Chapter 1

Greece: Scope of Application of the Treaty in Case of Income from Unknown Sources

Katerina Perrou

1.1. Introduction

During the period from 2014 until 2017, massive targeted tax audits were carried out by the Greek tax administration concerning years 2010, 2011 and 2012. These audits targeted individuals that had transferred funds from banks in Greece to banks outside Greece between 2010 and 2012. Many disputes arose as a result of these audits, as many taxpayers claimed that the transfers were not of income from unknown sources but normal savings from previous years' earnings. The decision of the Greek Supreme Administrative Court,[1] Chamber B, number 435/2017, dealt with the issue of the taxation of income of an individual from unknown sources in the context of the Greece-Russia Income and Capital Tax Treaty (2000) (hereinafter Greece-Russia double tax treaty).[2]

The legal issue decided by the Supreme Administrative Court, among other issues that were discussed, was whether the relevant tax treaty would apply where non-residents were found to have acquired income from unknown sources in Greece.[3] The case was referred to the Supreme Administrative Court after an appeal on points of law was filed by a taxpayer, requesting the quashing of decision number 4759/2015 of the Athens Administrative Court of Appeals, the court of first instance that had dismissed his lawsuit against the tax authority that had assessed his taxes.

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1. GR: *Συμβούλιο της Επικρατείας* [Council of State (Greek Supreme Administrative Court)].
2. GR: Law 3047/2002 (A'200); *Convention between the Government of the Hellenic Republic and the Government of the Russian Federation for the Avoidance of Double Taxation and for the Prevention of Fiscal Evasion with Respect to Taxes on Income and on Capital* (26 June 2000), Treaties IBFD [hereinafter Greece-Russia double tax treaty].
3. Decisions of the Supreme Administrative Court are final and have a "precedent-like" value, as, once a decision of the Supreme Administrative Court on a point of law has been issued, no new appeals on the same point of law are permitted ("*acte éclairé*").

1.2. Facts of the case

The case concerns an individual taxpayer who in 2010 transferred an amount of EUR 901,420.55 from his Greek bank account to a bank account outside Greece; in particular, he had transferred EUR 401,420.55 on 3 February 2010 and an additional EUR 500,000.00 on 22 November 2010. Following an audit order issued on 3 February 2014, the taxpayer was invited to explain the source of these funds to the Greek tax authority.

The tax audit found that the individual was registered as a Greek tax resident at the local tax office of Aspropyrgos, Attica, where he owned two apartments, each measuring 180 square metres, and one of which was registered as his home address. The taxpayer had not registered any business activity or any other occupation or professional activity in Greece. Between 2007 and 2012, he had reported nil income in the income tax returns he submitted as tax resident of Greece. On 25 February 2014, the taxpayer received a certificate from the Russian tax authority in Moscow confirming that he was a tax resident in Russia from 21 November 1991 to 25 February 2014, and that he had submitted his annual income tax returns in Russia for this period. The taxpayer was engaged in business activity in Russia and had reported income from this activity in Russia: in 2008, to the amount of EUR 282,241.21; in 2009, to the amount of EUR 46,023.83; in 2010, to the amount of EUR 109,799.56; and in 2011, to the amount of EUR 4,970.67. On 28 December 2008, the taxpayer had sold property in Russia and had received EUR 654,022.24.

The taxpayer did not produce any evidence that the amount that was found in his Greek bank account (EUR 901,420.55) had been transferred to Greece from Russia, where he had earned an income. The tax authority concluded that the taxpayer could not justify the origin of these funds, and proceeded to classify the entire amount as income from an unknown source. According to the legislation applicable at the time, income from unknown sources is to be taxed in the same way as income from professional activity.[4] Therefore, on the amount of EUR 910,420.55, the tax authority arrived at a combined figure of EUR 750,916.54 in a corrective assessment of his income tax and solidarity tax, plus penalties and surcharges. The taxpayer filed an appeal against this assessment.

4. GR: Law 3888/2010 (A' 175), art. 15(3).

The taxpayer argued, inter alia,[5] that as a tax resident of Russia, he was not subject to income tax in Greece, as this income was covered by either article 14 or article 21 of the Greece-Russia double tax treaty, and was therefore only taxable in Russia. The tax authority's position on this particular argument is not mentioned in the Court decision, if there was a counter-argument at all.

1.3. The court decision

Although the Court decided in favour of the taxpayer and referred the case back to the lower court for further consideration, the Court did not do so on the grounds argued by the taxpayer; the Court rejected the argument concerning the application of the Greece-Russia double tax treaty.

In a short paragraph of just a few lines,[6] and with rather unclear reasoning, the Supreme Administrative Court held that the provisions of articles 14 and 21 indicate that the Greece-Russia double tax treaty applies only when the source of the income is known or at least identifiable. The Court based this conclusion on the argument that, on the one hand, articles 6 to 20 refer to specific types or sources of income, and, on the other hand, article 21(1) refers to types of income that have not been dealt with in articles 6 to 20, but that article 21(2), according to the Court, does not apply in cases where income derives from known sources, in which case article 7 or 14 applies, depending on the case. Therefore, the Court concluded, the provisions of articles 14(1) and 21(1) of the Greece-Russia double tax treaty do not apply with respect to income from unidentified sources; this interpretation, the Court continued, is compatible with the aim and purpose of the treaty for combating income tax avoidance.[7]

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5. A number of other arguments and complaints were also put forward by the taxpayer, but since they are not connected to the application or interpretation of the Greece-Russia double tax treaty, they are not discussed in this chapter.

6. The relevant, short, discussion is found in paragraph 6 of decision 435/2017.

7. A similar approach had been followed by the Court of Appeals that had heard the case in the first instance. In paragraph 9 of the decision 4759/2015 of the Athens Administrative Court of Appeals, the lower court had held that the aim of the Greece-Russia double tax treaty is the avoidance of double taxation of income that is derived from identifiable sources, linking the application of the Convention with the general international obligation that Greece has in combating tax avoidance. Therefore, the lower court had concluded, the Convention can only apply on items of income that have been acquired lawfully and not in cases where the source of the income is unknown or cannot be identified.

1.4. Comments on the Court's reasoning

The Supreme Administrative Court was put in a difficult position by this case. It appears that certain oversights by the executors of the tax audit resulted in a weak case by the tax authority. In particular, with respect to the argument about the application of the tax treaty, it is certainly frustrating when a person who has declared himself to be a Greek tax resident and who owns property in which he lives and who has submitted (nil) income tax returns in Greece for a number of years also produces a certificate from the Russian tax authorities stating that for that same period he was tax resident in Russia. This should have prompted the Greek tax authority to examine the facts around the person's tax residency in order to establish his place of residence for tax purposes, based on the criteria of article 4 of the Greece-Russia double tax treaty. From the publicly available information, it appears that this did not happen at the audit level.

Another oversight by the executors of the tax audit was the failure to identify the source (both geographically and chronologically) of the taxpayer's income. In order to apply both the domestic legislation on the taxation of income from unknown sources and the provisions of the double tax treaty, it is crucial to establish the source of the income. The tax authority concluded, wrongly, that Greece was the source of the individual's income, since the amount transferred abroad was in a Greek bank account in 2010; it further concluded that that amount constituted income from the fiscal year 2010, because that was when the transfer occurred. Both conclusions were wrong, and were rejected by the Court. Establishing the facts beforehand would undoubtedly have affected the reasoning of the Court.

As far as the double tax treaty argument is concerned, it appears the Supreme Administrative Court put more emphasis on the aim, purpose and spirit of the treaty, rather than on the scope of application and interpretation of the provisions of articles 14 and 21 contained therein. Indeed, according to the general rule of treaty interpretation contained in article 31(1) of the Vienna Convention on the Law of Treaties (VCLT), "[a] treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose". The title and preamble of the Greece-Russia double tax treaty referring specifically to the fight against tax avoidance form part of the context of the treaty, as per article 31(2) of the VCLT, and constitute a general statement

of the object and purpose of the convention; therefore they should play an important role in the interpretation of the provisions thereof.[8]

This position was only marginally mentioned by the Court and, in any case, it does not constitute the main argument, only a subsidiary one to support the main argument that articles 14 and 21 do not apply in cases of income from unknown sources, where the suspicion of tax avoidance is strong. This reasoning is not very convincing.

Indeed, if a taxpayer is a tax resident in another contracting state, Russia in this case, and this is not challenged by the Greek tax authority, then the treaty comes into play. Greece, in that case, would be the source state, with limited taxation rights. When a taxpayer who is not a Greek tax resident is invited to provide information on the source of funds found in his Greek bank account, the tax authority must establish the origin of the funds. If they cannot be linked to Greece, then Greece does not have the right to tax them.

The Court did not follow this line of reasoning; instead it held that neither article 14 nor article 21 was applicable because neither applied to income from unknown sources. This conclusion, however, is not well founded.

First of all, one could argue that article 14 is not applicable since the "income from unknown sources", as per the relevant domestic law provision, is not to be assimilated into income from professional activities but only taxed in the same way as income from professional activities. Consequently, it can be argued in such cases that we are not in fact talking about "income from professional activities", in the sense that this income is used for the purposes of article 14 of the Greece-Russia double tax treaty. The reason, therefore, for the inapplicability of article 14 is that this was not a case of income from professional activities. As a result, the only other article that could apply would be article 21 on other income.

Article 21 of the Greece-Russia double tax treaty is modelled after article 21 of the OECD Model. Given that the OECD Model is supposed to be a comprehensive treaty, covering all income, article 21(1) contains a residual clause, intended to cover all other cases that are not covered by the foregoing articles of the OECD Model.[9] The income covered by article 21 is not

8. *See* on this point the reference in article 16(2) of the *OECD Model Tax Convention on Income and on Capital* (17 Nov. 2017), Models IBFD.
9. *See* the analysis in L.E. Schoueri, *Article 21: Other Income* sec. 1.1.1.1., Global Tax Treaty Commentaries IBFD (accessed 14 Aug. 2018).

only income of a class not expressly dealt with but also income from sources not expressly mentioned, irrespective of the state in which the income arises, and it concerns both income arising in a contracting state and income from third states.[10] However, article 21 cannot widen the scope of the OECD Model, and therefore does not apply to income not covered by a tax treaty as a whole.[11] Consequently, in cases where income does not fall in any of the classes described in articles 6-20, it is covered by the residual clause of article 21(1) as "other income", and it is taxed accordingly.

Article 21(2), on the other hand, provides for an exception to the provisions of article 21(1), in cases where the income is associated with the activities of a permanent establishment (PE) belonging to a resident of a contracting state but in the other contracting state.[12] Since the facts brought before the Supreme Administrative Court did not involve a Greek PE of a Russian enterprise, this paragraph is not relevant to the case. The Court's reference to this paragraph only creates confusion and should have been avoided.

In conclusion, in the present case, and given the fact that the tax residence of the taxpayer in Russia was not challenged by the tax authority, article 21 of the Greece-Russia double tax treaty should apply and any income from unknown sources, as per the domestic law provision, should be classified as "other income" for the purpose of article 21 and be taxable only in Russia.

1.5. Conclusion

As already mentioned, the Supreme Administrative Court decided in favour of the taxpayer, but the argument about the application of the Greece-Russia double tax treaty was rejected. In general, although the decision was good and balanced with respect to the application and interpretation of the domestic law provisions, the Court did not handle the double tax treaty issue successfully. The question is whether, given the precedent-like value of the decisions of the Greek Supreme Administrative Court, there will be another chance for the Court to fine-tune its case law on this point.

10. Article 21 provides a general rule relating to income not dealt with in articles 6(20) of the Convention; *see OECD Model Tax Convention on Income and on Capital: Commentary on Article 21* para. 1 (17 Nov. 2017), Models IBFD.
11. *See* the analysis in Schoueri, *supra* n. 9.
12. *See* para. 4 *OECD Model: Commentary on Article 21* (2017).

Chapter 2

France: Tax Treaty Abuse as *Fraus Legis*

Marilyne Sadowsky

2.1. Introduction

This decision of the French Council of State released on 25 October 2017 (396954, Cts Verdannet) deals with the question of whether the general anti-avoidance rule (GAAR) of article L 64 of the French Tax Procedure Code (FTPC) applies to tax treaties. By responding in the affirmative, the Supreme Court removed the remaining ambiguities created by former case law on this issue and raised interesting questions regarding *fraus legis*, domestic rules, tax treaties and states' intention.

2.2. Facts of the case

Mr Verdannet is a French tax resident. One day, on 30 December 2003, he decided to sign a promise to purchase some buildings in France *and*, on the same day, to create a Luxembourg holding company, "Partinverd". Mr Verdannet was the managing partner of this company as he held 99.99% of the shares. A month later, in January 2004, an amendment was made to the contract to substitute a new buyer. Which is why in July 2004, the Luxembourg company was substituted for Mr Verdannet in the purchase of these buildings, for EUR 2,908,836. In November 2005, following the amendment allowing the company to cover the cost of the transaction, Partinverd sold the buildings to a French company held by Mr Verdannet's ex-wife for EUR 4,900,000, and Mr Verdannet became a Swiss tax resident. According to article 4 of the France-Luxembourg Income and Capital Tax Treaty (1958)[1] (hereinafter France-Luxembourg tax treaty) the sale was exempt from capital gains taxes in both countries, as Partinverd had no permanent establishment (PE) in France.

1. *Convention between France and the Grand Duchy of Luxembourg for the Avoidance of Double Taxation and the Establishment of Rules of Reciprocal Administrative Assistance with Respect to Taxes on Income and Capital* [unofficial translation] (1 Apr. 1958), Treaties IBFD.

For the French tax authorities, if Mr Verdannet had carried out the transaction himself, he would have been subject to taxation under article 244 bis A of the French Tax Code (FTC). Indeed, as a Swiss tax resident, he would have had to pay a 33.33% French withholding tax on the capital gains resulting from the sale of a French immovable property. Consequently, the artificial substitution of the Luxembourg company aimed to avoid the taxation of capital gains in France. On grounds of abuse of law (article L 64 of the FTPC), the French tax administration set aside the substitution of the company to levy a tax directly under article 244 bis A of the FTC. The taxpayer's three children, as inheritors of their deceased father's estate, requested the discharge of the French withholding tax, or alternatively its reduction to 16% according to article 15 of the France-Switzerland Income and Capital Tax Treaty (1966).[2]

The administrative tribunal (*Tribunal administratif*, TA)[3] agreed to reduce the withholding tax to 16%. The three children lodged an appeal against this ruling before the Administrative Appellate Court (*Cour administrative d'appel*, CAA),[4] which confirmed the first judgment and the taxation in France on the grounds of abuse of law. Consequently, they gave notice to appeal before the Council of State (*Conseil d'Etat*, CE).

2.3. The court decision

The Supreme Court's reasoning contains three elements: (i) a reminder of national law; (ii) a reminder of conventional law and the application to the case; and (iii) legal qualification of an abuse of law.

2.3.1. National law

First, judges reminded the wording of article L 64 of the FTPC: "Acts that conceal the true scope of a contract or agreement by means of clauses […] that disguise either a realization or a transfer of profits or income may not be enforced against the tax administration. […] The tax administration is

2. *Convention between the French Republic and the Swiss Confederation for the Avoidance of Double Taxation with Respect to Taxes on Income and Capital* [unofficial translation] (9 Sept. 1966), Treaties IBFD.
3. FR: *Tribunal Administratif* (TA) [Administrative Tribunal] Montreuil, 22 Feb. 2013, 1201904.
4. FR: *Cour Administrative d'Appel* (CAA) [Administrative Appellate Court] Versailles, 17 Dec. 2015, 13VE01281.

entitled to restore the true character of the disputed transaction. […] If the administration has not complied with the consultative committee of abuse of law, it must provide evidence of the justification for the rectification".[5] On this basis, judges declared that the French tax administration could set aside a taxpayer's actions if they were able to prove that those acts were fictitious, or that, seeking the benefit of a literal application of the texts against the objectives pursued by their authors, these acts were inspired only by a tax avoidance objective. This applies when a taxpayer is attempting to take advantage of an act derived from a bilateral tax treaty that grants taxation authority for the purpose of eliminating double taxation and if the tax treaty does not explicitly provide an assumption of fraud.

2.3.2. Conventional law

Next, judges reminded the wording of article 4(1) of the France-Luxembourg tax treaty, before the 2006 amendment: "Income from industrial, mining, commercial or financial enterprises shall be taxable only in the State in which a permanent establishment is situated". According to this provision, the capital gains made by the Luxembourg company on the sale of a building located in France were not taxable in France, as the company had not been operating as a PE in France.

2.3.3. An abuse of law

Finally, judges confirmed the legal qualification of an abuse of law.

First, the interposition of the Luxembourg company, substituted for Mr Verdannet, who had initially signed the promise to purchase, was not justified on any economic, organizational or financial grounds. The holding company had not engaged in any real estate activity after the acquisition, despite its change of purpose. Thus, judges confirmed the qualification of an abuse of law given by the appellate court with respect to the artificial interposition of the Luxembourg company with no other purpose than to avoid taxation of capital gains in France.

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5. The original in French reads: "*Ne peuvent être opposés à l'administration des impôts les actes qui dissimulent la portée véritable d'un contrat ou d'une convention à l'aide de clauses:* […] *b. qui déguisent soit une réalisation, soit un transfert de bénéfices ou de revenus* [...]. *L'Administration est en droit de restituer son véritable caractère à l'opération litigieuse.* […] *Si l'administration ne s'est pas conformée à l'avis du comité, elle doit apporter la preuve du bien-fondé de la rectification*".

Second, the court concluded that the contracting parties to the tax treaty, namely France and Luxembourg, did not intend, in order to allocate the taxing power, to apply the provisions of this tax treaty to situations arising from artificial arrangements devoid of economic substance. The court of appeal was correct in stating that the transaction was contrary to the objectives pursued by the states. Consequently, the interposition of the Luxembourg company could not be enforced against the tax authority, and the taxpayer was personally liable for the tax. Therefore, his children would have to pay the tax.

2.4. Comments on the court's reasoning

To begin with, the context of the case is particularly interesting,[6] since it is an issue of double exoneration. In France, article 244 bis A of the FTC provides that non-French tax residents located abroad have to pay a withholding tax on capital gains resulting from the sale of a French immovable property. According to the OECD Model Convention, most French tax treaties provide for the taxation of real estate income or profits in the state where the property is located. With respect to business real estate, a specific clause applies the same rule, notwithstanding the general rule providing that business incomes are only taxable in the state where a PE is located. The problem is that old conventions, such as the France-Luxembourg tax treaty, do not include such clauses. Consequently, this treaty was silent about income and profits from business property.

Two options were possible. The first was to apply article 3 of the France-Luxembourg tax treaty, which deals with a specific rule on immovable property. The second was to apply article 4, which deals with a general rule on business income. On this question, there was conflicting case law in France and Luxembourg, resulting in correspondingly conflicting rulings by national courts. French courts applied article 4 of the tax treaty,[7] qualifying this kind of income as business profit. Consequently, without a PE in France, the income was taxable in Luxembourg. For the tax administration, this solution applied to the capital gains referred to in article 244 bis A of

6. E. Crépey, *Conclusions of the Public Reporter*, Revue de Droit Fiscal 2, com. 64 (11 Jan. 2018).
7. FR: Conseil d'État (CE) [Council of State], 9e et 8e ss-sect. [9th and 8th Chambers], 18 Mar. 1994, no. 79971, *SARL Investissement agricole et forestier*, *RJF*, 5/1994, no. 530.

the FTC.[8] Contrastingly, Luxembourg applied article 3 of the tax treaty,[9] and was thus deprived of its powers of taxation when buildings were located in France.

While this was not the first time that this issue had arisen, it was the first time that the Council of State had clearly addressed the question of tax treaty abuse. Indeed, two earlier cases, *Bank of Scotland* in 2006[10] and *Abbey National Treasury Services* in 2012,[11] opened a pathway to using the justification of an abuse of law to implement an anti-abuse clause relating to the beneficial owner. In line with these earlier cases, the court in this case was quite clear in its decision that tax treaties offer the same level of protection against abuse of law as domestic rules.

A number of brief comments may be made regarding this decision.

2.4.1. Domestic rules, conventional rules and *fraus legis*

Tax treaties are among the rules covered by article L 64 of the FTPC. The Council of State has declared that French tax authorities may set aside acts committed by a taxpayer on grounds of abuse of law, even if the norm is derived from a tax treaty that aims to allocate tax jurisdiction for the purpose of eliminating double taxation, and even if the treaty does not explicitly allow for a scenario of *fraus legis*. Thus, the judges in this case set out a condition. Domestic rules may be applied (article L 64 of the FTPC) only if the treaty does not provide an explicit rule of *fraus legis*. In which case, the tax treaty provides the legal basis for setting aside the effect sought by the taxpayer.

The question is: what does a tax treaty explicitly providing for an assumption of *fraus legis* actually mean? For some authors,[12] it seems to refer to general anti-abuse clauses in tax treaties. For instance, article 7(1) of the

8. Instructions BOI 14 B-2-00 and BOI 8 M-3-00 (4 Aug. 2000)
9. LU: *Cour administratif* (CA) [Administrative Court], 23 Apr. 2002, no. 14442 C, *Sté La Costa SARL*.
10. FR: CE, 3e et 8e ss-sect. [3rd and 8th Chambers], (29 Dec. 2006, no. 283314, *Sté Bank of Scotland*, RJF, 3/2007, no. 322.
11. FR: CE, 8e et 3e ss-sect. [3rd and 8th Chambers], (24 Apr. 2012, no. 343709, *Sté Abbey National Treasury Services*: RJF, 7/2012, no. 735.
12. D. Gutmann, *Abus de convention fiscale*, Bulletin Joly des Sociétés 4, p. 234 (Apr. 2018).