transactions that exceed the boundaries set by the SAAR.

For example, a thin capitalization rule does not prevent investors from funding subsidiaries by way of debt rather than equity, but it establishes a limit on the interest deductions that will be available in respect of the debt. A taxpayer can avoid the operation of the SAAR completely by remaining inside the safe harbour boundaries it establishes. Similarly, a rule that removes the tax benefit from low-interest or nil-interest loans to shareholders will apply where interest charged falls below the SAAR trigger threshold, but it has no impact on loans bearing higher interest rates.[66]

By setting boundaries for the use of particular tax rules, SAARs also provide signals on what is and is not considered abusive. For example, a controlled foreign corporation (CFC) rule does not unwind any investment in a tax haven, but it does attribute some of the income to the ultimate indirect owners under some conditions. There is no suggestion that the tax authorities would seek to invoke a GAAR to attribute income to the indirect owners where the income is earned by a subsidiary in a lower tax jurisdiction not covered by the CFC regime rules or the income is of a type explicitly not attributed under the CFC rules.

63. Some narrow SAARs in the United Kingdom may be described as TAARs, or targeted anti-avoidance rules; see the United Kingdom.
64. See Germany.
65. See the view offered in Ireland.
66. See, for example, Liechtenstein.

The different roles of GAARs and SAARs do not preclude simultaneous application of the two types of anti-avoidance rules in appropriate circumstances. An example is the use of loans from related companies to avoid the application of thin capitalization rules that only apply to loans directly made by parent companies. The tax authorities might first apply the GAAR to recharacterize the loans from related companies as loans from the parent company and then apply the thin capitalization SAAR to limit the interest deductions available to the borrower.[67]

An interesting question in respect of the relationship between GAARs and SAARs is what happens if there is no SAAR and the taxpayer enters into a transaction that would be caught by SAARs in other jurisdictions. This would be the case, for example, if a taxpayer used very high levels of debt to provide capital to a foreign subsidiary when there is no thin capitalization rule or invested via subsidiaries in low-tax jurisdictions when there is no CFC rule in effect. It has been suggested that the inaction of a legislature in areas such as these implicitly signals acceptance of the arrangements that would have transgressed the boundaries established by a SAAR.[68] The proposition remains untested in the courts.

1.8. GAARs and tax treaties

Can a GAAR in a country's domestic law be used to deny the benefits of a tax treaty? The Commentaries on the OECD Model Convention suggest that domestic GAARs are compatible with the application of a treaty.[69] This is despite the fact that, through a variety of mechanisms including constitutional design,[70] almost all countries ensure that treaties will override domestic law.

In some cases, the compatibility of domestic law GAARs and treaties that override domestic law derives from the treaties themselves (or ancillary agreements). Thus, treaties may include a measure that states directly that the treaties will not prevent authorities from applying domestic anti-avoidance rules.[71] Alternatively, the parties may agree jointly in supplementary

Please note that this sample chapter is limited to 14 pages.
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67. For examples, see Russia and Spain.
68. See, for example, India.
69. See paragraph 22 of the Commentary on Article 1 of the OECD Model Convention.
70. See, for example, Ireland.
71. See, for example, Hungary and Liechtenstein.

List of Authors

Lubica Adame works as the head of the International Tax Department of the Ministry of Finance of the Slovak Republic, where her responsibilities include a wide variety of international tax issues, among them the negotiation of double tax agreements, along with the OECD and EU agendas. Before joining the Ministry of Finance, she worked in a major international consulting firm in Slovakia as a tax advisor, specializing in cross-border taxation and tax planning. Ms Adame received a PhD from the University of Economics in Bratislava and an LLM in International Tax Law from the Vienna University of Economics and Business (WU). She cooperates with the tax institute of the University of Economics in Bratislava.

Andrés Báez Moreno is Associate Professor of Tax Law at the Universidad Carlos III de Madrid, a postdoctoral research fellow at IBFD on selected issues concerning the UN Model and a lawyer at the Madrid Bar. He has been a visiting pre- and postdoctoral researcher at the University of Münster, the University of Cologne, the University of Padua and at IBFD. His areas of expertise are domestic company taxation (in particular, commercial and tax accounting) and international taxation, fields in which he has published two books and more than 30 articles and contributions.

Mateus Calicchio Barbosa received his LLB from the University of São Paulo. He is a lawyer in São Paulo.

Ege Berber Villeneuve is currently a PhD candidate in the Doctoral Program in International Business Taxation at the Vienna University of Economics and Business (WU) and a recipient of DOC Fellowship of the Austrian Academy of Sciences at the Institute for Austrian and International Tax Law. She holds a law degree from Koç University (Istanbul), a master's degree in Public Law from Istanbul University and an LLM Finance degree from Goethe University (Frankfurt). Her research was funded by the Austrian Science Fund (FWF): W 1235-G16.

Marc Bourgeois is Professor of Tax Law and Public Finance Law at the Faculty of Law, Political Science and Criminology of the University of Liège (Belgium). He leads the Master of Advanced Studies in Tax Law at the University of Liège and is co-director of the University's Tax Institute. He has published and lectured, both in Belgium and abroad, on topics including fiscal federalism, general principles of tax law, anti-avoidance rules and principles of budgetary governance. He is also editor-in-chief of the Belgian *Revue de fiscalité régionale et locale*.

Yariv Brauner is a University of Florida Research Foundation Professor and Professor of Law at the Levin College of Law at the University of Florida. He joined the Florida faculty in 2006, after teaching at New York University, Northwestern University and Arizona State University. He has been a visiting professor and a guest speaker at various universities in the United States and abroad. He is the author of numerous articles published in professional journals and law reviews, and he is co-author of *U.S. International Taxation – Cases and Materials* (with Reuven S. Avi-Yonah and Diane M. Ring), now in its third edition. He has taught extensively in the fields of taxation, corporate taxation, international taxation, international trade law and the law of multinational corporations.

Simon Busch, LLM, PhD, is Assistant Professor at the Chair for Tax Management and the Laws of Liechtenstein and International Taxation at the University of Liechtenstein.

Hyejung Byun is Associate Professor at the University of Seoul. She serves as a non-permanent member of the Tax Tribunal, a committee member on the National Tax Administration Reform Committee of the National Tax Service, a member of the Tax Accountant Disciplinary Board of the Ministry of Strategy and Finance and a council member of the Local Tax Council of the City of Seoul. She has also served as a committee member on the National Tax Appeal of the National Tax Service. She is a research fellow in the Taxation Law and Policy Research Group of Monash University (Melbourne). Ms Byun received an LLB and an LLM from Ewha Womans University (Seoul), an LLM from the University of Wisconsin and an SJD in Taxation from the University of Florida.

Bristar Mingxing Cao holds a PhD in tax law from the Peking University Law School and is a Chinese lawyer and accountant. He is currently Deputy Dean of the Tax School at the Central University of Finance and Economics (Beijing) and Director of the China International Tax Center. He is also Secretary General of the International Fiscal Association China Branch and is dedicated to establishing a special master's programme in international tax law in China. He is the author of *A Dialectic Analysis of the Evolution of the Modern Tax Law – A Counter-Polar Comparison between the United States and China*, editor-in-chief of the series *Innovative China International Tax*, executive editor of the *Annual China Tax Report* and is leading the launch of the *China International Tax Review*. His areas of expertise are tax policy and law, international tax law and economic law.

Madalina Cotrut is a Romanian lawyer specialized in international tax law. She obtained her law degree in 2002 and an LLM in EU Law in 2007. Ms Cotrut worked for IBFD as a Principal Research Associate within the European Knowledge Team. Before joining IBFD, she worked for Deloitte and a top-ranking law firm in Romania, focusing on corporate taxation and international tax planning for multinational corporations. Her professional experience in tax consultancy includes international structuring of business portfolios, acquisitions and group restructurings, and assessing the tax risks on intra-group transactions and various business models. Ms Cotrut lectures and publishes regularly on a wide variety of international topics.

Gerardine Doyle is an academic and senior lecturer at University College Dublin College of Business and has served there as head of the Accountancy Department. She is tax researcher and lectures on tax law at both undergraduate and postgraduate levels. She is a alumnus of the Harvard Kennedy School of Government's Comparative Tax Policy and Administration programme (2014) and is a member of the European Association of Tax Law Professors (EATLP). Dr Doyle was editor of *Irish Taxation: Law and Practice* from 2007-2010 (in addition to contributing chapters to that series) and is a member of the Education Committee of the Irish Tax Institute. She is also a board member of the European Institute for Advanced Studies in Management.

Klaus Dieter Drüen has held the Chair of Business and Corporate Tax Law, Accounting and Public Law at Heinrich Heine University Düsseldorf since 2007. He is also one of the directors of the university's Center for Business and Corporate Law (CBC). In addition to his academic work, he has served since 2011 as a judge on the Fiscal Court of Düsseldorf.

Thomas Dubut is a graduate of the Sorbonne Law School. He has taught tax law at French universities (currently at the Sorbonne Law School and at Paris Dauphine University) for more than ten years and has been Visiting Research Fellow at the Vienna University of Economics and Business (WU) and at the National University of Athens (Greece). He has been involved in tax reforms or tax modernization efforts in several developing countries (Burundi, Haiti, Mali, Mauritania, Rwanda, Senegal, Somaliland and Madagascar) as an independent consultant for the IMF (LEG, FAD), the World Bank (IFC), Trademark East Africa, Adam Smith International and BDO East Africa.

Craig Elliffe is a Professor at the University of Auckland Law School, where he specializes in taxation. He was previously a tax partner at KPMG for 14 years and a tax partner at Chapman Tripp (New Zealand's largest law firm) for eight years. His research areas are, in particular, international tax, tax avoidance and capital gains tax reform. He has written extensively on tax issues and is the author of *International and Cross-Border Taxation in New Zealand*. He is, in addition, Director of the University of Auckland's Master of Taxation Studies programme. Mr Elliffe holds a BCom and an LLB from the University of Otago (New Zealand) and an LLM from Cambridge University. Mr Elliffe is a member of both the NZ Committee and the Permanent Scientific Committee of the International Fiscal Association.

Hanna Filipczyk holds degrees in law and philosophy and a PhD in law from the Nicolaus Copernicus University in Toruń (Poland). She is a tax advisor specializing in tax litigation (Arthur Andersen, Ernst & Young, Accreo Taxand and Enodo Advisors) and a member of Poland's Codification Committee of the General Tax Law and the IFA Poland. She has also worked as a lawyer-linguist for the Court of Justice of the European Union.

Judith Freedman is Pinsent Masons Professor of Taxation Law at Oxford University and Director of Legal Research at the Oxford University Centre for Business Taxation. She has served on various government committees, including the Aaronson Study Group, which considered the introduction of a general anti-abuse rule in the United Kingdom and has written extensively on taxation issues, including work on tax avoidance and compliance. Professor Freedman is the general editor of the *British Tax Review* and is on the editorial boards of several other journals. She is a member of the Council of the Institute for Fiscal Studies (IFS) and of the IFS Tax Law Review Committee. She was appointed a Commander of the British Empire (CBE) in 2013 for services to tax research and an Honorary Fellow of the Chartered Institute of Taxation in 2015.

Daniel Fuentes Hernández holds an LLM in International Tax Law from the Vienna University of Economics and Business (WU). He worked as a senior tax advisor at Ernst & Young (Mexico) for several years and in the International Division of the Fiscal Authority of the Principality of Liechtenstein for a one-year project. Currently, he is a PhD candidate in the Doctoral Program in International Business Taxation at the Institute for Austrian and International Tax Law at WU, where he is also a research associate, and also works as a senior manager in transfer pricing and corporate taxes of a multinational company in Liechtenstein.

Stjepan Gadžo is currently a research assistant at the Chair for Financial Law at the Faculty of Law, University of Rijeka (Croatia). He is also a PhD candidate at the Faculty of Law, University of Zagreb. He has published several articles in the area of tax law and public finance law. His main fields of interest are company taxation, value added taxation and international tax law.

Søren Friis Hansen is Professor of International Company Law at Copenhagen Business School. He was a member of the committee that prepared the Danish Companies Act of 2009. His research deals with Danish company and tax law as well as European company law and tax law.

Lidija Hauptman is Associate Professor of Accounting, Taxation and Auditing at the University of Maribor (Slovenia), Faculty of Business and Economics. She received her PhD from the University in Maribor. Her current research interests lie in taxation and accounting. She received a Marie Curie Fellowship in 2004 at the Department of Austrian and International Tax Law at the Vienna University of Economics and Business (WU). She has published papers in several national and international journals and other publications.

Marjaana Helminen is Professor of International and EU Tax Law at the University of Helsinki. She has also worked as a justice on the Supreme Administrative Court of Finland and as a tax adviser at Loyens & Loeff in Amsterdam.

Sigrid Hemels is Professor of Tax Law at the Erasmus School of Law (ESL) of the Erasmus University Rotterdam and a member of the tax group of Allen & Overy LLP, Amsterdam. She leads the ESL research programme "Fiscal Autonomy and its Boundaries". She has published and lectured, both in the Netherlands and abroad, on topics including tax incentives for charities and the arts, and European tax law.

Sabina Hodžić is Assistant Professor and head of the Department of Public Finance at the Faculty of Tourism and Hospitality Management, University of Rijeka (Croatia). Her main field of research is public finance and current taxation issues. She lectures on public finance and international taxation and is the author of several papers published in scientific journals.

Peter Hongler is a postdoctoral research fellow at IBFD, Amsterdam, a lecturer at the University of Zurich and an associate at Walder Wyss, Zurich. He was educated at the University of Bern (MLaw 2008) and the

University of Zurich (Dr iur. 2011). He worked as a research assistant to Prof. Dr Madeleine Simonek at the University of Zurich and the University of Lucerne. In 2010-11, he was a guest researcher at the Institute for Austrian and International Tax Law at the Vienna University of Economics and Business (WU).

Emer Hunt holds an LLB from Trinity College Dublin and an LLM from the London School of Economics and Political Science. She is a qualified solicitor in England and Wales, as well as in Ireland. She has worked as a lawyer in London, New York and Dublin, and was a partner with one of Ireland's largest law firms. She is currently studying for a PhD at the UCD Michael Smurfit Graduate Business School. Her research interests are in the area of international tax and the territoriality of tax systems.

Nilesh Kapadia holds a BCom from Mumbai University and is a chartered accountant in India. He also holds an LLM in International Taxation from the Vienna University of Economics and Business (WU). He has over 30 years' experience in professional practice, advising corporations, multinationals, banks and other institutions on tax matters. He is a Secretary of the International Fiscal Association, India Branch, and is on the International Taxation Committee of the Chamber of Tax Consultants, Mumbai. Previously, he served on the International Taxation Committee of the WIRC of ICAI and the Bombay Chartered Accountants' Society. He has addressed meetings for professionals organized by these bodies and has written various articles published in professional journals and newspapers. He has been attending the meetings of the Committee of Experts at the UN since October 2013 and has been invited to work on its subcommittee on taxation of services.

Irena Klemenčić is head of legal services at the Institute of Public Finance (Zagreb). She is a PhD student at the Faculty of Law, University of Zagreb. She has taken part in multiple research projects and has published articles on tax law and public finance. Ms Klemenčić's main fields of interest are international tax law, tax avoidance, company taxation and environmental taxes.

Patrick Knörzer, PhD, PhD, is Assistant Professor at the Chair for Tax Management and the Laws of Liechtenstein and International Taxation at the University of Liechtenstein.

Borbála Kolozs is a researcher in taxation law in Budapest, Hungary.

Svetislav V. Kostić is Assistant Professor at the University of Belgrade Faculty of Law, where he teaches general tax law, international tax law and EU tax law to both undergraduate and graduate students. He holds an LLB, an LLM and a PhD from the University of Belgrade Faculty of Law and an LLM from the New York University School of Law. In addition to his academic activities, Dr Kostić is a director of Deloitte Tax and Legal Services in Serbia and a treasurer of the Serbian IFA Branch. He is member of the practice counsel of the ITP at the New York University School of Law and has published approximately 30 articles in both Serbian and international publications.

Nataša Žunić Kovačević, JSD, is Associate Professor and head of the Department of Financial Law at the Faculty of Law, University of Rijeka (Croatia). She teaches courses for undergraduate/graduate, postgraduate and doctoral students, and her research interests focus on tax procedural law and European tax law.

Richard Krever is Professor and Director of the Taxation Law and Policy Research Group in the Monash Business School, Monash University (Melbourne). He is the author of numerous books and articles, and has been a Visiting Professor at multiple universities, including Harvard Law School. He has been seconded to or worked for a number of international organizations, including the IMF, the World Bank, the Asian Development Bank, government finance ministries and tax authorities, and a wide range of international development agencies.

Na Li, is post-doctoral researcher and lecturer at East China University of Political Science and Law (Shanghai) and is also a Chinese lawyer and US (New York State) lawyer practicing in cross-border investment and international taxation. She obtained an LLB from Fudan University (Shanghai) in 2001, an LLM in taxation from Boston University in 2009 and a PhD from Vienna University of Economics and Business (WU) in 2015.

Gustavo Lopes Courinha has been a lawyer since October 2001 and is currently Associate Professor at the University of Lisbon School of Law, where he obtained his LLB (1999), his LLM (2003) and his PhD (2012). He also coordinates the university's Advanced Postgraduate Programme in Tax Law (since 2007) and lectures in several other postgraduate and LLM programmes, including at the Catholic University of Portugal (since 2002). Dr Lopes Courinha is a frequent speaker at tax conferences in Portugal and abroad.

Peter Mellor is a research fellow in the Taxation Law and Policy Research Group in the Monash Business School, Monash University (Melbourne).

Shay Menuchin holds an LLB from Queen Mary University of London, an LLM in Taxation from the University of Florida and a PhD in Law from the London School of Economics and Political Science. He is a member of the NY State Bar and of the Israel Bar. Previously, he was global tax director of a multinational group. At the time of writing, he was the head of the US Tax Desk at KPMG in Israel.

Ioanna Mitroyanni is a tax lawyer and works as a policy officer at the European Commission, Directorate General for Taxation and the Customs Union (DG TAXUD). She joined the Commission in April 2008, a few months after she successfully completed a PhD on cross-border group taxation at the University of London. Since then, she has been working in the field of EU corporate tax law, dealing with the corporate tax directives and the proposal for a Common Consolidated Corporate Tax Base (CCCTB).

Lukas Moravec is an international taxation tutor and tax policy researcher at the Czech University of Life Sciences Prague and a lecturer at the College of European and Regional Studies in České Budějovice (Czech Republic), where he has benefitted from his previous experience as a tax planning projects manager.

Danuše Nerudová is Associate Professor, head of the Department of Accounting and Taxes and vice-rector of the Mendel University in Brno (Czech Republic). She is also a researcher at the Research Centre of the Faculty of Economics and Business, Mendel University in Brno. She lectures on international taxation and is the author of several books and papers on international taxation and tax harmonization within the European Union.

Aymeric Nollet is PhD researcher at the Faculty of Law, Political Science and Criminology of the University of Liège (Belgium). He specializes in the structural study of general and specific anti-abuse rules in the Belgian, Dutch and French tax systems. He is the author or co-author of multiple papers on topics including the concept of sham in tax law and the nature of GAARs and SAARs in the Belgian legal order.

Martha O'Brien is a Professor of Law in the Faculty of Law, University of Victoria, British Columbia. She holds an LLB from the University of Victoria (British Columbia) and an LLM in EU law from the Institut d'études europées, Université libre de Bruxelles. She practised law in

Vancouver, British Columbia from 1985-1990 (civil litigation) and from 1992-2000 (Canadian and international tax law) before her appointment to the University of Victoria Faculty of Law in 2000. She teaches the basic tax course and two advanced tax courses (corporate tax and international tax) as well as EU law, corporate law and legal ethics. Professor O'Brien has published numerous articles in leading Canadian and European journals.

Annet Wanyana Oguttu is Professor of Tax Law in the College of Law at the University of South Africa. She holds a PhD in tax law from the University of South Africa (followed by postdoctoral Studies at the University of Michigan), an LLM in Tax Law from the University of South Africa, an LLB from Makerere University (Kampala), a Higher Diploma in International Tax Law from the University of Johannesburg and a Diploma in Legal Practice from the Law Development Centre (Kampala). Dr Oguttu is the author of *International Tax Law: Offshore Tax Avoidance in South Africa*. She has published a number of articles in national and internationally accredited journals on various international tax law topics and is a rated researcher under South Africa's National Research Foundation. In 2014, she was appointed by the President of South Africa as one of the Commissioners of the South African Law Reform Commission. She is also a member of South Africa's Davis Tax Committee, appointed by the Minister of Finance in 2013 to assess South Africa's tax policy framework, for which she chairs the base erosion and profit shifting subcommittee. In 2012, she was appointed by UN DESA as a member of the Expert Group to Develop a UN Course on Double Tax Treaties to develop capacity among tax administrators in developing countries. She is an instructor of international tax law at the African Tax Institute (University of Pretoria) and a Visiting Professor at the University of Pretoria and the University of Johannesburg. She is currently board president of the South African Institute of Tax Practitioners, a member of the International Fiscal Association, a board member of the South African Fiscal Association and a board member of the African Tax Research Network.

Agnieszka Olesińska is Associate Professor at the Public Finance Law Department of the Faculty of Law and Administration, Nicolaus Copernicus University in Toruń (Poland). She is a vice-president of the Codification Committee of the General Tax Law in Poland and the State Examination Commission for Tax Advisors and is editor-in-chief of *Przegląd Orzecznictwa Podatkowego* (*Tax Cases Review*) and *Toruński Rocznik Podatkowy (Toruń Tax Yearbook).* Ms Olesińska also serves as legal counsel and a tax adviser, and she is a member of IFA Poland.

Stefan Olsson is Professor of Tax Law at Karlstad University (Sweden). His doctoral thesis, defended in 2001 at Gothenburg University (Sweden), dealt with excise taxes from a Swedish and European perspective. Having completed a study of the relationship between constitutional law and tax law in Sweden and Germany, he was appointed Associate Professor in 2007. Since then, his main research field has been accounting law and tax law. Dr Olsson was appointed Professor in 2010, and he is head of the Forum on Accounting and Control at Karlstad University. He is also a member of the Swedish Advance Rulings Board for indirect taxes.

Soo Jean Park is a tax researcher at the Korea Institute of Public Finance. She is a member of the Korean Institute of Certified Public Accountants and serves as a committee member on the National Tax Appeal of the National Tax Service. Ms Park received her PhD from the University of Seoul.

Paolo Piantavigna is a research fellow and lecturer in the Department of Law at the University of Pavia (Italy), where he previously served as tutor. He is currently a postdoctoral research fellow at IBFD on abuse and aggressive tax planning. He received his PhD from the University of Milano-Bicocca in 2009. He has served as visiting independent researcher in Tax Law at the Columbia Law School (2011) and at the Max Planck Institute for Intellectual Property, Competition and Tax Law (2008). He also works as a tax lawyer at Chiomenti Studio Legale (Milan). Among his publications, a book on tax abuse in Community law was published in 2011.

César Alejandro Ruiz Jiménez earned a law degree at the Instituto Tecnológico Autónomo de México and a master's degree in Tax Law at the Universidad Panamericana. He then studied International Taxation at the University of Florida and received an LLM in International Taxation on the research topic "The Adoption of the American Economic Substance Doctrine in the Mexican Legal System". He has worked as a tax attorney with the former president of the Mexican Academy of Tax Law, an adviser for the Mexican Supreme Court of Justice and as secretary for a federal administrative court in Mexico City. Since September 2011, he has been enrolled in the Doctoral Program in International Business Taxation at the Vienna University of Economics and Business (WU).

Luís Eduardo Schoueri is Professor of Tax Law at the University of São Paulo. He is a partner at Lacaz Martins, Pereira Neto, Gurevich & Schoueri Advogados and vice president of the Brazilian Tax Law Institute (IBDT). He is the author of *Direito Tributário*; *Normas Tributárias Indutoras e Intervenção Econômica*; *Preços de Transferência no Direito Tributário*

Brasileiro; *Planejamento Fiscal Através de Acordos de Bitributação:* Treaty Shopping; and *Distribuição Disfarçada de Lucros*.

Andrew Smith is an Associate Professor in the School of Accounting & Commercial Law, Faculty of Commerce and Administration, Victoria University of Wellington (New Zealand). His research interests are in international and corporate tax, and he has authored numerous papers and articles in a wide range of international journals. He is a member of the editorial board of the *Journal of the Australasian Tax Teachers' Association* and a member of the advisory board of the *New Zealand Journal of Taxation Law and Policy.* He is also a member of Chartered Accountants Australia and New Zealand.

Sabina Taškar Beloglavec is a senior lecturer at the Faculty of Economics and Business of the University of Maribor (Slovenia), where she concluded her graduate and postgraduate studies. Her postgraduate research interests involve two major issues: banking and international taxation. Her PhD thesis (in progress) deals with the probability of bank default. She is also active in other fields, including economic subject curriculum development and supervision of secondary schools – high schools at the National Education Institute of the Republic of Slovenia. She has published articles in several national and international journals and other publications.

Vladimir Tyutyuryukov, CSc, is Assistant Professor at KIMEP University (Kazakhstan) and a co-leader of the Central Asian Tax Research Center. Prior to assuming this position, he amassed extensive experience in tax consulting and academic teaching in Russia. Mr Tyutyuryukov is a member of the International Fiscal Association. His research is mainly focused on the countries of the CIS and the Eurasian Economic Union (formerly the Customs Union of Belarus, Kazakhstan and Russia), and his academic areas of interest are corporate taxation, international taxation and transfer pricing.

Ingebjørg Vamråk is currently a PhD research scholar at the Norwegian School of Economics, working on the project "Income Taxation of Derivatives". Mrs Vamråk is also a member of the Norwegian Tax Appeal Board, Foreign Tax Affairs, as well as a faculty member of the Norwegian Center for Taxation.

Viktoria Wöhrer is a research associate at the Christian Doppler Laboratory for 'Transparency in International Tax Law', established at the Institute for Austrian and International Tax Law at the Vienna University of Economics and Business (WU).

Martin Wenz, PhD, is Professor of Tax Law, head of the Institute for Financial Services and holds the Chair for Tax Management and the Laws of Liechtenstein and International Taxation at the University of Liechtenstein. He is a senior advisor to the government of the Principality of Liechtenstein regarding Liechtenstein and international tax law, and international tax cooperation and tax coordination.

Juan Zornoza Pérez is Professor of Public Finance and Tax Law at the Universidad Carlos III de Madrid, where he holds the PwC Chair on International Corporate Taxation. Prof. Zornoza is a founding member of the Ibero-American Observatory of International Taxation and is the author of five books and more than 120 chapters and articles published in textbooks and journals in Spain and abroad. His areas of expertise are domestic company taxation, international taxation and tax crimes.

Notes

Contact

IBFD Head Office
Rietlandpark 301
1019 DW Amsterdam
P.O. Box 20237
1000 HE Amsterdam, The Netherlands
Tel.: +31-20-554 0100 (GMT+1)
Email: info@ibfd.org
Web: www.ibfd.org

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