What ‘rules’: General Principles or Specific Rules?

The specific interest article 10a CITA 1969 in the Dutch corporate tax

Bachelor thesis
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Date: July 7th 2015

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Introduction

Through the years, companies are increasingly conscious of the ethical and social side of doing business.[1] These companies are aware of their social responsibility and are willing to pay their fair-share. Nevertheless, there are taxpayers who are constantly trying to 'beat the system'. Over time – as taxpayers become more familiar with the rules – they will change their behaviour in order to avoid them. This phenomenon – also called creative compliance – enables taxpayers to pay fewer taxes, without crossing any legal boundaries[2]. This outcome is contrary to the desire and purpose of the legislator, even though it is legal. Depending on the seriousness of the tax avoidance – often driven by the urgent need of funding the growing deficit of the public finance in the country – the legislator will address this problem. Mostly, the legislator will enact a Specific Anti-Abuse Rule, also known as SAAR. Subsequently, a vicious cycle is created: the taxpayer discovers a loophole in the rule, which is followed by another specific anti-abuse rule by the legislator, and so forth. As a result, many taxpayers and tax professionals state that the Dutch tax system has become too complex.[3] Ironically, the term 'tax engineering' is used: the science of interpreting, linking, and stretching formulations of rules in such manner that benefits the taxpayer the most.
In response to this vicious cycle, an important and relevant question arises: should specific rules or general principles be used to contest tax avoidance in the corporate world?

Rule-based decision-making is an assemblage of rules within a legal system, creating a link between a taxpayer's specific situation and the consequences thereof.[4] Consequently, the taxpayer can predict the outcome of his actions. As Ronald Dworkin states: "If the facts a rule stipulates are given, then either the rule is valid, in which case the answer it supplies must be accerted, or it is not, in which case it contributes nothing to the decision."[5] Principles – on the other hand – do not compel to a certain decision. Principles are part of the legal system, but they originate from society's view on ethical and social issues. Principle-based decision-making has a case-by-case basis approach, where all the relevant facts and circumstances are taken into account.[6] In this case, the taxpayer cannot predict the precise outcome of his actions. If the principle is straightforward and understood amongst subjects, the decision-maker can better ensure that the decision is in accordance with the ultimate purpose of the law.

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[1] Happe, R.H., 'Belastingrecht en de geest van de wet' (2011), Tilburg University, p. 7.
[2] Nieuweboer, M., 'Tax law as a decision making process', (2015), p. 2.
[3] Happe, R.H. 'Belastingrecht en de geest van de wet' (2011), Tilburg University, p. 13.
[4] Nieuweboer, M. 'Tax law as a decision making process', (2015), p. 3.
[5] Dworkin, R.M., 'The Model of Rules' (1967) 35 University of Chicago Law Review 25.
[6] Niueweboer, M.'Tax law as a decision making process', (2015), p. 4.

An example of rule-based decision-making in the Dutch corporate tax is the article 10a CITA 1969. The purpose of the legislator with regard to this interest article is to contest a scenario where the taxpayer artificially creates interest expenses within a group of affiliated entities, where by deducting interest, the taxpayer is transferring pre-tax income to a low tax jurisdiction and thus not contributing to its fair-share obligation.

Many tax advisors state that the SAAR article 10a CITA 1969 have become too complex. The complexity is caused by – inter alia – details in the delineation of the tax base[7], and the different rebuttal opportunities. This is why the following question will be discussed in this thesis: ***'Can a principle-based interest article effectively replace the current article 10a CITA 1969 in the Dutch corporate tax?'***

There are many ways in which a taxpayer can avoid taxes. One way is by increasing interest expenses by means of converting capital into loans within a group of affiliated entities. The interest expense is deductible from the income of the debtor, lowering by this means the tax base. If the interest revenue for the creditor is barely or not at all subject to a profit tax, a tax advantage arises. Creating loans (and thus interest expenses) without a sound business-like reason within a group of affiliated entities in this artificial fashion is called base-erosion. Furthermore, it is important to note that – in this thesis - by 'effectively being replaced' is meant: has the General Anti-Abuse Rule (GAAR) successfully produced the desired or intended purpose of the legislator? The purpose of the legislator is to prohibit base-erosion by means of creating scenarios where by deducting interest, the taxpayer is transferring pre-tax income to a low tax jurisdiction. In other words, the compliance of the taxpayer has to be in line with the intended purpose of the anti-abuse rule.

The main question of this thesis will be answered by using three sub-questions, and by conducting a research on relevant papers and articles regarding this topic. The first sub-question is: '*What are the characteristics of principle-based- and rule-based decision-making, and what are the key differences?*' In the first chapter the general differences between rule-based decision-making and principle-based decision-making will be addressed. Also, a comprehensive picture will be drawn of the advantages and disadvantages of these decision-making methods.

In the second chapter the sub-question '*What role does principle-based- and rule-based decision-making have in taxation?*' will be discussed. The scope of this chapter will be the effect of principles and rules on taxation. The concepts of a General Anti-Abuse Rule (GAAR) and a Specific Anti-Abuse Rule (SAAR) will be made intelligible. Fraus legis –

[7] Nieuweboer, M., 'Tax law as a decision making process', (2015), p.18.

better known as a doctrine that is not stated in the tax law, but is used by the Supreme Court[8] – will also be discussed in this chapter.

Thereafter, the third and last sub-question will be answered: *'Which anti-abuse rule - regarding deduction of interest on loans within affiliated group entities – is used in the Dutch corporate tax?'* The legislator has chosen to contest base-erosion caused by abusive interest deduction within affiliated group entities by means of a specific rule[9]. Therefore, in this chapter the SAAR article 10a CITA 1969 will be explained. In this chapter, the motive for introduction and most important jurisprudence will be shortly discussed. Also, the most important components of this specific anti-abuse article will be discussed. Furthermore, attention will be paid on the degree of the preciseness within article 10a CITA 1969.

The conclusions derived from the previous chapters will be used to determine if the legislator can effectively replace the current article 10a CITA 1969 with a principle-based interest article. In the conclusion the answer of the main and sub-questions will be – in short – given. In the last chapter, I will also give my opinion on how the legislator should – in the future – challenge corporate tax evasion: using specific rules, principles, or a combination of these two methods.

[8] Kooiman, W.R., 'De toetsing van fraus legis naar omstandigheden' (2012), Tijdschrift Formeel Belastingrecht, p. 1.

[9] Van der Geld, J.A.G., 'Hoofdzaken vennootschapsbelasting' (2014), Kluwer, Deventer, p.111.

1. Rule- and Principle-based decision-making
Paragraph 1.1 – Introduction

A rule-maker can stimulate, prevent, or put a stop to certain undesirable behavior by means of principle- or rule-based decision-making processes. Rule-based decision-making is the opposite of principle-based decision-making. Rules have an *all-or-nothing approach*[10]; either they apply on a certain situation, or they do not. A rule – made by a rule-maker – dictates the consequence of certain behaviors, decisions, or relationships. The outcome of the rule has to be in accordance with the purpose of the rule-maker. Unfortunately, this is not always the case. Principle-based decision-making process – on the other hand – has a *case-by-case approach*.[11] The rule-enforcer – such as the tax inspector or the courts – takes all the relevant facts of each case into account. Given all the relevant factors, the rule-enforcer will make a decision that is in accordance with the underlying purpose and objective of the rule-maker. The definition, consequences, advantages, and disadvantages of rule- and principle-based decision-making processes will be discussed in this chapter. For the purpose of this thesis, a rule-maker is the one who makes a set of rules. The rule-enforcer is the one who executes the rule, and the subject is the one who does or does not fall under the scope of the rule.

In this chapter the advantages and disadvantages of rule-based decision-making and principle-based decision-making will be evaluated by the degree of *predictability*, *fairness*, *efficiency*, *effectiveness*, *the allocation of power*, and *flexibility* of a rule or principle. A rule or principle is *predictable* when the subject can – with certainty – predict ex-ante what the outcome will be. The same criteria (the cause) will lead to the same outcome every time. A rule or principle is *fair* when situations that are similar are treated in a similar manner. Also, situations that are not similar are treated differently based on their differences. Rules or principles are *effective* when the outcome is successfully in accordance with the purpose and intention of the rule-maker. Furthermore, rules or principles are *efficient* when the rule-maker can – using minimal resources and maximum productivity – successfully achieve the wanted outcome. By *the allocation of power* is meant that the rule-maker has to allocate just enough power to the decision-maker – such as the Supreme Court – so that he or she can make a decision that is in accordance with the purpose of the rule-maker. In other words, a rule-maker cannot distribute too much power to the decision-maker so that he/she can make a decision that a rule or principle does not entitle them to do. A rule or principle is *flexible* when it is subject to change and is still applicable over the years.

[10] Happe, R.H., 'Belastingrecht en de geest van de wet' (2011), Tilburg University, p. 35.
[11] Nieuweboer, M., 'Tax law as a decision making process', (2015), p. 4.

Paragraph 1.2 – Rule-based decision-making

1.2.1 Introduction

Rules are either *descriptive* or *prescriptive*.[12] The goal of a descriptive rule is often to describe or explain certain relationships. A prescriptive rule – on the other hand – is designed to alter or contest certain unwanted behavioural patterns. Prescriptive rules are therefore more regulatory and do not focus on describing certain relationships. In other words, prescriptive rules provide a bridge between certain behaviour (the cause) and the consequence of that behaviour. In this thesis prescriptive rules will be discussed.

Furthermore, it is important to distinguish a *rule of thumb* from a *mandatory rule*.[13] Rule of thumbs are broad guidelines that a rule-enforcer has to comply with when making a decision. These – less binding rules – can be easily justified when the subject falls under the scope of a rule without it being the purpose of the rule-maker. For example, consider the classic speed limit example.[14] The rule states 'do not drive recklessly'. The definition of recklessly driving is not given, and is left open for interpretation. Due to particular circumstances, such as fog, drivers drive excessively slow on the freeway. On a sunny day, this would not be considered as safe. In other words, due to the circumstances, driving excessively slow is not recognised as reckless and irresponsible. Mandatory rules – used by tax legislators – are binding. They always provide reason for implementation when a subject falls under the scope of a rule, regardless of the actual intent of the rule-maker. In this thesis mandatory rules will be discussed.

1.2.2 Disadvantages

Creative compliance

Prescriptive rules are clear, exact, and predictable.[15] The behavioural pattern that will lead to the implementation of a rule is clearly specified. Consequently – given these clear criteria – the outcome of a rule is predictable. This is not seen as a problem until the subject bends the formulation of a precise rule to its advantage. As the subject becomes more familiar with the exact rule, it can take certain measures in order to avoid the consequence thereof without breaking the rule. [16] In fact, the more precise a rule is, the less challenging it will be to avoid the consequences thereof. This phenomenon, called *tax avoidance* or *creative*

[12] Schauer, F., 'Playing by the rules: A Philosophical Examination of Rules-based Decision making in Law and in Life', (1991), Oxford University Press, New York, p. 1.
[13] Schauer, F., 'Playing by the rules: A Philosophical Examination of Rules-based Decision making in Law and in Life', (1991), Oxford University Press, New York, p. 4.
[14] Used in: Cooper, G.S., 'The Design and Structure of General Anti-Tax Avoidance Regimes', (2009), Bulletin for International Taxation, p. 28.
[15] Braithwaite, J., 'Rules and Principles: A Theory of Legal Certainty', (2002), Australian Journal of Legal Philosophy, p. 50.
[16] Happe, R.H., 'Belastingrecht en de geest van de wet' (2011), Tilburg University, p. 14

compliance[17] in taxation, enables the subject to legally avoid a rule where. It is important to note that this outcome is not in accordance with what the rule-maker – such as the legislator – has in mind.

For example[18], consider a tax on excessive donations made by a person to another individual. Suppose that the rule-maker states that all donations of/or exceeding €2.000 per year will be taxed at a rate of 10 per cent. By creatively donating €1.999 on December 31 in one year and €1 on 1 January in the next year, the donor avoids the tax on donations without breaking the rule. Nevertheless, the underlying purpose and intentions of the rule-maker – which is to tax excessive donations to individuals – is not being met. Legally the donor does not fall under the scope of the rule, but the actual donation – an excessive one – does meet the conditions of the underlying purpose of the rule-maker.

Complexity

A rule that stands alone seems very precise and predictable. However, the world is not as simple. In practice a rule is often part of a whole network of other rules. These rules are often also interrelated. Consequently, evaluating the criteria that triggers the rule and consequence thereof becomes more complex.[19]

Selective inclusion and selective exclusion

In the process of specifying the scope of a rule *selective inclusions*- or/and *selective exclusions* to the rule are made by the rule-maker.[20] *Selective inclusion* includes certain specific behavioural patterns to the rule. If a subject meets these given criteria, he or she will suffer the consequence of the rule. The rule applies to everyone in this group. *Selective exclusion* – on the other hand – excludes specific behavioural patterns or groups from the rule. The subject that meets these criteria is excluded from the rule and does not face the consequences thereof. The rule does not apply to anyone in this group. These selective inclusions and –exclusions are not subject to change. Over time – as society and the law changes – a scenario may appear where the selective exclusions or –inclusions made in the past are no longer in accordance with the purpose of the rule-maker.

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[17] Braithwaite, J., ‘Rules and Principles: A Theory of Legal Certainty’, (2002), Australian Journal of Legal Philosophy, p. 57.

[18] Inspired by: Nieuweboer, M., ‘Tax law as a decision making process’, (2015), p. 2.

[19] Braithwaite, J., ‘Making tax law more certain: a Theory’, (2002), Centre for Tax System Integrity Research School of Social Sciences, Australian National University, Canberra, p.9.

[20] Schauer, F., ‘Playing by the rules: A Philosophical Examination of Rules-based Decision making in Law and in Life’, (1991), Oxford University Press, New York, p. 21.

For instance, consider the classic example of the digitalization and globalization of society.[21] Virtual transactions of goods and services are becoming more common. Foreign markets have become more accessible. A person can effortlessly purchase goods and/or services from the internet. With a click of a button, money can be transferred from one bank account to another via a simple mobile application. Many selective inclusions and/or – exclusion made – including in tax systems – are based on the past where the world was not so accessible as it is now. Consequently, they are no longer applicable to the emerging digital world and a subject can fall (or fail to fall) under the scope of a rule without it being the intention of the rule-maker. In taxation, this has resulted in discussions about tax reforms and how these digital goods and services should be taxed.

As a result of the selective inclusions and exclusion made, rules may be *over*- or *under inclusive*.[22] A rule is *over inclusive* when a behavioural pattern of a subject falls under the scope of the rule, without it being the purpose of the rule-maker.[23] A rule is *under inclusive* when a subject fails to fall under the scope of a rule, even though the behavioural pattern is clearly unwanted and not in accordance with the purpose of the rule-maker.[24] *Over-inclusiveness* and *under-inclusiveness* do not contribute to the effectiveness of a rule[25], because the outcome of the rule is not in accordance with the purpose and intention of the rule-maker. Furthermore, *over-inclusiveness* and *under-inclusiveness* do not contribute to the fairness of a rule[26], because in the first case the subject is forced to face the consequences of the rule, while in the second case the subject is freed from the consequences of the rule, which is obviously not the intention of the rule-maker.

As mentioned above, selective inclusions and selective exclusions are not subject to change. Consequently the probability of *over*- and *under inclusiveness* of a rule increases over time. This is why a rule maker has to constantly be re-evaluating the selective inclusions and exclusions made in a rule. For example, consider the classic 'vehicle in the park' example given by Hart[27] and Fuller[28], in which a rule states that all vehicles are prohibited

[21] Inspired by: Chapter 10 (pp. 235 - 260) in Braütigam, D., Fjeldstad, O. H., & Moore, M., (2008), Taxation and state building in developing countries, Cambridge.
[22] Schauer, F., 'Formalism', (March 1988), The Yale Law Journal, Vol 97, No. 4, p. 548
[23] Kaplow, L., 'Rules versus Standards: An Economic Analysis', (1992), Duke Law Journal, Vol 42, No. 3, Duke University School of Law, p. 591.
[24] Kaplow, L., 'Rules versus Standards: An Economic Analysis', (1992), Duke Law Journal, Vol 42, No. 3, Duke University School of Law, p. 591.
[25] Nieuweboer, M., 'Tax law as a decision making process', (2015), p. 6.
[26] Nieuweboer, M., 'Tax law as a decision making process', (2015), p. 6.
[27] Hart, H., 'Positivism and the Separation of Law and Morals', (1958), Harvard Law Review.
[28] Fuller, L., 'Positivism and Fidelity to Law: A Reply to Professor Hart', (Feb. 1958), Harvard Law Review, Vol. 71, No. 4.

access to a certain park. The purpose of the rule-maker is that – by implementing this rule – he wants to ensure a quiet, peaceful, safe and pollution free environment in the park. If the literal formulation of the rule is taken into account, the rule-maker considers all vehicles to be a nuisance.

Now consider a person who decides to take a bike ride in the park. A bicycle – being a form of transportation and thus a vehicle – is prohibited to enter the park, because it falls under the scope of the rule. In other words – despite the fact that a bicycle does not cause any noise and is very eco-friendly – it is still prohibited from entering the park. This rule results in *over-inclusiveness*, because a noiseless vehicle falls under the scope of the rule without it being the actual purpose of the rule-maker for implementing this rule in the first place.

On a certain day a group of patriotic individuals want to place a historic truck in the park to serve as a war memorial monument.[29] Besides being a monument, the truck still works perfectly fine. Considering the function of the truck – a monument – the vehicle will be no nuisance to individuals in the park. On the contrary, it may even become a sight where individuals can quietly reflect on their ancestors during the war. However, according to the literal formulation of the rule, the truck is not allowed to enter the park. Again, the rule is *over-inclusive*; a truck is prohibited access to the park solely because it is a vehicle. This outcome is not in accordance with the purpose of the legislator, because the truck does not cause any nuisance.

1.2.3 Advantages

Fairness

Besides disadvantages – as discussed in the previous paragraph – there are several advantages of a rule-based decision-making process.[30] Rules – first of all – advocate *fairness*.[31] A subject who falls under the scope of a rule will face the same outcome as another subject who also meets the criteria of a rule. In other words, rules treat cases that are the same in a similar manner, and cases that are not similar are treated differently based on their differences. Since – for example – the law seeks to promote *fairness*, this argument for rule-decision making-process is powerful.

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[29] Fuller, L., 'Positivism and Fidelity to Law: A Reply to Professor Hart', (Feb. 1958), Harvard Law Review, Vol. 71, No. 4.

[30] Schauer, F., 'Playing by the rules: A Philosophical Examination of Rules-based Decision making in Law and in Life', (1991), Oxford University Press, New York, p. 135.

[31] Nieuweboer, M., 'Tax law as a decision making process', (2015), p. 6.

Predictability

Second of all, rules are *predictable*.[32] In the previous paragraph the predictability of a rule was presented as being a mechanism for subjects to artificially bend the formulation of the rule to their advantage. It is important to note that this predictability and consistency of a rule also contributes to the (legal) certainty of the rule. As a result of the clearness of a rule, a subject can predict ex-ante[33] what the consequences are of certain behavioural patterns. This gives the subject a sense of security.

Efficiency

A rule is also *efficient* for the subjects and rule-enforcers. If and when a rule is more lucidly formulated, the subject can then easily, quickly, and cheaply interpret it and predict the outcome. A subject has to only take into consideration the relevant facts specified in a rule and not other potentially relevant circumstances and facts.[34] Because the subjects better understands a rule, they can better comply with it. Consequently, clear stated rules use less resources of a (legal) system.

Effectiveness

According to Braithwaite, a rule is *effective* depending on the circumstances.[35] A rule is – generally – *effective* when the outcome is successfully in accordance with the purpose and intention of the rule-maker. If the behavioural pattern that a rule-maker wishes to contest is stable, does not have a large sum of financials at stake or economic impact, and has a low degree of complexity, then a rule is effective.[36]

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[32] Braithwaite, M., 'Making tax law more certain: a Theory', (2002), Centre for Tax System Integrity Research School of Social Sciences, Australian National University, Canberra, p.54.
[33] Kaplow, L., 'Rules versus Standards: An Economic Analysis', (1992), Duke Law Journal, Vol 42, No. 3, Duke University School of Law, p. 565.
[34] Nieuweboer, M., 'Tax law as a decision making process', (2015), p. 7.
[35] Braithwaite, J., 'Making tax law more certain: a Theory', (2002), Centre for Tax System Integrity Research School of Social Sciences, Australian National University, Canberra, p.52.
[36] Braithwaite, J., 'Making tax law more certain: a Theory', (2002), Centre for Tax System Integrity Research School of Social Sciences, Australian National University, Canberra, p.75.

The allocation of power

The *allocation of power* is also an advantage of rule-based decision-making process.[37] A rule does not only formulate the criterion that triggers it and the outcome, but it also limits the power of the decision-maker. In other words, the decision-maker cannot easily influence the outcome of a rule because his power is limited by the rule. Rule-based decision-making is not prone to misleading judgements of a decision-maker.

Paragraph 1.3 – Principle-based decision-making

1.3.1 Introduction

Principles are vague standards made by a rule- or principle-maker. As Raz states: "rules prescribe relatively specific acts; principles prescribe highly unspecific actions".[38] Unlike rules, principles have an *ex-post* approach.[39] To clarify this, consider the classic speed limit example also mentioned above.[40] A rule will state: 'the maximum speed limit is 80 kilometres per hour'. A principle – on the other hand – will have a more broad formulation such as: 'do not drive recklessly'. In the latter, the speed limit is open for interpretation. In this case, *after* the facts and circumstances are known the decision-maker will decide if a subject was driving at an excessive speed. The decision of the decision-maker has to be in accordance with the purpose of the rule-maker. In other words, the standard or principle – 'do not drive recklessly' – is dominant. Principle-based decision-making determines the outcome of certain behavioural patterns on a *case-by-case basis.*[41] In this case, all relevant facts, circumstances, and relationships are taken into account. Examples of these circumstances are the weather, traffic, road conditions, and the time of day.

1.3.2 Disadvantages

Predictability

Unlike rules, principle- and standard-based decisions are *less predictable* and *certain*. Principles are derived from society's view on certain matters. According to Raz, "Principles, because they prescribe highly unspecific acts, tend to be more vague and less certain than rules."[42] Principle-based decision-making does not allow a subject to predict *ex-ante* what the outcome of his actions will be. Take the speed limit example presented in the previous introduction paragraph into account. In the rule-case, a subject can predict that if he drives at

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[37] Schauer, F., 'Formalism', (March 1988), The Yale Law Journal, Vol 97, No. 4, p. 543.
[38] Raz, J., 'Legal Principles and the Limits of Law' (1972), *Yale Law Journal*, p. 81.
[39] Kaplow, L., 'Rules versus Standards: An Economic Analysis', (1992), Duke Law Journal, Vol 42, No. 3, Duke University School of Law, p. 560.
[40] Such as G. Cooper in: Cooper, G.S. 'The Design and Structure of General Anti-Tax Avoidance Regimes', (2009), Bulletin for International Taxation, p. 28.
[41] Nieuweboer, M., 'Tax law as a decision making process', (2015), p. 6.
[42] Raz, J., 'Legal Principles and the Limits of Law' (1972), *Yale Law Journal*, p. 81.

a speed limit exceeding 80 kilometres per hour, he/she will fall under the scope of the rule. In the principle-based case, the subject does not know what is meant under 'reckless driving'. Consequently, in specific circumstances, the subject does not know exactly when he/she falls under the scope of a rule. This does not contribute to (legal) certainty of the subject. According to Braithwaite, since the law should strive for more *certainty* and *reliability*, it is more logical that rules should be used as an instrument to contest certain behavioural patters, instead of principles.[43] Rules are more certain than principles and therefore more predictable. Furthermore, a web of principles can lead to principles contradicting each other.[44] This – again – does not contribute to the legal certainty of a subject.

The allocation of power

As a result of the *ex-post approach* of principle-based decision-making, the discretionary power to determine the outcome thereof is shifted towards the rule-enforcer. The rule-enforcer determines on a *case-by-case basis* – taking all the relevant facts and circumstances into account – what the outcome will be. Consequently, the outcome is prone to judgements of the rule-enforcer.[45] Factors such as the mood, education, temper, and beliefs of the rule-enforcer will play a big roll in the decision-making process. Depending on the economic situation in a country a rule-enforcer can be more eager to lead the outcome in a direction where the subject is worse off. Take the speed limit example into consideration. Consider a scenario where police officers receive a bonus based on the revenue collected from fines. If a broad principle is used to contest excessive speeding, police officers will tend to hand out more fines. This can result in a situation where a rule-enforcer treats each case differently, even though they are very much alike.

1.3.3 Advantages

Effectiveness

Many experts – such as Happé and Cooper – argue for a more principle-based decision-making approach. Besides the disadvantages of principle-based decision-making process, there are also many advantages. According to Cooper, principle-based decision-making process is *effective*.[46] In this case, the principle or standard is dominant. The rule is not in the fore-font. The literal formulation of a rule is ignored, and the actual underlying

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[43] Braithwaite, J., 'Rules and Principles: a Theory of Legal Certainty', (2002), Australian Journal of Legal Philosophy, p. 9.

[44] Braithwaite, J., 'Rules and Principles: a Theory of Legal Certainty', (2002), Australian Journal of Legal Philosophy, p. 5

[45] Schauer, F., 'Formalism', (March 1988), The Yale Law Journal, Vol 97, No. 4, p. 543.

[46] Cooper, G.S., 'Legislating Principles as a Remedy for Tax Complexity' (2010), Issue No. 4, British Tax Review, p.12.

purpose of the rule-maker is set in the forefront. Therefore, the rule-enforcer can better apply an outcome that is in accordance with the purpose and intention of the rule-maker.

Flexibility

Furthermore, principles are *flexible*. Flexibility is measured by the degree of application of a principle as society changes over the years. Since in the case of principles or standards the underlying purpose of the rule-maker is the most important aspect, a decision-maker should look through the written formulations and at the actual purpose of the rule-maker. Therefore, as society changes, the underlying purpose of the principle maintains important.

Efficiency

Another advantage of principle-based decision-making is *efficiency*.[47] Rules can be very detailed and complex. Principles – on the other hand – are less detailed and, in an ideal situation, the purpose of the rule-maker is more straightforward. Therefore, by implementing principles instead of rules, the rule-maker will not only spend less time on making rules, but also on adjusting them for changes in society. Consequently, less resources of the (legal) system will be used.

Paragraph 1.4 – Summary

Table 1 summarizes principle- and rule-based decision-making processes. The 'X' used is the table has to be seen as a relative indication. For example, rules are relatively more predictable than principles. A principle – on the other hand – is relatively more effective than a rule. It is important to note that the fact the principles denotes more X's does not automatically indicate that a principle is relatively better than a rule. Depending on the preferences of a rule-maker, and the degree of importance he/she attaches to one of these factors, the rule-maker will choose a method accordingly.

[47] Cooper, G.S., 'Legislating Principles as a Remedy for Tax Complexity' (2010), Issue No. 4, British Tax Review, p.12.

Table 1

	Predictability	Effectiveness	Efficiency	Flexibility	Power-allocation towards decision-maker	Fairness
Rules	X		X			X
Principles		X	X	X	X	

Efficiency: depending on the circumstances, a rule or a principle is more efficient.

2. The Role of Principle- and Rules-based decision-making in Taxation

Paragraph 2.1 – Introduction

Tax avoidance is a problem that – generally – all tax systems in the world face. Depending on the seriousness of the tax avoidance – often driven by the urgent need of funding the deficit of the public finance in the country – the legislator will tackle this problem. In this thesis tax avoidance schemes will have the following characteristics.[48] First of all, the scheme has to be *artificially constructed*. This implies that the same outcome could have also been achieved by means of less- or simpler transactions. In other words, the taxpayer has made the construction unnecessarily complex. Second of all, the outcome of the scheme is *not in accordance with the purpose of the legislator*. Even though the outcome is legal, it is not in line with what the legislator had in mind. Another characteristic of tax avoidance is the *budgetary consequence*. Certain transactions result in an outcome where the taxpayer pays less tax, compared to the situation where these transactions did not take place. In other words, the taxpayer receives a tax advantage. A common tax-avoidance scheme is profit shifting, where the tax base of a company is transferred to a low-taxed jurisdiction, without the company having any (economic) substance in that jurisdiction.

The most common method used for contesting tax-avoidance schemes is by enacting a Specific Anti-Avoidance Rule (SAAR). A General Anti-Avoidance Rule (GAAR) is – on the other hand – often used as a last resort method for contesting tax avoidance schemes.[49] Countries such as Australia and Canada are known for implementing GAAR's to contest tax avoidance schemes.[50] In the Netherlands the term *fraus legis* is used. This term equates to a principle similar to a GAAR.

In this chapter the definition, characteristics, advantages, and disadvantages of a GAAR and SAAR will be discussed. Also, the term *fraus legis* will be discussed. Furthermore, the *effectiveness* of a GAAR and SAAR will also be discussed. A GAAR or SAAR is *effective* when the outcome is successfully in accordance with the purpose and intention of the legislator. In other words, the legislator has successfully contested a tax avoidance scheme by means of a GAAR or SAAR.

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[48] Zelenak, L., 'Codifying Anti-Avoidance Doctrines and Controlling Corporate Tax Shelters', (2001), SMU Law Review, Vol. 54, p. 178.

[49] Cooper, G.S., 'The Design and Structure of General Anti-Tax Avoidance Regimes', (2009), Bulletin for International Taxation, p. 26.

[50] Braithwaite, J., 'Making tax law more certain: a Theory', (2002), Centre for Tax System Integrity Research School of Social Sciences, Australian National University, Canberra, p.9.

Paragraph 2.2 – General Anti-Avoidance Rule

2.2.1 Introduction

A GAAR is used in tax-systems and is similar to principle-based decision-making. It is seen as a rule of principle(s). Certain behavioural patterns fall under the scope of a GAAR when the main purpose of the transaction(s) is to receive a tax benefit. In this case, the transaction(s) was artificially constructed and did not have a business-like purpose.[51] The GAAR contests abusive tax-avoidance schemes that are not in accordance with the purpose of the legislator. The purpose of the legislator is to contest abusive schemes that erode the tax base. The purpose of the legislator corresponds to the underlying principle of the GAAR. Taking the principle-driven GAAR into consideration, the tax inspector and courts will determine – on a case-by-case basis – whether the transaction(s) is tax-driven.

In short, if the decisive motive for conducting the transaction(s) is to receive a tax benefit and the scheme is not in accordance with the purpose of the legislator, because it is abusive, then the taxpayer will fall under the scope of the GAAR. In this case, the taxpayer will be deprived from the benefits resulting from the tax avoidance scheme.[52]

2.2.2 Disadvantages of GAAR

Uncertainty & discretionary power

A GAAR is principle-based. In other words, a broad principle is used to contest tax-avoidance schemes. However, there is a degree of indistinctness and uncertainty in the definition and explanation of a GAAR.[53] The purpose of the legislator is to contest *abusive* tax-avoidance schemes, but it is not clear when a transaction is abusive. A taxpayer can predict in which direction the legislator is pointing regarding abusive tax-avoiding transactions. However, a taxpayer cannot predict with a sufficient degree of certainty which transactions fall under the scope of a GAAR. As a result, a taxpayer cannot predict ex-ante what the tax consequence of a tax-related transaction will be. This does not contribute to the legal certainty of taxpayers. Joseph Raz shares this vision; a GAAR does not contribute to the openness and clearness of the law. As a result of the broad and indistinct formulation of a GAAR – and what exactly falls under abusive tax avoidance – the discretionary power is shifted towards the tax inspector and the courts.[54] The characterisation of abuse depends too

[51] Braithwaite, J., 'Making Tax Law More Certain: A Theory', (2002), Centre for Tax System Integrity Research School of Social Sciences, Australian National University, Canberra, p.2.

[52] Arnold, B.J., 'The Long, Slow, Steady Demise of the General Anti-Avoidance Rule', (2004), Canadian Tax Journal, p. 492.

[53] Cooper, G.S., 'The Design and Structure of General Anti-Tax Avoidance Regimes', (2009), Bulletin for International Taxation, p. 27.

[54] Cooper, G.S., 'The Design and Structure of General Anti-Tax Avoidance Regimes', (2009), Bulletin for International Taxation, p. 28.

much on the tax inspector and judge, since the GAAR only provides principles and guidelines.

Over-inclusiveness

Another disadvantage of a GAAR is that it can be *over-inclusive*.[55] It is evident that taxpayers do as much as possible to pay as little tax as possible. After all, minimizing expenses of an organisation with a commercial goal is a standard and a business-like motive.[56] Many companies spend a great deal of money on professional- and creative tax advice in order to achieve this goal. It is important to note that not all taxpayers are intentionally acting against the law, the GAAR, and its underlying purpose. Therefore, it is difficult to distinguish abusive tax planning from moderate tax planning. The latter does not challenge the purpose of the legislator. It is important to note that the tax avoidance in question is an abusive one.[57] The definition of what an abusive transaction is, or to what extent responsible tax planning can be done is subject to the tax inspector and courts.[58] Especially in times a financial distress the tax authorities might tackle a wider range of tax planning. In this case, the GAAR is *over-inclusive*; the taxpayer falls under the scope of a GAAR without it being the purpose of the legislator. Furthermore, tax planning often consists of a series of transactions. Not all the transactions in this series are abusive. Consequently, because the abusive transactions are difficult to distinguish from the non-abusive transactions, often non-abusive transactions also fall under the scope of a GAAR without it being the purpose of the legislator.

The *over-inclusiveness* of a GAAR does not contribute to the *effectiveness* thereof, because the outcome of the GAAR is not successfully in accordance with the purpose and intention of the legislator. Also, *over-inclusiveness* does not contribute to the *fairness* of the legislation, because transactions that are factually not the same are not treated differently based on their differences.

As discussed in the previous paragraphs, if a GAAR applies, the taxpayer will be deprived from the tax benefit resulting from an abusive tax-avoidance scheme.[59] No

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[55] Edgar, T., 'Building a Better GAAR', (2008), Virginia Tax Review, p. 874.
[56] Arnold, B.J., 'The Long, Slow, Steady Demise of the General Anti-Avoidance Rule', (2004), Canadian Tax Journal, p. 504.
[57] Cooper, G.S., 'The Design and Structure of General Anti-Tax Avoidance Regimes', (2009), Bulletin for International Taxation, p. 29.
[58] Aaronson, G., 'GAAR Study: a study to consider whether a general anti-avoidance rule should be introduced into the UK tax system', (11 November 2011), HM Treasury, p. 4.
[59] Arnold, B. J., 'The Long, Slow, Steady Demise of the General Anti-Avoidance Rule', (2004), Canadian Tax Journal, p. 492.

additional penalties are levied.[60] Penalties only apply when the taxpayer is accused of gross negligence or fraud. Given the literal formulation of tax rules, a taxpayer can construct a scheme in order to avoid the consequences thereof. It is important to note that the taxpayer has not acted illegitimately, which is why no lawsuit can be filed, and no fine can be levied. In other words, the only risk that a taxpayer takes when participating in an abusive tax-avoidance scheme is that he will be deprived from the tax benefit resulting from that scheme.[61] As a result, abusive tax-avoidance schemes have increased over the years, because the benefits resulting from the scheme is relatively larger than the risks.

Effeciency

A GAAR can weigh heavily on the resources of the tax authority and courts, because abusive tax-avoidance schemes are not easily recognised.[62] Not all tax-avoidance schemes are illegal and fall under the scope of a GAAR. Minimizing tax costs is a perfectly logical, legal and business-like reason for companies to perform certain transactions. These schemes should be separated from abusive tax-avoidance schemes. As mentioned above, abusive schemes are not easily identified, because they are often related to a series of transactions. Separately distinguishing these transactions may come at the expense of the authority's resources. A GAAR can therefore be *inefficient*.

2.2.3 Advantages of GAAR

Effectiveness

A GAAR is most effective in situations where the underlying principle of a specific tax rule is straightforward.[63] Only in these cases identifying abusive tax-avoidance behaviour is more evident. Arnold also shares this view; a GAAR is most effective when applied to steady cases with a low degree of complexity, and where the economic stake is not too high.[64] The British Treasury Department states in an article: "Making the principle apparent on the face of the legislation would … promote fairness and consistency in tax treatment… [It] should be more difficult for avoiders to argue that a scheme does not contravene

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[60] Luja, R.H.C, 'Regulation of Corporate Tax Avoidance in the Netherlands', (December 2010), Electronic Journal of Comparative Law, vol. 14.3, http://www.ejcl.org/143/art143 12.pdf, p. 8.

[61] Arnold, B.J., 'The Long, Slow, Steady Demise of the General Anti-Avoidance Rule', (2004), Canadian Tax Journal, p. 492.

[62] Weisbach, D.A., 'An Economic Analysis of Anti-Tax-Avoidance Doctrines', (2002), American Law and Economics Association, p. 103.

[63] Aaronson, G., 'GAAR Study: a study to consider whether a general anti-avoidance rule should be introduced into the UK tax system', (11 November 2011), HM Treasury, p. 7.

[64] Arnold, B.J., 'The Long, Slow, Steady Demise of the General Anti-Avoidance Rule', (2004), Canadian Tax Journal, p. 510.

principles than to argue that a scheme meets the literal requirements of the statute."[65] In other words, because the rule is not in the forefront, the subject cannot easily justify a behavior that does not meet the purpose of the legislator. A GAAR is *effective* when the outcome is successfully in accordance with the purpose and intention of the legislator. It is important that taxpayers, tax inspectors, and the courts understand what these principles – and targeted abusive behaviours – are.[66] In the case of a carefully formulated GAAR and where the underlying principle is evident, the court can better make a decision that is in accordance with the purpose of the legislator. According to Aaronson, in this case, a moderate GAAR should be enacted that tackles only abusive tax schemes, and not responsible tax planning.[67] The GAAR is not effective in those cases where the underlying purpose of the tax rule is not straightforward. In these cases, distinguishing moderate tax planning from abusive tax planning is difficult. As a result, the discretionary power is shifted towards the tax authorities.

Flexibility

Over the years, the application of a GAAR is *timeless* and *flexible*. Since the GAAR is a rule of principles, the principle of the rule is the most important aspect. The core of the principle is to contest abusive tax planning. It is of little importance if the society of law changes, the underlying principle will remain dominant. As a result, a GAAR can last for years.

2.2.4 Fraus-legis

Fraus-legis is an anti tax-avoidance doctrine used in many European countries, including the Netherlands. The term fraus-legis dates back to the Roman law. It is a broad and general doctrine often used as a last resort when no other judicial instrument applies to contest abusive tax-avoidance schemes.[68] In other words, fraus-legis is seen as the last 'weapon' of the Tax Supreme Court that can still be used to prevent that the law is being used in a manner that is contrary to its purpose. A transaction falls in the scope of the fraus-legis doctrine when the *motive condition* and the *standard condition* are met.[69]

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[65] HM Treasury and HMRC, 'Principles-based Approach to Financial Products Avoidance: a Consultation Document', (December 2007), http://customs.hmrc.gov.uk.
[66] Nieuweboer, M., 'Tax law as a decision making process', (2015), p. 7.
[67] Aaronson, G., 'GAAR Study: a study to consider whether a general anti-avoidance rule should be introduced into the UK tax system', (11 November 2011), HM Treasury, p. 4.
[68] Niessen, R.E.C.M., 'Fraus legis in de 21e eeuw', Nederlands Tijdschrift voor Fiscaal Recht, p. 1, http://www.ndfr.nl/link/NTFRB2011-6
[69] Van der Geld, J.A.G., 'Hoofdzaken vennootschapsbelasting' (2014), Kluwer, Deventer, p.116.

The *motive condition* is met when receiving tax benefits is the main or decisive purpose of a transaction. Such transactions often have a high degree of complexity and artificiality. The same commercial outcome could have also been accomplished by means of a more simple transaction. The written contract of a transaction or relationship is not relevant, but the actual purpose of the taxpayer regarding the transaction or relationship is. In other words, the transaction(s) is tax-driven.

The *standard condition* is met when the transaction or relationship – leading to the reduction of the tax burden – is in violation with the purpose and intent of the legislation. There is no tax avoidance scheme when a taxpayer simply chooses a more economical construction that is inherent in the law. The point is that the taxpayer seeks a tax advantage that is clearly not intended by the legislator.

Paragraph 2.3 – Specific Anti-Avoidance Rule

2.3.1 Introduction

A frequently used method by legislators to challenge abusive tax avoidance schemes is by enacting a SAAR. A SAAR is comparable to rule-based decision-making. These specific rules build a bridge between the criteria of an abusive tax-avoidance scheme and the consequence thereof. In this case, the rule is dominant. For example, consider article 20 CITA 1969 in the Dutch corporate income taxation. This article states that a loss is attached to an entity. In other words, only that entity is allowed to deduct the loss from its income. If this SAAR was not enacted, a relatively easy way for deducting losses is by taking-over an unprofitable entity with deductible losses. This SAAR states that – generally – the take-over of an unprofitable entity does not imply that the acquiring entity can (limitlessly) deduct the losses.

Another example of a SAAR enacted in the Dutch tax system is article 13 paragraph 9 till 15 CITA 1969. This section of the law states that the participation exemption is denied, and replaced, by a foreign tax deduction when the (non business-related) subsidiary is directly or indirectly situated in a low-tax jurisdiction. If this anti-abuse rule was not enacted, by transferring movable capital to a subsidiary in a low tax jurisdiction, the parent entity would receive a tax exemption on the dividends paid by the subsidiary, and – on the other hand – the subsidiary would be subject to little or no profit tax, because its situated in a low tax jurisdiction.

These specific rules are enacted in order to prevent certain unwanted and abusive behavioural patterns. In this paragraph the characteristics, advantages, disadvantages and effectiveness of a SAAR will be discussed.

2.3.2 Disadvantages

Creative compliance

A SAAR is a clear, exact and predictable rule enacted by the legislator to contest abusive tax planning. As a result of the clearness and predictability of a SAAR, a taxpayer can predict *ex-ante* what behavioural pattern leads to the implementation of the SAAR. Consequently, the taxpayer can creatively use the precise formulation of a SAAR to his advantage. This phenomenon is called creative compliance.[70] In other words – by creatively complying with the rule – the taxpayer has created a loophole, which results in avoiding the implementation of the SAAR and not paying his fair share.[71] Note that these rule-dodging actions done by taxpayers are not necessarily illegal, but they are surely not in accordance with the purpose of the legislator, which is to contest abusive tax planning. Furthermore, since a SAAR is not subject to the principle of the rule, but rather the formulation thereof, the tax inspector and courts are also tempted to stretch the formulation in such manner that the outcome is more in accordance with the purpose of the legislator.[72] This contributes to the uncertainty of the legislation.

Complexity

Depending on the (budgetary) seriousness of the tax-avoidance scheme, the legislator will cover the loophole by enacting a new SAAR. Consequently a vicious cycle is creating between drafting new SAAR's and rule dodging.[73] As a result of this vicious cycle, the tax system becomes very *complex*. Only wealthy taxpayers – such as multinationals – will be able to afford high quality tax advise in order to find a silver lining in the midst of the chaos of rules. Other – less wealthy taxpayers – cannot afford such costly tax advice. For these taxpayers the law becomes very *uncertain*, because while they are complying with a SAAR, they cannot predict when or for how long the SAAR is applicable, since a 'cat and mouse' scenario is going on between legislators and wealthy taxpayers.[74]

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[70] Robertson, D., 'Judicial Discretion in the House of Lords', (1998), Oxford University Press,
p. 48.

[71] Happe, R.H., 'Belastingrecht en de geest van de wet' (2011), Tilburg University, p. 7.

[72] Aaronson, G., 'GAAR Study: a study to consider whether a general anti-avoidance rule should be introduced into the UK tax system', (11 November 2011), HM Treasury, p. 5.

[73] Happe, R.H., 'Belastingrecht en de geest van de wet' (2011), Tilburg University, p. 7.

[74] Braithwaite, J., 'Making Tax Law More Certain: A Theory', (2002), Centre for Tax System Integrity Research School of Social Sciences, Australian National University, Canberra, p. 57.

Flexibility

Unlike a GAAR, a SAAR is not *timeless* and *flexible*. As discussed above – because the principle is not in the forefront and the rule is very precise and predictable – a taxpayer can avoid paying tax by creatively complying. In other words, the taxpayer has created a loophole. Each time the taxpayer creates a loophole, society changes, or the law changes the legislator has to enact a new SAAR or adjust the old one. Thus, a SAAR is not subject to change. It is important to note that the constant adjusting and drafting of SAAR's weighs heavily on the resources of the judicial system and the government.

2.3.3 Advantages

Predictability and allocation of power

A SAAR is a rule of rules, and therefore clearly formulated rule is predictable. The taxpayer knows precisely which abusive tax-avoidance behaviour the legislator seeks to contest. The predictability of a SAAR eases the taxpayer, and it contributes to the legal certainty.[75] Furthermore – unlike a GAAR – the identification of tax-avoidance is not dependent on the subjective interpretation of the tax administrator or judge. In other words, the power to determine the outcome is not shifted towards the tax administrator or judge.

Paragraph 2.4 – Summary

Table 2 summarizes the effectiveness of a GAAR and a SAAR. In table 1 attention is paid to other – more general – characteristics of rules and principles. These characteristics also – generally – apply to GAAR's and SAAR's.

Table 2

	Effective	
	Short run	Long run
General Anti-Avoidance Rule	YES, but only if the underlying principle is straightforward	YES, only if additional penalties are imposed
Specific Anti-Avoidance Rule	YES	NO (creative compliance)

[75] Cooper, G.S., 'The Design and Structure of General Anti-Tax Avoidance Regimes', (2009), Bulletin for International Taxation, p. 28.

3. Anti-Abuse Interest Rule in the Dutch Corporate Tax concerning Affiliated Groups

Paragraph 3.1 – Introduction

A taxpayer can avoid tax by purposely lowering the tax base, without crossing any legal boundaries. If this is done in an artificial manner, this phenomenon is called base-erosion. In the recent years many countries are becoming more concerned about tax-avoidance and base erosion within multinational companies. After all, a company situated in a country uses that country's public resources, and should therefore pay their fair share. Also, the relatively low tax burden of multinationals – compared to national companies – has sparked controversy.[76] As a result, the OECD and G20 have started the 'Base Erosion and Profit Shifting' initiative, also known as BEPS.

The tax base has an income and cost component. In order to lower the tax base a taxpayer can either lower the income, increase the costs, or both. In general, groups will want to allocate income to the low-rate jurisdictions and expenses to high-tax jurisdictions. In this thesis, base erosion by means of artificially creating loans – and therefore deductible interest expenses – within a group of affiliated entities will be discussed.

It is said that the Dutch corporate tax system discriminates against equity.[77] As a result of the *classic system*[78] applied in the Dutch corporate tax system, the taxpayers are motivated to use debt financing instead of equity financing. It should be no surprise that the difference in tax treatment between interest expenses and dividend has influenced taxpayers to erode the tax base by creating interest expenses. It is important to note that deducting interest expenses is not illegitimate. In fact, the Dutch legislator has permitted interest cost deduction; but if – on the one hand – interest is deductible from the income of the debtor and – on the other hand – the interest revenue is barely or not at all subject to a profit tax, and the creditor and debtor are – economically – the same person, an unwanted tax advantage arises. In other words, taxpayers could – at any time – enter into an artificially constructed loan contract with an affiliated entity in order to create deductible interest costs. The taxpayer can artificially create a loan with an affiliated company – by converting equity into loan with a long-term payment schedule – by means of distributing dividend, contributing capital to an affiliated entity, receiving a refund of the invested capital in an affiliated entity, or even by the acquisition or expansion of the share in an affiliated entity. In these cases a creditor and debtor relationship is created between affiliated entities, without the presence of a business-like purpose, such as restructuring the company.

[76] Van der Geld, J., 'Hoofdzaken vennootschapsbelasting' (2014), Kluwer, Deventer, p. 111.
[77] Stevens, L., et al., 'Jaarboek Overheidsfinanciën 2013', p.164.
[78] Profit tax is levied on the profit of an entity. Thereafter, the distributed profit – after profit tax – to the shareholders is also taxed.

The Dutch legislator has chosen to contest group base erosion – by deducting interest expenses – by means of a specific and detailed anti-avoidance rules: article 10a CITA 1969, enacted on 1 January 1997.[79] Contesting base erosion and strengthening the fiscal infrastructure were among the important motives for the enactment thereof. Before this, the tax inspector contested interest expense base erosion – within affiliated entities – by means of article 31 of the General Tax Act (Richtige Heffing) and fraus legis (Abuse of Law).[80] Article 31 of the General Tax Act is a General Anti-Avoidance provision that challenges transactions that did not factually alter any – economic – relationships within the group of affiliated companies, and that were mainly performed in order to pay less tax. Fraus legis – as discussed in paragraph 2.2.4 – applies when a company has entered into a loan contract with an affiliated company where the main or decisive purpose of this transaction is to receive tax benefits. Furthermore, the transactions and debt is in violation with the actual purpose of the legislator.

Evidently, the legislator has chosen a SAAR for a reason. Therefore, in this chapter the specific anti-base erosion article 10a CITA 1969 will be discussed. As society and the legislation changes, and/or taxpayers become more familiar with the specific rules – and therefore avoid them – many transactions were created which did not fall under the scope of the anti-base erosion article; this has lead to legislative responses, namely the changes in article 10a CITA 1969 in 2007 and 2008. In this chapter, attention will also be paid to the differences between article 10a CITA 1969 before and after 2007.

Many tax experts and taxpayers argue that the current specific affiliated group interest-deduction article has become too complex.[81] The complexity is caused by – inter alia – details in the delineation of the tax base[82], and the different rebuttal opportunities of article 10a CITA 1969. As a result of the degree of *complexity* regarding article 10a CITA 1969, an alternative approach will also be discussed: a principle-based interest article. In this chapter, an example of a principle-based interest article will be given. The advantages and disadvantages of this broad article will also be discussed.

[79] Van der Geld, J., 'Hoofdzaken vennootschapsbelasting' (2014), Kluwer, Deventer, p. 111.
[80] Van Strien, J., 'Renteaftrekbeperkingen in de Vennootschapsbelasting', (2006), Fiscale Monografieën, nr. 119, p. 253.
[81] Evers, M., 'Een alternatief voor Santie- en Antimisbruikbepalingen', Forfaitair, 2006/170, http://www.ndfr.nl/link/FF2006-170-01, p. 1.
[82] Nieuweboer, M., 'Tax law as a decision making process', (2015), p.18.

Paragraph 3.2 – Specific anti-abuse article 10a CITA 1969

3.2.1 Introduction

In this paragraph, the history of the SAAR article 10a CITA 1969 will shortly be discussed. Furthermore, the most important components of article 10a CITA 1969 will be discussed: *the debt*, *the tainted transactions*, *the causality between the debt and tainted transactions*, *the rebuttal opportunities*, and *the criterion for affiliated entities or persons*. It is not intended to give a comprehensive description and analyses of the article; the focus lies on the degree of specificity between the different components of article 10a CITA 1969 before and after 2007. Also, the degree of *predictability*, *overkill*, *underkill*, *fairness*, and *complexity* of each component of article 10a CITA 1969 will be discussed.

The article is *predictable* when the taxpayer can predict ex-ante whether the interest expenses are deductible or not. *Overkill* occurs when transactions fall under the scope of the interest rule and suffer the consequence thereof, without it being the intention of the legislator. *Underkill* – on the other hand – occurs when a transaction(s) fails to fall under the scope of the interest article, while the characteristics of the debt or transaction(s) factually are comparable to the ones mentioned in article 10a CITA 1969. In this case, the interest expense is tax-deductible, without it being the purpose of the legislator. *Overkill* and *underkill* do not contribute to the effectiveness of the affiliated group interest-deduction article, because in these cases the SAAR article has not successfully produced the desired or intended purpose of the legislator. The purpose of the legislator is to prohibit affiliated group base-erosion by means of creating scenarios where by deducting interest, the taxpayer is transferring pre-tax income to a low tax jurisdiction. The interest-deduction article is considered to be *fair* when the same outcome applies to all taxpayers who have conducted similar transactions. Also, a different outcome must apply to taxpayers who performed different transactions. The anti-abuse interest article is considered to be *complex* when taxpayers find it difficult to understand – and therefore correctly comply – with the intricate rule. Therefore, the complexity of the interest-deduction article does not stimulate the attractiveness of the Dutch tax regime to business, such as foreign entities.[83]

3.2.2 Background information

The verdict of the case HR BNB 1996/5 – also known as the Plc-case – was the direct cause for the enactment of the specific article 10a CITA 1969 on 1 January 1997.[84] In this case, an entity established in the United Kingdom (A Plc) held all the shares in a Dutch subsidiary entity in the Netherlands (BV X) and the Dutch subsidiary BV B, also situated in

[83] Van der Geld, J., 'Hoofdzaken vennootschapsbelasting' (2014), Kluwer, Deventer, p. 164.
[84] Van der Geld, J., 'Hoofdzaken vennootschapsbelasting' (2014), Kluwer, Deventer, p. 115.

the Netherlands.[85] A Plc sold all its shares in BV B to BV X. The purchase price was converted into a loan, with A Plc as the creditor and BV X as the debtor. Shortly thereafter, a tax-consolidated group was created between BV X and BV B. Consequently; the interest expense is deductible from the profit of the tax-consolidated group. In this case, the Supreme Court has decided that fraus legis and article 31 of the General Tax Act (Richtige Heffing) could not prohibit the deduction of the interest expenses, because the interest income received by the English creditor – A Plc – was subject to a profit tax. Therefore, according to the Supreme Court, the deduction of interest is in accordance with the underlying purpose of the law. The fact that the British parent entity did not factually pay a profit tax was of little importance. In other words, interest deduction by the debtor is accepted - if the interest income received by the creditor is subject to a profit tax – even though the creditor did not factually pay a profit tax due to foreign withholding taxes, tax credits, and/or losses.[86] Evidently, the outcome was to the detriment of the Dutch tax inspector and the Dutch public treasury. As a result, on 1 January 1997 article 10a CITA 1969 was enacted. According to Van Strien, this anti-abuse article has successfully overruled the base erosion jurisprudence – concerning interest deduction – that was to the detriment of the Dutch tax inspection.[87]

Section 10a CITA 1969 is a codification and amplification of the fraus legis jurisprudence concerning interest deduction.[88] For example, unlike the interest-deduction jurisprudence, Section 10a CITA 1969 – generally – shifts the burden of proof towards the taxpayer.[89] In 2007 and 2008 Section 10a CITA 1969 was altered significantly.[90] The motives for the alterations in the Dutch profit tax legislation were to strengthen the Dutch business climate and to make the Dutch profit tax EU-proof.[91] With regard to some aspects, the scope of this article was broadened and it has become more specific. Nevertheless, the essence of the interest article has remained the same. In short, deduction of interest on loans – within affiliated group entities – is not allowed when the loan is related to certain specific tainted transactions, which are specifically denominated in this article. However, the taxpayer is able to deduct interest expenses if the taxpayer had *decisive* business-like motives for conducting these transactions, or if the interest income received by the creditor is subject to a profit tax that is in accordance with the Dutch tax standards.

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[85] Van der Geld, J., 'Hoofdzaken vennootschapsbelasting' (2014), Kluwer, Deventer, p. 123.
[86] Van der Geld, J., 'Hoofdzaken vennootschapsbelasting' (2014), Kluwer, Deventer, p. 126.
[87] Van Strien, J. 'Renteaftrekbeperkingen in de Vennootschapsbelasting', (2006), Fiscale Monografieën, nr. 119, p. 315.
[88] Kamerstukken II, 1995-1996, 24696-3, p.15.
[89] Van Strien, J., 'Renteaftrekbeperkingen in de Vennootschapsbelasting', (2006), Fiscale Monografieën, nr. 119, p. 264.
[90] Wet 'Werken aan winst', Kamerstukken, 30 572.
[91] Kok, Q.W.J.C.H., 'De Wet VPB 2007', (December 2006), Kluwer, Deventer, p. 1.

3.2.3 The amendments in 2007 and 2008

3.2.3.a Scope of article 10a CITA 1969

Since 1 January 2007, interest expenses can only be forbidden if the interest is payable to an affiliated entity or person. Also the tainted transaction(s) has to be related to that affiliated entity or person. In other words, the interest deduction anti-abuse article is now only intended for base-erosion within groups of affiliated entities.[92] The scope of this rule is therefore reduced. Furthermore, since 1 January 2007 article 10a paragraph 1 CITA 1969 is formulated in such a manner that a taxpayer does not only fall under the scope of the rule when the taxpayer conducted the tainted transaction(s) himself, but also when the tainted transaction(s) is conducted by affiliated entities and persons.[93] With regard to this component, the scope of the anti base-erosion rule is broadened.

3.2.3.b Terminological changes

As taxpayers become more familiar with the specific rules – and therefore avoid them – many transactions were created which did not fall under the scope of the anti-base erosion articles; this has lead to legislative responses, namely the changes in article 10a CITA 1969 in 2007 and 2008. Before 2007, the specific term ‘monetary loan’ was used in article 10a paragraph 2 CITA 1969 (old). As a result, by skilfully using financial leases or life annuity obligations, the taxpayer would avoid the application of article 10a CITA 1969 (old). In other words, by complying creatively, the taxpayer does not fall under the scope of the rule, resulting in the deduction of interest expenses or life annuity premiums. Evidently, this is not what the legislator had in mind. This is a classic example of *underkill.* The debt fails to fall under the scope of the interest article, while the characteristics of the debt are – economically – comparable to the ones mentioned in article 10a CITA 1969.

Consider the verdict of the Supreme Court on 11 July 2008, number 43.376. By skilfully transforming a debt into a life annuity obligation, the taxpayer did not fall under the scope of article 10a CITA 1969 (old). In this case, the life annuity obligation was related to one of the tainted transactions mentioned in article 10a paragraph 2 CITA (old): the acquisition of shares in an affiliated entity. However, as a result of the literal interpretation of a ‘monetary loan’, article 10a CITA 1969 (old) could not prohibit the deduction of the annuity premiums. It is evident that this is not what the legislator had in mind. As a result – since 2007 – the term ‘monetary loan’ was replaced by a more broad term ‘debt’. Consequently, financial lease agreements and life annuity obligations fall under the scope of

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[92] Tweede Kamer, vergaderjaar 2005-2006, 30572, nr. 3, blz. 20.

[93] Bouwman, J.N., ‘Werken aan aftrekbeperkingen: de eindstand’, Dossier VPB 2007 2007/04, p. 2.

this article. In other words, the scope of article 10a CITA 1969 (new) is broadened. Furthermore, the broad term 'acquisition of capital' used in article 10a paragraph 2 sub c CITA 1969 (old) has been substituted for a more specific term in article 10a paragraph 1 sub c CITA 1969 (new): 'distribution of profits, repurchase of invested capital, or the acquisition or expansion of capital investments'.[94]

3.2.3.c Tainted transactions

Predictability

An important advantage of the specific interest-deduction article in the Dutch corporate income tax system is the predictability thereof. The certainty and predictability is one of the main reasons why the legislator has decided tot contest group base erosion – by means of interest deduction – with a specific interest article.[95] This was mainly a response to the expressed uncertainty among entities established in the Netherlands, and the effect on the Dutch business climate. According to them, fraus legis did not contribute to the legal certainty and predictability of the tax law. Consequently, the targeted tainted transactions are now precisely given in article 10a paragraph 1 CITA 1969 (new). Therefore, the taxpayer can predict ex-ante the transactions that will fall under the scope of the rule. The predictability contributes to the legal certainty of taxpayers.

However, the predictability of the interest-deduction article is not fully justified. Often, there is a degree of uncertainty concerning the formulation of the interest-deduction articles since the tax law does not provide straightforward definitions of the terms 'tax mitigation', 'tax avoidance', and 'tax evasion'.[96] The legislator has chosen to translate these terms into a SAAR article. But, it is often not clear what the precise purpose of the legislator is. For example, when does 'legally or factually, directly or indirectly' apply in order to link interest deduction resulting from a loan with an affiliated entity and the tainted transaction mentioned in Section 10a paragraph 1 CITA 1969?[97] During the legislative process and shortly thereafter, the State secretary of Finance has made policy decisions and written explanatory notes in order to clarify these uncertainties. Consequently, a broad formulation such as 'legally or factually, directly or indirectly' becomes more precise and specific. Also, a tainted transaction can – in the course of the years – become untainted, and vice versa. It is

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[94] Kok, Q.W.J.C.H., 'De Wet VPB 2007', (December 2006), Kluwer, Deventer, p. 45.
[95] Nota nav het verslag, TK, 1995-1996, 24 696, p. 7.
[96] Luja, R.H.C, 'Regulation of Corporate Tax Avoidance in the Netherlands', (December 2010), Electronic Journal of Comparative Law, vol. 14.3, http://www.ejcl.org/143/art143 12.pdf, p. 3.
[97] Marres, O., 'Winstdrainage door renteaftrek : beoordeling van artikel 10a Wet op de vennootschapsbelasting 1969', (2005), Kluwer, Deventer, p. 308.

unclear when this occurs.[98] Many of the uncertainties in the formulation of this precise interest rule are clarified by the jurisprudence. However, this may take years. The first jurisprudence related to article 10a CITA 1969 appeared almost 10 years after the enactment thereof. The main reason why it takes long for jurisprudence to appear is because taxpayers guardedly create transactions that fall outside the scope of article 10a CITA 1969. Before conducting a transaction, professional tax advice is given, security is sought, and often advance ruling agreements or arrangements are made between the taxpayer and Tax Authority. In other words, many times cases do not even reach the courts.

Fairness

Generally, a specific anti-abuse interest rule contributes to the fairness of the tax system. The tainted transactions and relationships are precisely given in article 10a paragraph 1 CITA 1969 (new). In other words, the interest article has an *all-or-nothing* approach; either a transaction falls under the scope of the rule, or it does not. Interest expenses are not deductible for the taxpayers who have conducted a tainted transaction(s), provided that they failed to prove the rebuttal opportunities.

3.2.3.c.1 External acquisition as a tainted transaction

Since 1 January 2007, a loan – financed by an affiliated group entity or person – contracted for the acquisition of an entity that is not yet affiliated before the acquisition thereof, also falls under the scope of this rule.[99] Before 2007, the association between the taxpayer and the acquired or expanded equity investment (target company) was determined before the acquisition thereof, and not after.[100] With regards to this component, the rule is more precise, and the scope of the rule is broadened. As a result of the rebuttal opportunites in article 10a CITA 1969, if a taxpayer can prove that the conducted transaction(s) and debt had a decisive business-like purpose, the interest expenses are deductible. Therefore, article 10a paragraph 1 sub c CITA 1969 (new) only targets external acquisitions without a business-like purpose. In other words, because of the rebuttal opportunities states in article 10a CITA 1969, paragraph 1 sub c (new) does not result in *overkill.*

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[98] Van Strien, J., 'Renteaftrekbeperkingen in de Vennootschapsbelasting', (2006), Fiscale Monografieën, nr. 119, p. 327.

[99] Article 10a paragraph 2 sub c CITA 1969 (old), and article 10a paragraph 1 sub c CITA 1969 (new).

[100] Kok, Q.W.J.C.H., 'De Wet VPB 2007', (December 2006), Kluwer, Deventer, p. 52.

3.2.3.d Causality requirement

Article 10a CITA 1969 is only applicable if there is a causal relationship between the debt – financed by an affiliated group entity or person – and the tainted transactions mentioned in paragraph 1 (new) of the article. This is the core of article 10a CITA 1969. If there is no causality between the debt and the tainted transaction(s), article 10a CITA 1969 does not apply, allowing the interest expenses to be deductible. Verdicts such as HR 17 June 2005, 40 819, BNB 2005/304 gave rise to article 10a paragraph 2 CITA 1969 (new). In this case, the taxpayer – a subsidiary of a parent company situated in France – held all the shares in a Belgian subsidiary entity. A capital contribution to the Belgian subsidiary entity was followed by a loan to the French parent entity financed by the Belgian subsidiary. Shortly thereafter, the French parent entity financed a loan to the taxpayer in order to acquire the shares in an external entity. Shortly hereafter, the Belgian subsidiary financed a loan to the taxpayer in order to help pay back the previous debt contracted with the French parent entity. As a result, the tax inspector stated that article 10a paragraph 2 sub c CITA 1969 (old) applies, meaning that the interest expenses on the series of loans contracted between the affiliated entities are not deductible. According to the tax inspector, there is a causal relationship between the capital contribution and the loans. Conclusively, the Supreme Court stated that the interest expenses on the loans are in fact deductible, because at the time of the capital contribution in the Belgian subsidiary, the taxpayer had no intention of acquiring the shares in the external entity. In other words, there is no causality between the debt and the capital contribution in the Belgian subsidiary. In this case, article 10a paragraph 2 sub c CITA 1969 (old) did not apply. According to Kok, it is important to note that the Supreme Court does not hereby conclude that causality is not possible in cases where the loan follows the tainted transaction.[101] In this case, the fact that the taxpayer did not intend to acquire the external shares at the time of capital contribution in the subsidiary was decisive.

Before 1 January 2007, the State secretary of Finance has made policy decisions and written explanatory notes to provide an explanation about the symmetric causal relationship between the loan and tainted transaction(s).[102] However, the causal relationship between the loan and tainted transaction was not precisely stated in article 10a CITA 1969 (old). Since 1 January 2007 the symmetric causal relationship between the loan and tainted transaction is stated in paragraph 2 (new). Now, it is precisely stated in the corporate tax law that a transaction falls under the scope of article 10a CITA 1969, not only when the tainted transaction(s) follows the loan, but also in cases where the loan follows a tainted transaction(s). In other words, the rule has become more precise.

[101] Kok, Q.W.J.C.H., 'De Wet VPB 2007', (December 2006), Kluwer, Deventer, p. 52.
[102] Tweede Kamer, vergaderjaar 1995-1996, 24696, nr. 3, p. 18.

Overkill

Consider two newly established subsidiaries: one of them, financed by equity investments, and the other financed by debt investments. If the subsidiary financed by equity investments wishes to change its financing structure by repaying the equity investments followed by the creation of a loan, it will fall under the scope of Section 10a CITA 1969.[103] As a result of the causal relationship between the capital repayment and the debt, the interest expenses on the debt are not deductible. However, it is important to note that this transaction is not abusive. An entity has the right to finance the company with debt or equity. Therefore, the outcome is not in accordance to the purpose of the legislator, which is to contest abusive interest deduction within groups of affiliated entities. On the other hand, if the subsidiary company financed by debt investments wishes to change its financing structure – by repaying the debt, followed by equity investments – it will not fall under the scope of article 10a CITA 1969. Conclusively, entities are stimulated to finance newly established subsidiaries with debt investments, instead of equity investments.[104]

3.2.3.e Rebuttal opportunities

Since 1 January 2007 the differences in rebuttal opportunities for article 10a paragraph 1 and 2 CITA 1969 (old) have been eliminated. Before 2007, interest expenses – with regards to paragraph 1 (old) transaction(s) – were deductible if the taxpayer could prove that he had an overriding business-like motive. Interest expenses – with regards to paragraph 2 (old) transaction(s) – were deductible if the taxpayer had an overriding business-like motive, or if the creditor was subject to a profit tax that is reasonable compared to the Dutch tax system. Different transactions had different rebuttals. Now – as a result of joining paragraphs 1 and 2 (old) together – uniform rebuttal opportunities apply.

Rebuttal opportunity 1

Also, the tax inspector has the opportunity to prove that the debt or the related tainted transactions did not have a business-like purpose, and the overriding motive thereof was creating tax benefits. In this case, the taxpayer falls under the scope of article 10a CITA 1969, resulting in the prohibition of deduction of interest expenses.

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[103] Van Strien, J., 'Renteaftrekbeperkingen in de Vennootschapsbelasting', (2006), Fiscale Monografieën, nr. 119, p. 345.
[104] Van Strien, J., 'Renteaftrekbeperkingen in de Vennootschapsbelasting', (2006), Fiscale Monografieën, nr. 119, p. 345.

Rebuttal opportunity 2

The rebuttal opportunities have become more specific. Before 2007, a taxpayer could prevent the application of article 10a paragraph 2 CITA 1969 (old) if the creditor was subject to a profit tax that is considered as reasonable compared to Dutch tax standards. This was a broad rule, since a 'reasonable profit tax that is in accordance with Dutch standards' was not provided. In order to clarify the vague and unpredictable formulation of this rule, a more specific rule was given in the explanatory memorandum. In this case, a profit tax is considered to be reasonable when the tax base and tax rate is consistent with the standards applied by the OECD members regarding domestic entities and persons that are not subject to a special tax regime.[105] Article 10a paragraph 3 sub b CITA 1969 (new) states that an effective tax rate of at least 10 per cent is considered as reasonable. [106] The rule has therefore become more precise. However, this rule was too precise, allowing taxpayers to comply creatively: by skillfully choosing a jurisdiction with an effective tax rate of precisely 10 per cent, the taxpayer can deduct the interest expenses. This is a classic example of *underkill*: by complying creatively the taxpayer does not fall under the scope of article 10a CITA 1969 (new), even though the debt and/or related tainted transactions factually fall under the scope of this article. This is not what the legislator had in mind. As a result, this scheme was short lived. Since 1 January 2008 – even though the taxpayer has already proven the presence of an effective tax rate of at least 10 per cent – the tax inspector has the opportunity to prove that the transaction(s) were conducted with the overriding purpose of compensating losses – or other tax claims – arising in that year or on the short term.

Complexity

Many tax experts and taxpayers argue that the current specific affiliated group interest-deduction article has become too complex.[107] Complexity does not contribute to the legal certainty of the taxpayer. According to Aaronson, the length and complexity of the anti-abuse articles is a result of the constant drafting of rules in order to anticipate tax-avoidance schemes that some taxpayers might construct in order to avoid the rules in such a manner that is not in accordance to the purpose of the legislator.[108] In this case, the complexity is mainly caused by details in the different rebuttal opportunities. As mentioned above, since 1 January 2008 the tax inspector also has the opportunity to invalidate the already proven – by the

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[105] Tweede Kamer, vergaderjaar 1995-1996, 24696, nr. 3, p. 21.
[106] Eerste Kamer, vergaderjaar 2006–2007, 30572, C, blz. 23.
[107] Evers, M., 'Een alternatief voor Santie- en Antimisbruikbepalingen', Forfaitair, 2006/170, http://www.ndfr.nl/link/FF2006-170-01, p. 1.
[108] Aaronson, G., 'GAAR Study: a study to consider whether a general anti-avoidance rule should be introduced into the UK tax system', (11 November 2011), HM Treasury, p. 5.

taxpayer – effective tax rate of 10 per cent. As a result, the rebuttal opportunities have become very intricate.

Also, the rebuttal opportunities in article 10a paragraph 3 sub a CITA 1969 (new) states that the interest expense is deductible when the taxpayer had a predominant business-like motive to perform the transaction.[109] The burden of proof lies on the taxpayer. Proving the extent of the business-like purpose of a transaction can be very costly and complex, especially when series of transactions were performed. Furthermore, it is perfectly normal that a company seeks to minimize its costs. A company has the right to arrange its business model in such a manner that minimizes the costs. Taxes – being an expense for companies – may also be minimized to certain extent. The exact distinction between abusive tax-avoidance and responsible tax planning is unclear.

As a result of the complexity, only tax administrators and tax professionals understand the intricate SAAR article. Wealthy taxpayers – such as multinationals – are able to afford high quality tax advise in order to find a silver lining in the midst of the chaos of intricate rules in article 10a CITA 1969. However, less wealthy taxpayers cannot afford such costly tax advice in order to gain understanding of the different dimensions of the rebuttal opportunities. Consequently, for these taxpayers the law becomes very *uncertain*, and even inaccessible.[110] Furthermore, the complexity of the interest-deduction article does not stimulate the attractiveness of the Dutch tax regime to business, such as foreign entities.[111]

3.2.3.f Criterion for affiliated entities or persons

Since 1 January 2007 the criterion regarding affiliated entities or persons has also altered. Now, in article 10a paragraph 4 CITA 1969 is added that the amount of shares held by the spouse, partner, or minor children of the taxpayer, is added to the amount of shares held by the taxpayer. As a result, the scope regarding the criterion for affiliated persons have become broader and more specific.

Overkill

The criterion regarding affiliated entities and persons can have overkill as a result. Consider the precise 'one-third association' criterion given article 10a paragraph 4 and 5 CITA 1969. In short, the legislator considers entities to be affiliated when the parent company has an equity investment of or exceeding one-third in the subsidiary. In this case,

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[109] Marres, O., 'Winstdrainage door renteaftrek : beoordeling van artikel 10a Wet op de vennootschapsbelasting 1969', (2005), Kluwer, Deventer, p. 308.

[110] Braithwaite, J., 'Making Tax Law More Certain: A Theory', (2002), Centre for Tax System Integrity Research School of Social Sciences, Australian National University, Canberra, p. 57.

[111] Van der Geld, J., 'Hoofdzaken vennootschapsbelasting' (2014), Kluwer, Deventer, p.164.

the legislator considers the parent company to have an important and significant role in the management and control system of the subsidiary. However, according to Van der Geld, the legislator has not justified why an equity investment of or exceeding one third has been chosen.[112] Often, this numerical value does not correspond to the reality. It is possible that a parent company holding one third of the shares in a subsidiary has little say in that company. As a result, this numerical value does not correspond to the reality. Nevertheless, the parent company will fall under the scope of the affiliated group interest-deduction article, assuming that all other conditions are met. In other words, the downside of using precise numerical values in interest-deduction articles is that it can lead to overkill.[113] Overkill does not promote fairness, because cases who are factually not alike are treated the same.

3.2.4 Summary article 10a CITA 1969

Table 3 and 4 summarize the aspects of article 10a CITA 1969 before and after 2007.

Table 3: before 2007

	Predictability	**Overkill**	**Underkill**	**Fairness**	**Complexity**
Debt			YES (‘monetary loan’)	NO (underkill does not promote fairness)	
Tainted transactions	YES			YES (all-or-nothing approach)	
Causality		YES (newly established subsidiary entity)		NO (overkill does not promote fairness)	
Rebuttal opportunity 1					YES (when business-like purpose?)
Rebuttal opportunity 2	NO (when is a tax rate reasonable?)				
Criterion for affiliated group or person		YES (does one third association reflect reality?)		NO (overkill does not promote fairness)	

[112] Van der Geld, J., ‘De herziene deelnemingsvrijstelling’, (1990), Fiscale monografieën nr.20, Kluwer, Deventer, p. 148.
[113] Marres, O., ‘Winstdrainage door renteaftrek : beoordeling van artikel 10a Wet op de vennootschapsbelasting 1969’, (2005), Kluwer, Deventer, p. 174.

Table 4: after 2007

	Predictability	Overkill	Underkill	Fairness	Complexity
Debt			NO (broad term 'debt')		
Tainted transactions	YES			YES (all-or-nothing approach)	
Causality	YES (the new paragraph 2)	YES (newly established subsidiary entity)		NO (overkill does not promote fairness)	
Rebuttal opportunity a					YES (when business-like purpose?)
Rebuttal opportunity b	YES (reasonable tax rate is given)				YES (introduction rebuttal opportunity tax authority)
Criterion for affiliated group or person		YES (does one third association reflect reality?)		NO (overkill does not promote fairness)	

Paragraph 3.3 –Principle-based Interest Article concerning Affiliated Groups

3.3.1 Introduction

As discussed above, the affiliated group rule-based interest article 10a CITA 1969 has many disadvantages: complexity and overkill being some of them. An important motive for the legislator for enacting the SAAR article to contest abusive affiliated group interest deduction is the certainty and predictability thereof. However, in many cases the specific and complex interest articles fail to contribute to the certainty and predictability thereof. Consequently, a logical reaction would be to contest abusive affiliated group interest-deduction schemes differently. In this paragraph, a principle-based interest article – as an effective tool to contest abusive affiliated group interest-deduction – will be discussed. In other words, should the legislator enact a broad principle-based rule – such as fraus legis – in the legislation?

An example of a principle-based interest-deduction article is: *'Interest expenses and debt expenses are not deductible from a taxpayer's profit when the loan(s) is part of an abusive and artificial scheme with the overriding and decisive purpose of lowering the tax burden'*.[114] The *certainty* of an interest expense GAAR will be discussed. Furthermore, the degree of *discretionary power* of the tax inspector and courts will be discussed in this paragraph.

3.3.2 Certainty

According to Marres, replacing specific interest-deduction rules for a more principle-based interest rule will lower the degree of complexity significantly, but the complexity will be substituted for uncertainty.[115] A vague principle such as *'Interest expenses and debt expenses are not deductible from a taxpayer's profit when the loan(s) is part of an abusive and artificial scheme with the overriding and decisive purpose of lowering the tax burden'*[116] is not clearly specified. When is a transaction considered to be abusive? To what degree can a taxpayer lower its tax burden without triggering the principle?

The degree of uncertainty will decline when a significant amount of jurisprudence arises. However, this may take years. The growing amount of jurisprudence will – consequently – contribute to the complexity of the tax law. Consequently, broad principles will converge into more specific rules, and vice versa.[117] For example, consider article 10a paragraph 3 sub b CITA 1969 (new) where the convergence is noticeable: a broad principle of a 'profit tax that is in accordance with the Dutch tax standards' was converted into a precise and predictable rate of 10 per cent. Furthermore, as jurisprudence arises, one verdict might contradict or over-rule another verdict. Taxpayers have to keep track of the court verdicts and alter their behavior accordingly.

3.3.3 Discretionary Power

A broad principle-based interest article – such as the one mentioned above – increases the degree of uncertainty. The definition of what an abusive transaction is, or to what extent responsible tax planning can be done is subject to the judgment by the tax inspector and courts.[118] In other words, the distinction between moderate tax planning and

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[114] Inspired by: Marres, O., 'Winstdrainage door renteaftrek : beoordeling van artikel 10a Wet op de vennootschapsbelasting 1969', (2005), Kluwer, Deventer, p. 291.

[115] Marres, O., 'Winstdrainage door renteaftrek : beoordeling van artikel 10a Wet op de vennootschapsbelasting 1969', (2005), Kluwer, Deventer, p. 290.

[116] Inspired by: Marres, O., 'Winstdrainage door renteaftrek : beoordeling van artikel 10a Wet op de vennootschapsbelasting 1969', (2005), Kluwer, p. 291.

[117] Schauer, F., 'The convergence of Rules and Standards',(2003), New Zealand Law Review, p. 328.

[118] Aaronson, G., 'GAAR Study: a study to consider whether a general anti-avoidance rule

abusive tax planning lies in the hands of the tax authorities. As a result of the case-by-case approach of such interest principle, a taxpayer cannot predict which interest related transaction(s) is considered to be abusive, partly because the determination thereof is subject to the mood, knowledge, information, and aspirations of the tax authority. Especially when the financial interests of the taxpayer are large, the dependency on the tax inspector is very hazardous. In times a financial turmoil tax authorities might even tackle a wider range of tax planning, without this being the purpose of the legislator. Consequently, a broad affiliated group interest article – such as the one mentioned above – contradicts the predictability promoted by the 'Rule of Law'. The 'Rule of Law' indicates that the legislator decides what the law is. The government, tax authorities, courts, and taxpayers are subject to these rules. The 'Rule of Law' reflects Montesquieu's principle of separation of powers, also knows as 'Trias Politica'. In short, this principle states that the legislative, executive, and judiciary powers have to be separated. In other words, the 'Rule of Law' strongly opposes to the arbitrary effects of a government – and of other powerful subjects – on the legislation. Consequently, the 'Rule of Law' attaches great importance to the predictability of the law. In other words, a taxpayer should be able to predict ex-ante what the consequences of conducting certain transaction(s) will be.

Furthermore, in complex business structures – with many cross-boarder transactions – it is difficult to distinguish moderate interest-deduction structures from abusive ones. The discretionary power given to the tax authorities is minimized only when the general interest article is based on clear and straightforward principles.[119] In this case, the tax inspector, the courts, and the taxpayers are well aware of which transactions or relationships trigger the application of the principle. Since the Dutch tax system does not provide straightforward definitions of principles regarding 'tax mitigation', 'tax avoidance', and 'tax evasion'[120] it is difficult to distinguish abusive tax planning from moderate tax planning without giving too much discretionary power to the tax inspector and courts.

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should be introduced into the UK tax system', (11 November 2011), HM Treasury, p. 4.

119 Aaronson, G., 'GAAR Study: a study to consider whether a general anti-avoidance rule should be introduced into the UK tax system', (11 November 2011), HM Treasury, p. 7.

120 Luja, R.H.C, 'Regulation of Corporate Tax Avoidance in the Netherlands', (December 2010), Electronic Journal of Comparative Law, vol. 14.3, http://www.ejcl.org/143/art143-12.pdf, p. 3.

4. Conclusion

Paragraph 4.1 – Introduction

In this chapter the answer to the main and sub-questions will be – in short – given. Furthermore, an opinion will be given on how the legislator should – in the future – challenge corporate tax avoidance: using specific rules, principles, a combination of these two.

Paragraph 4.2 Final conclusion

Tax avoidance is a permeating problem in tax systems. In recent years, many countries are becoming more concerned with this phenomenon. There is a lot of criticism amongst governments, citizens, and national companies on multinationals that engage in abusive tax planning. According to them, multinationals have a social responsibility and should pay their fair share. It is important to note that tax planning itself is not illegal. A company has the right to arrange its business model in such manner that expenses – such as taxes – are minimized. The tax planning is question is an abusive one. In this case, the transaction(s) conducted by the taxpayer is evidently not in accordance with what the legislator has in mind. The taxpayer can interpret the literal formulation of a rule in such a manner that the taxpayer avoids the implementation thereof. In this case, the decisive motive of the transaction(s) is to pay less tax. There is a lack of a business-like motive for conducting these transactions. As a result of the increasing criticism on abusive tax planning schemes, the G20 together with the OECD have initiated the 'Base Erosion and Profit Shifting' initiative, also known as BEPS. Limiting base-erosion by means of interest deduction in one of the points of discussions of the BEPS initiative.

Legislators can choose to challenge interest deduction base erosion by means of General Anti-Avoidance Rules (GAAR) – comparable to principle-based decision-making – or by means of Specific Anti-Avoidance Rules (SAAR), comparable with rule-based decision making. In chapter two the advantages and disadvantages of the GAAR and SAAR are discussed, these advantages and disadvantages correspond with the SAAR enacted in the Netherlands to challenge affiliated groups base erosion by means of creating interest expenses.

In the Netherlands the legislator has chosen to contest interest deduction base erosion within groups of affiliated entities by means of a SAAR: article 10a CITA 1969. Before this, the legislator challenged abusive tax planning by means of fraus legis, and article 31 of the General Tax Act. These were principle-based rules. But, since many of the verdicts of the courts were to the detriment of the tax inspector, article 10a CITA 1969 was enacted. On 1 January 2007 the SAAR article 10a CITA 1969 has altered significantly. Noticeable is that many components of the rule have become more specific. For example, article 10a paragraph 2 CITA 1969 (new) was introduced to specifically state that transactions also fall under the scope of this rule when the loan follows a tainted transaction. Furthermore, a specific tax rate of 10 per cent was introduced in article 10a paragraph 3 sub b CITA 1969 (new). Nevertheless, in some aspects the rule has become broader. For example, in article 10a paragraph 2 CITA 1969 (old) the specific term 'monetary loan' was given. By creatively complying with this rule, taxpayers would prevent the application thereof. Consequently, nowadays the broad term 'debt' is used. Conclusively, a SAAR such as article 10a CITA 1969 has features of rules and of principles. Remarkable is that – over the years – these principles converge into rules, and vice versa.[121]

According to the Dutch legislator, the specific rules will contribute to the certainty and predictability of the tax legislation.[122] However, there is a degree of uncertainty amongst the interpretation and the formulation of the specific affiliated group interest-deduction article. Some of these uncertainties are clarified by jurisprudence. Nevertheless, not all uncertainties are justified. For example, how can a taxpayer prove that a transaction was driven by an overwhelming business-like purpose?

Another disadvantage of precise numerical values in an interest-deduction article is that it can lead to overkill.[123] Overkill does not contribute to the effectiveness of the interest-deduction article, because in these cases the Specific Anti-Abuse Rule has not successfully produced the desired or intended purpose of the legislator; challenge abusive tax planning within groups of affiliated entities by creating deductible interest expenses without the presence of a business-like purpose.

Furthermore, many taxpayers and tax professionals argue that the interest-deduction article 10a CITA 1969 has become too complex. The complexity is caused by – inter alia – details in the delineation of the tax base[124], and the different rebuttal opportunities. As a result, the uncertainty amongst taxpayers who cannot afford expensive and creative tax advice has increased.[125] For them, good tax advice has even become inaccessible.

As a result of the disadvantages of Specific Anti-Abuse Rules regarding interest deduction mentioned above and in the previous chapters, a logical reaction would be to take a different approach: ***'Can base-erosion within groups of affiliated entities effectively be contested by means of a principle-based interest article, instead of article 10a CITA 1969?'***

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[121] Schauer, F., 'The convergence of Rules and Standards',(2003), New Zealand Law Review, p. 328.
[122] Nota nav verslag, TK, 1995-1996, 24 696, blz. 7.
[123] Marres, O., 'Winstdrainage door renteaftrek : beoordeling van artikel 10a Wet op de vennootschapsbelasting 1969', (2005), Kluwer, Deventer, p. 174.
[124] Nieuweboer, M., 'Tax law as a decision making process', (2015), p.18.
[125] Braithwaite, J., 'Making Tax Law More Certain: A Theory', (2002), Centre for Tax System Integrity Research School of Social Sciences, Australian National University, Canberra, p. 57.

In other words, should a broad principle – such as fraus legis – be implemented in the Dutch tax legislation to contest abusive tax planning schemes by creating interest expenses within groups of affiliated entities?

According to Marres, replacing specific interest-deduction rules for a more principle-based interest rule will lower the degree of complexity significantly, but at the same time, the complexity will be substituted for uncertainty.[126] The degree of uncertainty is mostly due to the fact that the Dutch tax law does not provide straightforward definitions of the terms 'tax mitigation', 'tax avoidance', and 'tax evasion'.[127] Surely, the degree of uncertainty will decline when a significant amount of jurisprudence arises. But, as a result of the cautious and preventive handling of taxpayers in order to avoid the courts, this may take years.

Since the Dutch tax law does not provide a definition of the term 'tax avoidance', it will not always be clear when a tax-avoidance scheme is abusive, especially in cases where a series of transactions were conducted by the taxpayer. Consequently, the *discretionary power* is shifted towards the tax inspector and the courts. The distinction between moderate tax planning – which is in accordance with the purpose of the legislator – and abusive tax planning lies in the hands of the tax authorities.

A GAAR is most effective in areas in the lax law where the underlying principle of a specific tax rule is straightforward.[128] In these cases identifying the abusive tax-avoidance behaviour is more evident. The GAAR does not effectively contest tax-avoidance schemes that have a high degree of complexity, and where the economic and financial stake is too high.[129] Conclusively, base erosion by means of interest deduction within a group of affiliated entities should only be contested by means of a principle – such as fraus legis - in those areas where the underlying purpose of the legislator is evident and straightforward. In this case, the tax inspector, the courts and taxpayers understand the underlying purpose of the legislator, and can therefore make decisions accordingly. In those areas in the tax law where the underlying purpose of the legislator is not straightforward or evident – to tax inspectors, courts, and taxpayers – abusive tax avoidance schemes should be challenged by means of a SAAR. If a general principle is used to contest areas in the tax law where the purpose of the legislator is not evident, the principle will – over the years – convert into rules. Therefore, a principle is not effective is these cases.

[126] Marres, O., 'Winstdrainage door renteaftrek : beoordeling van artikel 10a Wet op de vennootschapsbelasting 1969', (2005), Kluwer, Deventer, p. 290.

[127] Luja, R.H.C, 'Regulation of Corporate Tax Avoidance in the Netherlands', (December 2010), Electronic Journal of Comparative Law, vol.14.3, http://www.ejcl.org/143/art143-12.pdf, p. 3.

[128] Aaronson, G., 'GAAR Study: a study to consider whether a general anti-avoidance rule should be introduced into the UK tax system', (11 November 2011), HM Treasury, p. 7.

[129] Arnold, B.J., 'The Long, Slow, Steady Demise of the General Anti-Avoidance Rule', (2004), Canadian Tax Journal, p. 510.

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