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GENERAL AND SPECIFIC TAX ANTI-AVOIDANCE RULES IN EUROPEAN UNION

Master thesis

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LIST OF ABBREVIATIONS

ATAD - Anti-Tax Avoidance Directive

BEPS - Base erosion and profit shifting

CFC - controlled foreign companies

CIT - corporate income tax

CJEU - Court of Justice of the European Union

DD - double deduction

D/NI - deduction/non-inclusion

EBC - excess borrowing costs

EBITDA - Earnings Before Interest, Taxes, Depreciation, Amortisation and Management

ECOFIN - Economic and Financial Affairs Council configuration

EU - European Union

GAAR - general anti-avoidance rule

IRL - interest limitation rule

IRD - Interest and Royalties Directive

MD - Merger Directive

MNE - multinational enterprise

MS - Member States

OECD - Organisation for Economic Cooperation and Development

PE - permanent establishment

PPT - principal purpose test

PSD - Parent-Subsidiary Directive

SAAR - specific anti-avoidance rule

TFEU - Treaty on the Functioning of the European Union

INTRODUCTION

Relevance of the master thesis. Taxation is a crucial policy tool that governments use to finance public services, redistribute wealth, and promote economic growth. The effectiveness of tax policy depends on the ability of governments to design and implement a tax system that is fair, efficient, and sustainable. The issue of tax avoidance is one of the most pressing challenges facing governments and international organisations worldwide. Tax avoidance, which involves the use of legal mechanisms to reduce or avoid tax liabilities, poses a significant threat to the integrity of the tax system and undermines public confidence in it.

This phenomena developed in direct proportion to how well each particular nation's economy was doing. It should be noted that tax law provisions at the level of national regulations may vary in the specifics of the chosen solutions, but they all have the same goal: to invalidate the effects of tax reduction resulting from actions that are legal but driven solely by tax avoidance[1].

The existence of the internal market also creates challenges for the European Union (EU) in terms of tax policy. Because different member states have different tax systems and rates, there is a risk of tax competition and tax avoidance. Companies may be tempted to shift profits to countries with lower tax rates, reducing their overall tax liabilities and distorting competition. The EU has been at the forefront of efforts to combat tax avoidance. In recent years, the EU has introduced a range of measures aimed at preventing tax avoidance and enhancing tax transparency, including the General Anti-Avoidance Rule (GAAR) and the Specific Anti-Avoidance Rule (SAAR). The GAAR is a general rule that seeks to counteract tax arrangements that are deemed to be abusive or artificial, while the SAAR is a specific rule that targets particular types of tax avoidance schemes.

In addition to these rules, the EU has also implemented measures to increase tax transparency and information exchange between Member States. In 2016 the Commission's ambitious plan for fairer, easier, and more efficient business taxes in the EU includes the Anti-Tax Avoidance Package.

The Package includes specific actions to stop aggressive tax planning, increase tax transparency, and level the playing field for all EU enterprises.

It will support Member States (MS) in taking decisive and well-coordinated action against tax evasion, and it will guarantee that businesses pay taxes wherever they make profits

[1] Tomasz Wach, "Counteracting international tax avoidance practices," *Financial Law Review* 1, 13 (2019): 47, https://doi.org/10.4467/22996834FLR.19.004.10522.

within the EU. These measures include the Anti-Tax Avoidance Directive (ATAD) and the Common Reporting Standard, which require companies and financial institutions to disclose more information about their tax arrangements. The ATAD includes five anti-avoidance rules as an instrument against abusive tax practices.

On the one hand, by implementing effective anti-avoidance rules, the EU demonstrates its commitment to these standards and promotes a level playing field for businesses and taxpayers. Unified rules are important for combating tax avoidance, ensuring tax fairness, enhancing tax transparency, promoting investment and economic growth, and meeting international tax standards.

On the other hand, the directive has also faced criticism from some quarters. One criticism of the ATAD is that it may have unintended consequences that could harm legitimate business activities. For example, the directive includes a rule that limits the amount of interest deductions that companies can claim for tax purposes. Another criticism of the ATAD is that it may not go far enough in addressing tax avoidance. The experts have argued that the measures included in the directive are too weak and may not be effective in combating the most aggressive forms of tax planning.

Correct payment of taxes is important for the entire socio-economic life. That is why it is necessary to understand the nature of these norms, the contradictions that arise in the interpretation and implementation of ATAD, provides valuable insights into the effectiveness of the anti-avoidance rules in the EU and the broader issues of tax policy and governance, propose ways to solve problems and improve existing legislation.

The scientific research problem. Due to the global problem of tax avoidance and in light of recent changes in the field of international taxation, it is crucial to analyse the GAAR and SAAR with objectivity. The EU Member States have different tax systems and rules, and the implementation of ATAD has been uneven across the EU. This has led to discrepancies in the way that ATAD is applied, creating potential for tax avoidance.

In the light of the adoption of the ATAD and its implementation, the important question arises: **are the GAAR and SAAR offered by the EU sufficient enough to effectively help solve the problem of tax avoidance?** The current research is aimed at answering this question.

Scientific novelty and the level of the analysis of the research problem. Thesis research areas include an analysis of the theoretical background of GAAR and SAAR in EU before the adoption of the ATAD, considered the tax anti-avoidance rules after the implementation of ATAD, problems and critics which arise from the implementation of directive and core issue the

efficiency of modern GAAR and SAAR.

For todays we have different literature on the characteristics, problems and effectiveness of GAAR and SAAR in EU, which includes works by academics like Cubillos González, J, Dorien Beckers, Antony Seely ,Till Moser, Sven Hentschel, Cihat Öner, Diane de Charette etc.

For instance, Stefanie Geringer provided a critical analysis of the implementation of ATAD in Austrian legislation[2]. At the same time, Katerina Perrou the similar analysis in relation to the Greek legislation[3].

The researches made by Susi Baerentzen about the effectiveness of General Anti-Avoidance Rules justifies one of the highly potent weapons for the tax administrations and states to fight tax avoidance is the introduction of (GAARs) in both the ATAD and the Base erosion and profit shifting (BEPS) Project and deserves due attention[4] .

The study of Werner Haslenher and Katerina Pantazatou aims to provide an overview of the recently implemented anti-tax avoidance and evasion measures, notably the ATAD and Directive on Administrative Cooperation 6. It reviews the implementation of these directives across different Member States and assesses the problems that arise with regard to the interpretation of some of the directives' provisions[5].

Even though such scientific opinions merit weight, they frequently do not take into account the all present issues with GAAR and SAAR. This means that even though the issue of rules' effectiveness and their correspondence has been thoroughly investigated and discussed by academics around the world, it still needs further study, particularly in the context of examining the effectiveness and inconsistencies that result from the application of these rules.

The aim of the master thesis. The research aims to provide a comprehensive evaluation of the existence GAAR and SAAR in the EU, as well as measurements of their practical implementation, identifying key issues and make suggestions for their improvement to prevent tax avoidance.

The objectives of the research. In order to achieve the set aim of the research, the

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[2] Stefanie Geringer, "Critical Review Of The ATAD Implementation: The Implementation of the ATAD by Austria," *Intertax,* 50, 4 (2022): 356-366, https://doi.org/10.54648/taxi2022031.

[3] Katerina Perrou "Critical Review Of The ATAD Implementation: The Implementation of the ATAD in Greece," *Intertax,* 50, 8/9 (2022): 619-634, https://doi.org/10.54648/taxi2022061.

[4] Susi Baerentzen, *The Effectiveness of General Anti-Avoidance Rules* (Amsterdam: IBFD, 2022), 2, https://www.ibfd.org/sites/default/files/202210/20_007_the_effectiveness_of_general_anti_avoidance_rules_final_web.pdf

[5] Werner Haslehner and Katerina Pantazatou, *Assessment of recent anti-tax avoidance and evasion measures (ATAD & DAC 6) (Luxemburg: European Union, 2022), 1, https://www.europarl.europa.eu/thinktank/en/document/IPOL_STU(2022)703353*

following tasks must be carried out:

1) To disclose and discover the legal nature of the GAAR and SAAR.
2) To analyze main EU legislation related to tax avoidance.
3) To assess the practical implementation of GAAR and SAAR.
4) To identify the challenges and limitations of GAAR and SAAR in the EU.
5) Relying on the legal analysis carried out in this master thesis to provide a proposal for solving problems and increasing the efficiency and unification of GAAR and SAAR in the EU.

The practical significance of the master thesis. From a practical standpoint, both academics and practitioners might find use for the current research. The comprehensive analysis presented in the master's thesis will be relevant for further research since the study provides understanding of the legal nature of tax anti-avoidance rules, the problems encountered in the implementation of these norms and the level of their effectiveness.

The master's thesis can be helpful for tax law students who seek to enhance their understanding of such complex subjects as tax avoidance.

As it offers suggestions and recommendations to strengthen and harmonize the current regulations, this research has relevance from the standpoint of potential revisions to the current EU legislation in the area of tax avoidance.

The defended statements.

1. The implementation of ATAD raises a lot of concerns about potential inconsistency, uncertainty of interpretations, gaps, which causes many disagreements and misunderstandings on these matters.
2. The existing GAAR and SAAR that are contained in the EU and Member States law are not efficient and unified enough and require further consideration.

Methods used in the master thesis. The following research methods were used in the process of writing the master's thesis:

1) Data collection and data analysis method. The study examines a wide range of pertinent sources, including European Union and individual state legislation, supranational legal documents, case law, academic papers, and analytical pieces. An exhaustive and thorough overview of the GAAR and SAAR is produced by the systematisation and structuring of the processed data.

2) Historical. The analysis of numerous legal acts at the EU and national levels using a historical perspective enables us to comprehend and correctly interpret the dynamic of legislative

changes.

3) Linguistic method. The linguistic approach is used in the work with the aim of obtaining a thorough and accurate understanding of the chosen topic and related terms, as well as avoiding confusion or misinterpretation of the relevant concepts.

4) Comparative legal method. Allowed made it possible to identify similarities and differences in the approaches to the GAAR and SAAR, implementations of ATAD. Logical method. By applying the logical method in the master's thesis, scientific views and opinions on the subject of research are summarised and relevant conclusions and recommendations are formulated from them.

5) Logical method. By applying the logical method in the master's thesis, scientific views and opinions on the subject of research are summarised and relevant conclusions and recommendations are formulated from them.

Structure of research. It consists of several parts:

In the first part of the master's thesis, the general description of abusive tax practice, the nature of GAAR and SAAR, their origin and approaches to their interpretation, the need for their unification.

The second part of the study is devoted to the analysis of existing legislative regulations of tax avoidance. The comprehensive study of existing GAAR and SAAR. EU's court practice in the relevant field will be analysed. Also, the problem of the scope of the interpretation and implementation of ATAD and measures proposed to increase the effectiveness will be covered.

1. GENERAL OVERVIEW OF THE LEGAL NATURE AND EVOLUTION OF TAX ANTI-AVOIDANCE RULES IN EUROPEAN UNION

1.1. Concept of tax avoidance

Tax avoidance is a problem for all Member States of the European Union due to its negative impact on the tax system. This is mainly because tax avoidance behaviour is 'contrary to fiscal equity, has a serious impact on the budget and distorts international competition and capital flows[6].

The adverse fiscal and economic impacts of tax avoidance strategies have been the focus of the BEPS Project since its beginning in 2013. In 2015, Organisation for Economic Cooperation and Development (OECD) research estimated that the cost of tax avoidance by multinational enterprises (MNEs) ranged from USD 100 to $240 billion, which is equivalent to 4-10% of global corporate income tax (CIT) revenues. In addition to significant revenue losses, BEPS also causes other adverse economic effects, such as tilting the playing field in favour of tax-aggressive MNEs, exacerbating the corporate debt bias, distorting the location of highly mobile, intangible assets and misdirecting foreign direct investment[7].

Therefore, defining and understanding the concept of tax avoidance is a highly important issue in order to be able to combat this phenomenon. The concept of tax avoidance has long been controversial in tax policy and tax administration. Linguistic differences between countries in the use of the terms "*tax evasion*", "*tax mitigation*"and "*tax avoidance*" contribute to the difficulty in determining the concept of tax avoidance.

There is not any universal definition of tax avoidance. The concept of tax avoidance has been defined by different authors in their own words, such as Hanlon and Heitzman describe tax avoidance as "*a continuum of tax planning strategies where perfectly legal activities are at one end, and more aggressive activities would be closer to the other end*", and Dyreng, Hanlon, and Maydew state that all financial transactions that lead to a reduction in tax liability reflect the tax avoidance behaviour of the firm[8]. We can see on Table 1 how certain scholars define the concept of tax avoidance.

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[6]Organisation for Economic Cooperation and Development. *Harmful Tax Competition: An Emerging Global Issue.* Paris, 1998.

[7] "Action 11 BEPS data analysis,"Organization for Economic Co-operation and Development, accessed 10 June 2023, https://www.oecd.org/tax/beps/beps-actions/action11/.

[8]Anshu Duhoon and Mohinder Singh, "Corporate tax avoidance: a systematic literature review and future research directions," *LBS Journal of Management & Research* 21, 1 (2023):51-68.

Author	Definition
Edward Kleinbard (USC law professor)	Tax avoidance represents the subset of tax planning arrangements that bends technical tax rules to eliminate tax obligations without actually violating the law.
Ronen Palan (University of Birmingham)	Tax avoidance is the process of trying to reduce tax payable by legal means, exploiting loopholes in tax legislation but contradicting the spirit of the law.
Reuven Avi-Yonah (University of Michigan law professor)	Tax avoidance is conduct that is technically within the letter of the law, but avoids the legislative purpose of the law.
Chris Jones (Aalborg University, Denmark)	Tax avoidance means a situation is structured in a way to obtain a tax benefit by technically abiding by the law, but contravening its purpose.

(*Table 1*)

Thus, tax avoidance refers to tax planning strategies that take advantage of loopholes or ambiguities in tax laws and regulations to reduce the tax burden. At its core, this concept is not directly illegal, but it is contrary to the objectives and purpose of the law.

It is important to clarify that tax avoidance does not mean tax evasion. The main difference is that tax evasion is illegal while tax avoidance is not. The general view is that tax evasion is the use of illegal means to avoid paying taxes and is a criminal offence subject to criminal sanctions[9]. This refers to dishonest tax reporting, which includes overstating deductions or claiming income, earnings, or gains that are lower than the actual amounts obtained. Nearly all nations consider tax evasion to be a crime, punishable by penalties, jail time, or both. Tax avoidance and tax evasion are on different ends of the legal spectrum, despite the fact that they both include attempts to reduce tax payments[10].

[9]Márquez P. Lampreave , "An Assessment of the Anti-Tax Avoidance Doctrines in the United States and the European Union," *Bulletin for International Taxation* 2012 66, 3 (2012): 50.

[10] "Understanding Tax Avoidance vs Tax Evasion - Key Differences", Tookitaki, accessed 15 June 2023, https://www.tookitaki.com/compliance-hub/understanding-tax-avoidance-vs-tax-evasion-key-differences.

There are many different ways to evade taxes, but they all entail lying to the tax authorities about a person's or company's income and/or assets in order to lower the amount of taxes owed. Furthermore, tax evasion can also have negative effects on allocation behaviour, drastically lower the value of tax incentives, artificially bias macroeconomic indicators, delay efforts to monetize developing countries' economies, and alter income redistribution[11].

The distinction should be made between illegal tax evasion and the technically legal gray area of tax avoidance - but combating both through a mix of enforcement, regulation, and transparency is crucial to preserve equitable and efficient tax systems.

However, it is significantly more difficult to distinguish between tax avoidance and tax mitigation. Tax avoidance and mitigation are not synonymous. A tax decrease that the levying statute expressly promotes or permits is referred to as tax mitigation. On the other hand, tax avoidance, which is commonly defined as a tax reduction strategy that complies with the text but violates the spirit and intent of the law, appears to be in the middle of tax evasion and tax mitigation[12].

Frequently, courts have made a similar difference. As one example, Lord Nolan distinguished between tax avoidance and mitigation in the Willoughby case by stating that:

> *The hall mark of tax avoidance is that the taxpayer reduces his liability to tax without incurring the economic consequences that Parliament intended to be suffered by any taxpayer qualifying for such reduction in his tax liability. The hall mark of tax mitigation, on the other hand, is that the taxpayer takes advantage of a fiscally attractive option afforded to him by the tax legislation, and genuinely suffers the economic consequences that Parliament intended to be suffered by those taking advantage of the option*[13].

As follows, tax mitigation refers to tax planning strategies that make use of legally permitted deductions, credits, allowances, and exemptions to minimise one's tax burden. The key difference is that tax mitigation follows the spirit and intent of tax legislation. It does not try to circumvent the purpose of the tax incentives and allowances utilised. Tax mitigation is guided by legislative intent and involves transparent reporting and transactions. It is considered an acceptable form of minimising one's taxes while also improving business efficiency and economic

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[11]Daniel Davidov, "The Difference Between Tax Avoidance and Tax Evasion"(master's thesis,Tilburg University, 2016), 18, https://arno.uvt.nl/show.cgi?fid=142028.

[12] Lampreave, *supra note*, 9: 50.

[13] "Inland Revenue Commissioners v Willoughby and related appeal, STC 995,"UK Parliament, accessed 15 July 2023,https://publications.parliament.uk/pa/ld199798/ldjudgmt/jd970710/willough.htm.

outcomes. While tax avoidance exploits grey areas, tax mitigation operates within the rules set by policymakers.

1.2. Legal nature of GAAR and SAAR

Governments trying to raise money fairly have long faced difficulties due to tax avoidance and tax evasion. Tax authorities have responded by creating a number of legal doctrines and tools to combat aggressive tax planning strategies that adhere to the letter but not the spirit of the law. GAARs and SAARs are two of the most popular anti-avoidance measures. Although GAARs and SAARs are significant policy tools, there is ongoing discussion regarding their legal status and implications.

The principles of statutory interpretation and the governing authority's acknowledged authority to prevent tax abuse are the foundations for the validity of both GAARs and SAARs. They do, however, occupy a convoluted legal space between judicial doctrines that restrict the reach of taxation and statutory provisions designed to collect revenue. Denying or recharacterizing transactions that would otherwise be allowed under a literal interpretation of the tax code is the main goal of anti-avoidance regulations. Through this, GAARs and SAARs address concerns regarding the balance of powers by bridging the gap between the intended purpose and the text of legislation.

The general anti-avoidance or anti-abuse principle, doctrine or clause has received many names according to its class or variant applied in each country. This is how it can be mentioned: the principle of economic reality, of economic interpretation, substance over form, the reason for business, the principle of profit, legitimate nature of the business, doctrine of economic substance, simulation, of multiple acts, fraud of the law, abuse of legal forms, abuse of the law, theory of the new realism, theory of valid economic motives, etc[14].

Internationally, this provision is referred to as the GAAR ("General Anti-Avoidance Rule") and is distinguished from the SAAR ("Specific Anti-Avoidance Rule") to the extent that it targets abuses generally. The SAAR differs from the GAAR to the extent that it applies to specific tax situations[15].

GAAR is a concept that gives the tax authority of a nation the authority to refuse tax

[14] "General Anti-Avoidance or Abuse Clause (GAAR): its genesis and evolution in Tax Law. Legal certainty," Inter-American Center of Tax Administration, accessed 8 July 2023,https://www.ciat.org/ciatblog-general-anti-avoidance-or-abuse-clause-gaar-its-genesis-and-evolution-in-tax-law-legal-certainty/?lang=en#_ftn5.
[15] *Ibid*.

benefits for transactions or arrangements that have no commercial substance and whose main objective is to obtain tax benefits.

A tax authority may use a GAAR as a last resort to invalidate unlawful tax avoidance schemes that would otherwise be compliant with the terms and statutory interpretation of regular tax law. As a rule, a GAAR is intended to invalidate otherwise legal actions that are discovered to be carried out in a way that compromises the objectives of the tax code, such as when a taxpayer has exploited or abused the law[16].

SAAR for both domestic and international tax avoidance refers to certain regulations that prohibit "*aggressive tax planning*" because they specifically target identifiable methods of tax avoidance. These regulations aim to prevent tax evasion by prohibiting things like excessive payments made by linked companies for cross-border transactions, dubious sources of funding for loans or share capital, transactions that withhold bonuses or dividends, and artificial agreements made when transferring movable property[17].

One of the problems that creates uncertainty is the application of a GAAR and its interaction with SAARs. There is no clarity in the interaction between GAARs and SAARs. In domestic situations, GAARs are used to complement SAARs, which creates in some cases conflicts and overlaps[18].

Whereas GAARs function as a broad catch-all provision for tax avoidance schemes that are not otherwise covered, SAARs target particular abusive arrangements. However, the practical application of either can become unclear due to the coexistence of multiple, detailed SAARs and GAARs. Even when they follow SAARs, taxpayers find it difficult to predict with certainty whether a particular transaction conforms with the letter or spirit of the law or if it will be invalidated under the GAAR. The lack of clarity undercuts the intention behind anti-avoidance regulations by impeding tax planning and lowering voluntary compliance.

It is important to note the following point about the possible relationship between GAAR and SAAR.

The principle of *lex specialis derogat legi generali*, meaning that special rules override general ones, applies when specific anti-avoidance rules compete with general anti-avoidance rules in a given situation. This competition arises in instances where both rules address tax abuse,

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[16] Christophe J Waerzeggers and Cory Hillier, "Introducing a General Anti-Avoidance Rule (GAAR): Ensuring That a GAAR Achieves Its Purpose,"*TAX LAW IMF TECHNICAL NOTE 1, 1 (2016): 1-10.*

[17] Parthasarathi Shome, *Taxation History, Theory, Law and Administration* (Switzerland: Springer International Publishing, 2021), 312.

[18] Irma Mosquera Valderrama and Irene Burgers, "Review of 'Anti-avoidance measures of general nature and scope-GAAR and other rules," *Bulletin for International Taxation* 73, 10 (2019): 6.

having identical purposes, regulating situations of past tax abuse, and operating by favoring substance over form. In the context of "mechanically applied" anti-avoidance rules for corporate income taxation, the special rules, which don't require proving abuse, and general rules don't compete but function in tandem. The special rule applies when the form of a tax situation aligns with its substance, while the general rule comes into play when there are indications of tax abuse, and the form doesn't correspond to the actual content. In such cases, both rules can be applied, each addressing specific aspects within its scope[19].

This position is quite reasonable as it allows for a comprehensive approach to avoiding tax schemes and ensuring greater efficiency in dealing with tax avoidance.

To sum up, while derived from principles of statutory interpretation and the authority of tax regulators, GAAR and SAARs emerged as legal mechanisms for combating tax avoidance that adhere to the letter but not the spirit of tax laws, occupying an ambiguous space between legislation and judicial doctrine. Although, SAARs target specific abusive arrangements, GAAR serve as a broad catch-all provision; however, their coexistence creates uncertainty in application and creates discussions in academic circles.

1.3. Judicial doctrine of the "abuse of law"

The "*abuse of law*" doctrine that has been developed in the case law of the Court of Justice of the European Union (CJEU) serves as an important basis for GAARs in the tax laws of EU Member States. This doctrine provides a broad judicial anti-avoidance framework that has shaped the policy approach to GAARs across the EU.

The problem of "*abuse of law*" is an urgent case for correction and improvement that exists in all legal orders. Community law (EU law) also considers abuse as a priority. This seems to be the source of nearly 30 years of case law of the CJEU, which justifies opposing the existence of abusive practices even in the absence of norms that clearly define this power, both in the Community and in the national order. Moreover, the emergence of the concept of abuse of law is explained precisely because of the disruptive normative context specific to the European legal order[20].

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[19] Ingrida Steponavičienė, "Įmonių grupėms ir jų kontroliuojančiosioms įmonėms taikomos kovos su pelno mokesčio vengimu taisyklės Lietuvoje ir teisinio tikrumo principas: sisteminio reguliavimo iššūkiai," (doctoral dissertation, Mykolas Romeris University, 2022), 427-428, https://www.mruni.eu/wp-content/uploads/2022/03/Ingrida-Steponaviciene_disertacija_MRUweb.pdf.

[20] Paolo Piantavigna, *Abuso del diritto fiscale nell' ordinamento europeo* (Torino: Giappichelli, 2011), 12.

Thereby, the “*abuse of law*” doctrine has become a cornerstone of the CJEU`s approach to combat abusive tax practices in the EU. It provides a broad anti-avoidance framework to uphold the purposes of EU law where legislative gaps exist. The development of this principle was essential for the integrity of the European legal system.

The “*abuse of law*” doctrine has been developed by the CJEU in its case-law beginning with 1974.

C-33/74 Van Binsbergen was the first case in which the CJEU dealt with the problem of “*abuse of law*”. The CJEU recognises that Member States may enact laws limiting the freedom to provide services insofar as the regulations are intended to stop people from breaking national laws or making "U-turns" in a significant portion of the ruling, even though the court does not define abusive conduct.

The CJEU states that “*a Member State cannot be denied the right to take measures to prevent the exercise by a person providing services whose activity is entirely or principally directed towards its territory of the freedom guaranteed by article 56 of the Treaty on the Functioning of the European Union (TFEU) for the purpose of avoiding the professional rules of conduct which would be applicable to him if he were established within that state*[21]”.

Afterwards, as stated in paragraphs 21 and 22 of Kefalas, national measures and anti-abuse provisions that forbid "circumvention" or "U-turn" transactions constitute restrictions on free movement; therefore, the CJEU more directly addressed the question of abuse of Community law in C-367/96 Kefalas and C-212/97 Centros. The application of those rules, which are intended to combat abusive practises, must allow the restrictions to be justified.

In Barbier C-364/01, the CJEU stated that "*the exercise of fundamental freedoms cannot be excluded simply because Member States apply different income and corporate taxes*[22]".

In Emsland-Stärke C-110/99, the CJEU introduced a dual test of subjective and objective factors and clarified its understanding of the concept of “*abuse*”:

“*A finding of an abuse requires, first, a combination of objective circumstances in which, despite formal observance of the conditions laid down by the Community rules, the purpose of those rules has not been achieved*[23]”.

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[21] “Johannes Henricus Maria van Binsbergen v Bestuur van de Bedrijfsvereniging voor de Metaalnijverheid, Case-33/74.” EUR-Lex, accessed 20 July 2023, https://eur-lex.europa.eu/legal-content/en/ALL/?uri=CELEX:61974CJ0033.

[22] “The heirs of H. Barbier v Inspecteur van de Belastingdienst Particulieren/Ondernemingen buitenland te Heerlen, Case C-364/01.” EUR-Lex, accessed 21 July 2023, https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:62001CJ0364.

[23] *Ibid.*, para. 52.

"*It requires, second, a subjective element consisting in the intention to obtain an advantage from the Community rules by creating artificially the conditions laid down for obtaining it. The existence of that subjective element can be established, inter alia, by evidence of collusion between the Community exporter receiving the refunds and the importer of the goods in the non-member country*[24]".

First, the objective element examines whether, despite formal harmonisation, the material objectives and effects of the EU Regulation are met on the basis of the overall situation. It looks beyond technical harmonisation to the economic reality of the regulation.

Second, the subjective element requires proof of an intention to gain an unfair advantage by creating artificial conditions to benefit from EU interests. Collusion can show this intention, but it is not the only way to establish subjective abuse.

Abuse does not only arise from obtaining an advantage, but in particular from artificially manipulating conditions that are contrary to the objectives of EU regulations.

Moreover, the abuse of law principle does not invalidate EU rights per se, but only prevents the abuse of those rights contrary to the law objectives.

In conclusion, this two-pronged approach reveals the CJEU's nuanced analysis of anti-abuse. The abuse of law test sets a high hurdle, requiring both objective non-fulfillment of the objectives of the EU Regulation and subjective bad faith. This prevents abusive regulation while protecting the legitimate use of EU law. The doctrine attempts to balance the sovereignty of Member States, the rights of taxpayers and the integrity of the EU legal order.

In the Halifax case, the European Court of Justice was faced with the question of whether there was a legal basis for national tax authorities to refuse to deduct a taxpayer's input VAT on the basis of "abuse", despite the fact that the text of the Sixth VAT Directive does not make any reference to the concept of abuse. In his opinion, Attorney General Poires Maduro stated: "[...] *argued that this concept of abuse operates as a principle governing the interpretation of Community law and that the principle of 'abuse of Community law' can therefore be applied to VAT as part of Community law, even if the Directive does not refer to this principle*[25]". The CJEU supported this argument and held that EU customs law is an application that confirms the concept of abuse of Community law detailed in Emsland Stärke[26].

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[24] Case C-364/01, *supra note*, 22: para. 53.

[25] "Halifax and Others Case C-255/02." Opinion of advocate general Poiares Maduro, EUR-Lex, accessed 22 July 2023, https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:62002CC0255&rid=2

[26] Frans Vanistendael, "FROM ABUSE TO BASE EROSION, HOW DID IT COME TO THIS?," in *A GUIDE TO THE ANTI-TAX AVOIDANCE DIRECTIVE* Haslehner Werner, Pantazatou Aikaterini, Kofler Georg, Rust Alexander (Cheltenham: Edward Elgar, 2020), 12.

The Halifax case established the principle that abuse of Community law is the overriding principle in any interpretation of Community law and that this principle should be applied even where it is not expressly referred to in the relevant EU rules or regulations. In the Halifax case, the applicable regulation was EU secondary tax law and did not contain anti-abuse rules. The concept of what constitutes abuse derives from the concept of “abuse of Community law”, which applies in all other areas of law except tax law[27].

In Halifax, a domestic case concerning harmonised taxation in Cadbury Schweppes, the CJEU was faced with a cross-border task requiring an analysis of the compatibility and legitimacy of domestic rules on fundamental freedoms with EU law. whether the freedom of establishment provisions of Article 43 would constitute an unjustified restriction on this fundamental freedom by preventing established entities from locating in other Member States[28].

According to CJEU doctrine, the fact that a taxpayer moves to another Member State or carries out cross-border transactions in order to pay less tax does not in itself constitute an abuse, as long as the move is genuine[29]. As noted in paragraph 55, restrictions on fundamental freedoms may be justified on grounds of combating abusive practices where the specific purpose of such restrictions is to counteract conduct consistent with the creation of a wholly artificial arrangement[30].

Thus, according to CJEU doctrine, residents and non-residents are in different situations that may justify different treatment, but where both are in an objectively comparable legal position, such different treatment cannot be justified and constitutes indirect discrimination on grounds of nationality under EU law. Restrictions on fundamental freedoms may, however, be justified if they are appropriate to ensure that the objective pursued is achieved and do not go beyond what is necessary to achieve the objective pursued (proportionality), as well as for "clear reasons of public interest [31]" in the case of the free movement of capital. It is justified by the exception recognized by Article 58, now Article 65 TFEU[32].

The Thin Cap Group case dealt with the question of whether freedom of establishment and the UK's anti-avoidance regulations on "thin capitalization" were compatible. In this case,

[27] Vanistendael, *supra note*, 26: 14.
[28]“Treaty establishing the European Community,” EUR-Lex, accessed 23 July 2023, https://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:12002E043:EN:HTML.
[29]“Cadbury Schweppes plc and Cadbury Schweppes Overseas Ltd v Commissioners of Inland Revenue, Case C-196/04.” EUR-Lex, accessed 23 July 2023, https://eur-lex.europa.eu/legal-content/EN/ALL/?uri=CELEX%3A62004CJ0196.
[30] Case C-196/04, *supra note* , 26: para. 55.
[31] *Ibid*., para. 53.
[32] *Ibid*., para. 49.

interest paid to a firm formed in a different Member State was subject to the UK's thin capitalization regulations. The Thin Cap Group Case used the Lakhorst-Hohorst case as a precedent. In that case, the CJEU held that the German thin capitalization rule was incompatible with Community rules unless it was justified by the objective of counteracting tax evasion through wholly artificial arrangements that infringe fundamental freedoms[33].

In the Thin Cap Group Litigation, the EU added new elements to the doctrine developed in earlier cases. The judgement contains a new approach to the concept of a purely artificial regulation. While the criterion in the Cadbury-Schweppes case was lack of economic substance, in this case the CJEU relied on Article 9 of the OECD Model Convention to understand what constitutes a wholly artificial arrangement[34]. A non-resident entity does not comply with the arm's length principle for resident entities, which may be considered "a*n objective factor that can be independently verified to determine whether all or part of the transaction in question represents a wholly artificial arrangement*[35]". Courts have adopted two criteria to determine whether the limitations imposed by tax avoidance and thin capitalization restrictions are proportionate: national rules based on the arm's length principle are disproportionate if the taxpayer is given the opportunity to provide evidence of economic reality without undue administrative restrictions and are not considered disproportionate[36].

Furthermore, the CJEU recalls the principle of proportionality and states that where there is a purely artificial arrangement with no underlying commercial justification, tax benefits may only be denied to the extent that they exceed the arm's length price[37]. Even after the Thin Cap , abusive practices may still exist. Similar approaches have continued in a number of other cases concerning the possible existence of abuse. Cases following the same structure as Thin Cap include Glaxo Welcome, SGI, SIAT, Itelcar and Commission vs. the UK.

First, the CJEU decided which of the applicable freedoms (freedom of establishment, freedom to provide services, free movement of capital or free movement of labour) applied. Second, the CJEU found that the national rules in dispute restricted the above-mentioned freedoms. Consequently, the Court held that the restrictions were justified by the need to 'combat abusive practices', 'prevent tax avoidance' and 'combat tax evasion and avoidance'. The view put forward by

[33]" Lankhorst-Hohorst GmbH v Finanzamt Steinfurt, Case C-324/00." EUR-Lex, accessed 26 July 2023, https://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:62000CJ0324:EN:HTML.
[34] "Test Claimants in the Thin Cap Group Litigation v Commissioners of Inland Revenue, Case C-524/04." EUR-Lex, accessed 26 July 2023, https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:62004CJ0524_SUM&from=EN.
[35] *Ibid*., para. 81.
[36] *Ibid*., para. 82.
[37] *Ibid*., para. 83.

the CJEU is that restrictive measures can only be justified on these grounds if the measures specifically target 'purely artificial arrangements'. They can only be justified on one of these grounds. However, in defining this 'wholly artificial arrangement', the CJEU's case law is surrounded by a contradiction[38].

To sum up, the development of the abuse of law doctrine by the CJEU represents an important evolution in EU law. Starting with vague references in early cases such as Van Vinsbergen, the CJEU gradually formulated a two-pronged test for identifying abusive practices, requiring both objective avoidance of the objectives of EU rules and subjective intent to gain unfair advantage.

While key decisions such as Emsland Stelke, Halifax and Cadbury Schweppes have set out the basic principles, inconsistencies remain on the definition of artificial arrangements and proportionate responses. This jurisprudence continues to evolve through new case law applying abuse of law analysis to direct taxes, VAT and customs duties.

Overall, the abuse of law doctrine provides the CJEU with important powers against tax avoidance to promote the objectives of EU law, while balancing Member State sovereignty and taxpayers' rights. While uncertainties remain, combating abusive tax practices is a cornerstone of the EU legal order and the CJEU's continued development of this case law-based doctrine is crucial in shaping EU-wide anti-avoidance policy.

1.4. OECD/G20 BEPS Project

Historically, international tax cooperation has focused on the signing of treaties on the avoidance of double taxation, the main purpose of which is to reduce double taxation. This cooperation has established a set of international concepts and norms that underlie the existing network of more than 3,000 bilateral treaties on the avoidance of double taxation. This is what the internal tax system has historically sought to comply with in order to minimise problems of improper interaction that can lead to adverse consequences and distortions. In particular, double taxation of cross-border trade and investment. More recently, international tax cooperation has focused on limiting the ability of multinational corporations to exploit the existing gap and mismatches between domestic tax systems and double taxation avoidance treaty[39].

[38] Markus Seiler, *GAARs and Judicial Anti-avoidance in Germany, the UK and the EU* (Vienne: Linde, 2016), 12.
[39] Mr. Christophe J Waerzeggers, Mr. Cory Hillier and Mr. Irving Aw, “The Evolution of Tax Law Design within an Increasingly Destabilized International Tax Law Framework” in *Corporate Income Taxes under Pressure: Why Reform*

The OECD's BEPS Action Plan, launched in 2013, represents a joint international effort to combat aggressive tax evasion by multinational companies. The 15-Point plan aims to modernise the international tax system and ensure that profits are taxed in the case of real economic activity. The BEPS project has had a significant impact on the development of tax avoidance policies in the European Union. The final BEPS recommendation strengthened the EU's efforts to address tax avoidance within its own legal framework. The important actions of the BEPS plan, including preventing double taxation avoidance treaty abuse, limiting interest deductions, increasing transparency and addressing harmful tax practices, to important EU measures such as the ATAD. The BEPS project has provided a new impetus for the EU to coordinate and implement robust, standardised anti-avoidance measures among member states. It continues to serve as an important blueprint for the continuous strengthening of the EU's tools to combat tax avoidance.

Immediately after the BEPS project, there was a strong trend towards countries adopting anti-avoidance rules to address the remaining weaknesses and flaws of the existing international tax system[40].

The 15-point plan contains actions that served as a basis for the creation of future legislative GAAR and special anti-avoidance rules in the EU in particular: Action 2 - neutralising the effects of hybrid mismatch arrangements, Action 3 - designing effective rules on controlled foreign companies (CFC), Action 4 - limit base erosion via interest deductions and other financial payments, Action 6 - preventing treaty abuse. These Actions should be considered in more detail.

Firstly, Action 2 concerns hybrid mismatches which exploit differences in countries' tax treatment of financial instruments, assets, and entities to achieve double non-taxation outcomes. These arrangements take advantage of gaps between jurisdictions' rules to reduce tax liabilities in ways not intended by either country. A common example is an instrument treated as debt in one country but equity in another, enabling tax deductions without corresponding recognition of income[41].

The OECD BEPS measures aim was to eliminate the tax benefits derived from hybrid mismatches through a coordinated framework of recommendations. These provide domestic law rules and model treaty provisions to neutralise hybrid advantages by preventing multiple deductions or deductions without taxation. Once implemented, the rules should automatically apply

Is Needed and How It Could Be Designed, Mooij, Ruud A. de. Klemm, Alexander, Perry, Victoria J. (Washington: International Monetary Fund , 2021), 342.

[40]Waerzeggers, Hillier and Aw, *supra note*, 39.

[41] Organisation for Economic Co-operation and Development. *OECD/G20 Base Erosion and Profit Shifting Project 2015 Final Reports. Frequently Asked Questions, Paris, 2015.*

without further tax authority intervention. They are designed to stop hybrid arrangements being used for base erosion and profit shifting[42].

Secondly, the controlled foreign company rules allow jurisdictions to tax the income earned by foreign subsidiaries of domestic controlling companies before the actual distribution of profits. This should counteract the shift of profits to low-tax subsidiaries so that income is not deferred indefinitely. The CFC rules serve as a fallback to the transfer pricing rules. The OECD BEPS project has set out recommendations for effective CFC rules to prevent base erosion and profit shifting. This includes the definition of CFC income and the provision of foreign tax credits or exemptions to avoid double taxation. The adoption of the CFC rules is not mandatory, but it provides options for countries that want to implement new regimes or strengthen existing regimes. Despite past trends away from CFC rules, its presence for decades in dozens of countries demonstrates its ongoing role in the fight against BEPS. The OECD guidance allows for customised CFC rules for profit transfer that also fit the country's general tax policy objectives[43].

Thirdly, intra-group lending enables multinational enterprises to generate excessive interest deductions beyond actual third party financing costs. This represents a simple profit shifting technique as interest is tax deductible while equity is not. The OECD BEPS project recommends a fixed ratio rule limiting an entity's net interest deductions to 10-30% of its Earnings Before Interest, Taxes, Depreciation, Amortisation and Management (EBITDA). An optional group ratio rule bases the limitation on the overall group's net interest/EBITDA ratio. This coordinated approach aims to address BEPS risks from interest deductions[44].

The recommended interest limitation rules are not obligatory but facilitate convergence of countries' practices. Specific sectors like banking and insurance require further work given their particular features. Excess interest expense above the set ratio is non-deductible, but can be carried forward or back. The rules target base erosion from intra-group lending while allowing wider tax policy objectives. They provide a common approach for countries to introduce limitations on interest deductibility[45].

Finally, Action 6 said about treaty shopping which refers to arrangements where someone who is not a resident of the countries party to a tax treaty on the avoidance of double taxation attempts to obtain the benefits granted by the treaty. This often involves establishing shell companies or conduits in countries with favourable tax treaties. The BEPS minimum standard aims

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[42] OECD, *supra note,* 41.
[43] *Ibid.,* 9.
[44] *Ibid.*, 10.
[45] *Ibid.*

to address treaty shopping through changes to bilateral tax treaties.

The minimum standard requires adopting rules that effectively target treaty shopping. Treaties should state the intention to avoid tax evasion and avoidance. Countries could implement this common intention by including in their treaties: requires (1) a combination of a “limitation-on-benefits” rule (LOB, which is a specific anti-abuse rule) and of a “principal purpose test” rule (PPT, a general anti-abuse rule); (2) the inclusion of the PPT rule, or (3) the inclusion of the LOB rule supplemented by a mechanism that deals with conduit arrangements, such as a restricted PPT rule applicable to conduit financing arrangements 13 in which an entity otherwise entitled to treaty benefits acts as a conduit for payments to third country investors. Different anti-abuse rules provide certainty or flexibility. The treaty anti-abuse rules are applicable through modifications to existing treaties using a multilateral instrument developed by over 90 countries[46].

In conclusion, the creation of tax anti-avoidance rules has been greatly impacted by the OECD's BEPS initiative. Even while not all BEPS measures are required, they do offer standardised choices for nations to implement strong and well-coordinated anti-avoidance regulations. Meanwhile, the EU's legislative framework was reinforced and brought into line by the BEPS guidelines to counteract aggressive tax avoidance. Major EU measures included key Actions such as the ATAD which will be discussed in more detail in the next chapter.

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[46] OECD, *supra note*, 41: 13.

2. ANALYSE OF LEGAL FRAMEWORK ON GENERAL AND SPECIFIC TAX ANTI-AVOIDANCE RULES IN EUROPEAN UNION

Harmonisation of Corporate Taxation there are four Directives that seek to harmonise certain tax provisions in the field of direct taxation among different Member States. These directives contain rules aimed at addressing tax avoidance. These are:

- the Parent-Subsidiary Directive (2011/96) – which aims to, inter alia, eliminate tax obstacles to cross border distributions of intra-group profits;
- the Interest and Royalties Directive (2003/49) – which aims to eliminate withholding taxes on cross border interest and royalty payments between related companies ;
- the Merger Directive (2009/133) – which aims to eliminate tax hurdles to cross-border corporate reorganisations; and
- the Anti-Tax Avoidance Directive (2016/1164) (ATAD) and the Amending Directive to the 2016 Anti-Tax Avoidance Directive (2017/952) (ATAD 2) – which contain anti-abuse measures against common forms of aggressive tax planning

In addition, there are several proposed directives, such as:

- a directive to tackle the misuse of shell companies;
- a directive to introduce global minimum taxation of large multinational enterprises;
- a directive introducing an allowance on equity;
- a directive to introduce a Common Consolidated Corporate Tax Base, including the possibility for EU group companies to consolidate for tax purposes ;
- directives to tax the digitised economy[47].

2.1. GAAR of Council Directive 2003/49/EC (Interest and Royalties Directive)

Article 5 of the Interest and Royalties Directive (IRD) includes an important general anti-avoidance rule. According to this, Member States have the authority to refuse the benefits of the Directive in cases where an arrangement or series of arrangements serve primarily as an instrument of tax avoidance rather than being genuine. The anti-abuse rule aims to stop the creation of fictitious corporate structures that are only used to take advantage of the Directive's tax benefits. It allows member states to combat schemes that avoid taxes through the use of conduit companies and other ruses to circumvent the Directive. This anti-abuse clause acknowledges that, although

[47] Vasiliki Agianni et al., *European Tax Handbook 2023* (Amsterdam: IBFD, 2023), 14.

removing tax barriers is essential for the single market, protections against those who would take advantage purely for tax optimisation rather than legitimate economic activity are also required.

Article 5 provides: "1. *This Directive shall not preclude the application of domestic or agreement-based provisions required for the prevention of fraud or abuse. 2. Member States may, in the case of transactions for which the principal motive or one of the principal motives is tax evasion, tax avoidance or abuse, withdraws the benefits of this Directive or refuse to apply this Directive*[48]". The Interest and Royalty Directive does not establish any additional particular requirements for tax avoidance. It is particularly noteworthy that the Interest and Royalty Directive's GAAR specifically refers to "*motive*" in its text as the factor that determines whether a tax avoidance or evasion occurs, in contrast to the GAAR of other Directives. It appears to confirm that the taxpayer's subjective element is significant in a GAAR[49].

The Directive doesn't provide definitions for the terms "evasion," "avoidance," or "abuse." An individual analysis of the entire operation in question is necessary for the application of this rule. Accordingly, the competent authorities cannot limit their actions to using preset general criteria[50]. Nevertheless, certain circumstances may be viewed by the tax authorities as signs of abuse. Abuse could occur, for instance, if the interest and/or royalties are transferred entirely or in part soon after they are received (even in cases where there is no legal requirement to do so), the recipient lacks substance, or the recipient is interposed solely to obtain the benefits of the Directive. As a result, domestic safe harbours might not hold—for example, requiring a minimum level of substance in a structure before it can be considered abusive. The general principle of EU law states that the taxpayer must not be granted the benefits under the Directive and fundamental freedoms, even in cases where there are no domestic or agreement-based provisions upon which such a refusal may be predicated. This principle states that EU law cannot be relied upon for abusive or fraudulent purposes. Evidence of abuse must include both objective and subjective elements[51].

On February 26, 2019 the CJEU issued the long-awaited judgments on the cases concerning the Danish government withholding tax on dividends and interest paid by Danish

[48]"Council Directive 2003/49/EC of 3 June 2003 on a common system of taxation applicable to interest and royalty payments made between associated companies of different Member States ," EUR-Lex, accessed 10 October 2023, https://eur-lex.europa.eu/legal-content/EN/ALL/?uri=celex%3A32003L0049.

[49] Denis Weber, "The proposed EC Interest and Royalty Directive," *EC Tax Review*, 9, 1 (2000): 16, https://doi.org/10.54648/261252.

[50] "Deister Holding AG, formerly Traxx Investments N.V. (C-504/16), Juhler Holding A/S (C-613/16) v Bundeszentralamt für Steuern, Joined Cases C-504/16 and C-613/16," EUR-Lex, accessed 12 October 2023, https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A62016CA0504.

[51] "N Luxembourg 1 and Others v Skatteministeriet, Joined Cases C-115/16, C118/16, C-119/16 and C-299/16," EUR-Lex, accessed 12 October 2023, https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:62016CJ0115.

companies to companies in other EU Member States. More specifically, the cases dealt with the interpretation of the anti-abuse clauses laid down under Art. 1, para. 2 of the Parent-Subsidiary Directive and Art. 5 of the Interest and Royalties Directive. The main statements from these CJEU judgements will be discussed in more detail in the subchapter 2.2.

In conclusion, Article 5 of the Interest and Royalties Directive contains a general anti-abuse rule that permits Member States to refuse treaty benefits in cases where the main purpose of the arrangements is tax avoidance. Its ambiguous use of the terms "*evasion*", "*avoidance*", and "*abuse*" without definitions, however, raises the possibility of uneven implementation amongst states. There is uncertainty because national courts ultimately determine whether or not particular cases constitute abuse, even though the CJEU has provided indicative factors. It is also problematic for tax authorities to bear the burden of demonstrating subjective tax motives. The framework poses challenges by expecting tax administrators to establish that the subjective prerequisite of the GAAR in IRD stands fulfilled - namely that the transaction under question was carried out "*...with the principal motive or one of the principal motives is tax evasion, tax avoidance or abuse..*[52]*"* Demonstrating that tax considerations played more than just an incidental role represents a substantial evidentiary burden for authorities given the inherent complexity in conclusively proving underlying motive, intent and purpose behind corporate decisions on financing structures, policies etc, especially amidst resource limitations and sophisticated concealment techniques.

However, concerns regarding maintaining Directive benefits even for fabricated arrangements are raised by EU regulations restricting unilateral state actions against alleged abuse. Directives are still legally binding, though, and member states shouldn't take them lightly. In general, the Interest and Royalties Directive's anti-abuse framework is not entirely clear and effective.

At the same time, EU rules limiting unilateral state actions against perceived abuse raise concerns about preserving directive benefits even for contrived arrangements. Clearer definitions, standards and procedures are needed to ensure better coordination and outcomes avoiding both double taxation and unintended non-taxation.

2.2. GAAR of Council Directive 2011/96/EU (Parent-Subsidiary Directive)

The Parent-Subsidiary Directive (PSD) was adopted in 1990 and amended in 2003 to facilitate

[52] Council Directive 2003/49/EC, *supra note,* 48: Article 5.

cross-border corporate investment within the EU. It aimed to reduce tax differences between domestic and EU-wide corporate groups. A recast directive in 2011 consolidated the rules. The key elements are:

- the parent company's state must avoid double taxation on subsidiary profits, either exempting foreign dividends or giving a tax credit;
- subsidiary dividends to the parent are exempt from withholding taxes;
- the rules apply for distributions to permanent establishments in other Member States;
- they also cover payments from subsidiaries to permanent establishments of the same parent company.

The Parent-Subsidiary Directive removes tax obstacles for EU corporate expansion and cross-border investment through dividends. It enforces consistent treatment and eliminates disadvantages relative to domestic groups[53].

Directive 2015/121 On 27 January 2015, the Council adopted the Amending Directive to the 2011 Parent-Subsidiary Directive (2015/121) that introduced a GAAR into the Parent-Subsidiary Directive (2011/96). Article 1 (2) to (4) are amended as:

> *2. Member States shall not grant the benefits of this Directive to an arrangement or a series of arrangements which, having been put into place for the main purpose or one of the main purposes of obtaining a tax advantage that defeats the object or purpose of this Directive, are not genuine having regard to all relevant facts and circumstances. An arrangement may comprise more than one step or part. 3. For the purposes of paragraph 2, an arrangement or a series of arrangements shall be regarded as not genuine to the extent that they are not put into place for valid commercial reasons which reflect economic reality. 4. This Directive shall not preclude the application of domestic or agreement-based provisions required for the prevention of tax evasion, tax fraud or abuse*[54].

In the preamble (5) of the amending Directive 2015/12120, the Council mentions that Article 1(2) is a "*common minimum anti-abuse rule*". According to the room document of Parent Subsidiary Directive amendment[55], such common minimum anti-abuse rule aims to reduce inconsistency between Member States and provides a model for Member States whose tax systems

[53] Vasiliki Agianni et al., *supra note* 47: 21.
[54] "Council Directive 2011/96/EU of 30 November 2011 on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States ," EUR-Lex, accessed 23 October 2023, https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=celex%3A32011L0096.
[55] Denis Weber, "The New Common Minimum Anti-Abuse Rule in the EU Parent-Subsidiary Directive: Background, Impact, Applicability, Purpose and Effect," *Intertax* 44, 2 (2016): 103.

do not have such GAAR[56].

The terms "*arrangement*" and "*series of arrangements*" are not defined in the PSD but likely have a broad interpretation similar to the initially proposed definition covering transactions, schemes, actions, operations, agreements, etc.

It's worth noticing that the new GAAR of the Parent Subsidiary Directive contains tests structure.

The subjective test if the arrangement was set up "*for the main purpose or one of the main purposes of obtaining a tax advantage*", it will be subject to the new anti-abuse rule. This is known as a "*subjective test*", wherein it must be proven, *quaestio facti*[57], that the transactions were motivated by reaping the advantages of a specific tax law (in this case, the Directive provisions). If one were to take the subjective test literally, it would mean that obtaining a tax advantage cannot be the sole purpose for a specific arrangement or series of arrangements. Rather, it seems adequate that obtaining a tax benefit was one of the main purposes. Put another way, if attaining the Directive benefits was also a primary goal, an arrangement motivated by one or more important objectives that have nothing to do with obtaining those benefits may nonetheless violate the new anti-abuse rule.

At first glance, it might seem that the Directive anti-abuse regulation, which only requires that receiving a benefit be "*one of the main purposes*", has a relatively low (subjective) misuse threshold. The more sensible subjective test is whether the regulation is solely or at least primarily concerned with achieving PSD benefits. In other words, even if achieving the benefits of PSD is "*one of the main objectives*", the benefits of PSD should be recognized if real economic objectives are pursued[58].

In addition, regard must be had to the fact that the new antiabuse rule has an open-ended personal scope, as it in no way refers to the taxpayer that has allegedly "*committed*" the abuse. Instead, it looks at whether or not one of the main purposes for setting up the "arrangement" or "*series of arrangements*" was to obtain the benefits of the PSD[59]. As a result, one may argue that a taxpayer that does not play an active role in the abusive arrangement can be caught under the anti-abuse provision.

A tax benefit would only be considered to "*defeat the object or purpose of this Directive*"

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[56] Filip Debelva and Joris Luts, "The General Anti-Abuse Rule of the Parent-Subsidiary Directive," *European Taxation* 55, 6 (2015): 223.
[57] Paolo Piantavigna, "Tax abuse in European Union Law: A Theory," *EC Tax Review* 20, 3 (2011): 143.
[58] Debelva and Luts, *op. cit.,* 225.
[59] *Ibid*.

in cases when the new anti-abuse rule is applicable. This test thus bears a great deal of similarity to the objective test that the CJEU has traditionally advanced[60].

It should be mentioned that the objective test's general goal is to determine if, even in cases where the law's wording is strictly followed, benefits to the individual in question undermine the legislation's intended aim[61]. When it comes to the PSD, this refers to circumstances when a taxpayer asserts a benefit under the PSD's provisions in word, but the act of granting such treatment goes against the intent and objective of those provisions.

Therefore, the application of the anti-abuse rules means that the PSD is applied in accordance with its purpose and intent rather than its (literal) text. Under the standard burden of proof allocation, a taxpayer can validly claim the benefits of PSD as long as the anti-abuse rules (including the objective test) are not met. This means that in certain circumstances, the burden is on the tax authorities to prove that the provision of the benefit in question would frustrate the purpose and intent of the PSD, which is not easy to prove as the purpose and intent of the PSD is broad and general and consequently the objective test is not easy to meet. Moreover, whereas one can make a theoretical distinction between the objective and subjective tests, distinguishing both tests is probably difficult in practice[62].

The "*genuineness*" test in the PSD anti-abuse rule requiring valid commercial reasons reflecting economic reality seems redundant. The term "*genuine*" is not normally used in EU anti-abuse law, which refers to "artificial" arrangements instead. Valid commercial reasons already feature in the subjective motive test. "*Economic reality*" comes from the CJEU wholly artificial arrangement doctrine.

There are also conceptual issues with applying the genuineness test. Lacking substance may indicate abuse but some activities like shareholding inherently require little substance. Denying benefits to "*pure holding companies*" that perform essential activities just because they lack operational activities could disproportionately hit them versus "mixed" holding firms. The genuineness test appears to add little given the existing subjective and objective analyses while risking overly broad denial of benefits[63].

Under the PSD anti-abuse rule, member states must deny all directive benefits if arrangements are deemed abusive. This includes the subsidiary exemption from withholding taxes

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[60]Debelva and Luts, *supra note*, 56: 226.

[61] Rita de la Feria and Stefan Vogenauer, *The Prohibition of Abuse of Law: An Emerging General Principle of EU Law* (Portland: Bloomsbury Publishing, 2011), 523.

[62] Vogenauer and de la Feria, *op.cit.*, 524.

[63] Debelva and Luts, *supra note*, 56: 228.

and elimination of parent double taxation. Denying both benefits for perceived abuse can significantly impact taxpayers through multiple international taxation[64].

A literal reading suggests even arrangements only partially affected by abuse could see full denial of PSD benefits. This blanket approach risks creating disproportionate results, especially juridical and economic double taxation. While combating directive misuse is appropriate, the possibility of denying all benefits should be weighed against principles of proportionality and potential consequences for taxpayers engaged in cross-border activities the PSD intends to facilitate.

National safe harbours (e.g. a minimum level of substance so that a structure is not considered abusive) may not apply[65]. Member States should deny tax treaty benefits where an arrangement constitutes an abuse of rights, even if they have not introduced specific anti-avoidance legislation in their national law. This requirement derives from the general EU anti-abuse principles[66] GAAR provisions under treaties necessary to prevent national tax evasion, tax fraud or abuse.

In terms of indicators of avoidance, the PSD and the IRD are extremely similar. Furthermore, the features in the CJEU case are comparable or blended. Therefore, as mentioned earlier, we need to consider CJEU judgments on the cases concerning the Danish government withholding tax on dividends and interest paid by Danish companies to companies in other EU Member States.

The most relevant statements of the CJEU judgements can be summarised as follows.

- In the absence of domestic or agreement-based anti-abuse provisions for implementing clauses outlined in the PSD and the IRD, national authorities and courts retain the discretion to deny taxpayers the exemption from withholding tax on dividend and interest payments. This is based on the overarching principle in EU law that prohibits the reliance on EU regulations for abusive or fraudulent purposes. Specifically, for the PSD, there is no imperative need to delve into the interpretation of the term "beneficial owner."
- In the context of the IRD, the explicitly provided beneficial ownership clause in Articles 1(1) and 4 suggests an interpretation designating an entity that genuinely

[64] Debelva and Luts, *supra note*, 56.

[65] "Østre Landsret — Denmark, Skatteministeriet v T Danmark, Y Denmark Aps, Joined Cases C-116/16 and C-117/16," EUR-Lex, accessed 30 October 2023, https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A62016CA0116.

[66] "Z Denmark ApS v Skatteministeriet, Case C-299/16," EUR-Lex, accessed 30 October 2023, https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:62016CN0299.

benefits from the interest or royalty payments. It implies that an entity qualifies as the beneficial owner only when it receives these payments for its own benefit and not as an intermediary, such as an agent, trustee, or authorized signatory, acting on behalf of another entity. Moreover, the beneficial ownership clause within the IRD draws inspiration from Article 11 of the OECD Model Tax Convention, making the interpretation of beneficial ownership in bilateral conventions and their commentaries relevant when scrutinising IRD provisions.

- While the determination of whether a specific case amounts to an abuse of law rests with the national court, the CJEU has provided several indicators to guide assessments. These include situations where a substantial portion of dividends or interest/royalties is promptly passed on by the receiving company to entities failing to meet the conditions for PSD/IRD application. This could be due to their non-establishment in any Member State, non-incorporation in forms covered by the PSD/IRD, non-subjection to taxes listed in the PSD/IRD, or lacking the status of a "parent company". Further indications involve scenarios where a company's sole activity is receiving and transmitting dividends or interest/royalties, with no substantial economic activity discernible.
- Instances of abuse might also arise from the existence of contracts in financial transactions, variations in how transactions are financed, valuation of intermediary companies' equity, and the inability of conduit companies to derive economic benefits from receiving dividends. The beneficial owner's residence in a non-EU state does not make the withholding tax exemption under the PSD contingent on fraud or abuse findings. Concerning the burden of proving abuse, while companies seeking exemption are generally required to demonstrate compliance with PSD or IRD conditions, the specific proof of an abusive practice lies with the tax authority of the source Member State. The tax authority must establish that the alleged beneficial owner is essentially a conduit company, facilitating an abuse of rights.
- Turning to the 'subject-to-tax clause' in the IRD, the CJEU has clarified that this requirement remains unmet if a company, while liable to corporate income tax in its Member State of establishment, effectively does not bear such tax on the received interest.
- In cases where no fraud or abuse is identified, the provisions related to the free movement of capital do not impede national legislation requiring a resident company

to withhold tax on interest paid to a non-resident company. However, the free movement of capital does preclude legislation mandating such withholding if interest is paid by a resident company to a non-resident company, while a resident company receiving interest from another resident company is not obligated to make an advance payment of corporation tax. In such scenarios, the resident company is not required to pay corporation tax related to that interest until a substantially later date than the deadline for paying the tax withheld at the source.

- Furthermore, the free movement of capital precludes national legislation where a resident company, subject to an obligation to withhold tax at source on interest paid to a non-resident company, does not take into account the expenditure in the form of interest directly related to the lending, incurred by the non-resident company. This stands in contrast to a resident company that receives interest from another resident company and is allowed to deduct such expenditure in establishing its taxable income[67].

To sum up, case law aims to strike a balance between preventing abusive tax avoidance arrangements and ensuring that valid cross-border activities enjoy the intended benefits. However, the emphasis on case-by-case analysis risks inconsistent application in the absence of clearer guidance. Terms such as 'lack of substance' are vague without indicators of the minimum permissible behaviour. More clarity is needed on permissible domestic anti-avoidance rules.

The ECJ has established important principles against automatic denial of benefits or requiring proof of tax avoidance intent. Nevertheless, uncertainty remains for Member States and taxpayers between permitted arrangements and inappropriate abuses in practice. A more sophisticated framework with clear line-drawing elements indicating permitted tax relief and tax avoidance would ensure better consistency and results. Otherwise, questions will remain regarding the correct application of the GAAR and the proportionality of refusals.

The Parent-Subsidiary Directive's 2015 GAAR amendment establishes subjective and objective tests for identifying tax avoidance arrangements. However, key terms remain vague and domestic implementation inconsistent. CJEU case law aims to balance preventing abuse and ensuring valid activities get intended benefits, but risks inconsistent application without clearer guidance.

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[67] "CJEU RULES ON PARENT-SUBSIDIARY & INTEREST AND ROYALTIES DIRECTIVES ANTI-ABUSE CLAUSE," McDermott, Will & Emery, accessed 13 October 2023, https://www.mwe.com/insights/cjeu-rules-on-parent-subsidiary-interest-and-royalties-directives-anti-abuse-clauses/.

The GAAR framework involves inherent uncertainties for both tax authorities and taxpayers regarding acceptable tax mitigation versus improper avoidance. However, it is worth noting that the GAAR contained in the PSD is a significant step towards combating tax avoidance.

2.3. GAAR of Council Directive 2009/133/EC (Merger Directive)

The objective of the 2009/133 Merger Directive (MD) is to streamline cross-border reorganisations inside the European Union. It is a codified version of the 1990/434 Merger Directive and its revisions. The Directive allows for the postponement of paying capital gains taxes on some cross-border reorganisations. The participating corporations and their shareholders shouldn't have any immediate direct tax consequences from these transactions, such as corporation taxes, income taxes, or capital gains taxes. Until such assets are retransferred, the associated taxes are postponed. Facilitating cross-border mergers, splits, and similar transactions between businesses founded in Member States is the aim of the Merger Directive (90/434). The implementation of Merger Directive (90/434) enables groups of companies to reorganise their activities into the most appropriate structure for operating within the European Union without incurring the tax costs which would otherwise generally apply to such transactions[68].

The Directive contains an important general anti-avoidance provision in Article 15. Article 15(1)(a) provides:

> *1. A Member State may refuse to apply or withdraw the benefit of all or any part of the provisions of Articles 4 to 14 where it appears that one of the operations referred to in Article 1: (a) has as its principal objective or as one of its principal objectives tax evasion or tax avoidance; the fact that the operation is not carried out for valid commercial reasons such as the restructuring or rationalisation of the activities of the companies participating in the operation may constitute a presumption that the operation has tax evasion or tax avoidance as its principal objective or as one of its principal objectives*[69].

According to Article 15(a), if tax evasion or tax avoidance is the taxpayer's "principal objective or one of the principal objectives" for conducting an operation, the benefit of the Fiscal

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[68] Vasiliki Agianni et al., *supra note* 47: 18.

[69] "Council Directive 2009/133/EC of 19 October 2009 on the common system of taxation applicable to mergers, divisions, partial divisions, transfers of assets and exchanges of shares concerning companies of different Member States and to the transfer of the registered office of an SE or SCE between Member States ," EUR-Lex, accessed 9 October 2023, https://eur-lex.europa.eu/legal-content/EN/ALL/?uri=celex%3A32009L0133.

Merger Directive may be refused. When operations are conducted for "*valid commercial reasons*", it is assumed that the taxpayer's primary goal in conducting the merger is to avoid or evade tax. Stated differently, the taxpayers use valid commercial reasons as rebuttal evidence to support their non-tax avoidance objectives.

Thus, the Merger Directive's Article 15(a) allows denying benefits if tax avoidance is a main motive, with valid business purpose as rebuttal evidence per the ECJ.

Article 15(1)(a) of the Merger Directive has attracted limited academic attention compared to the general EU abuse of law doctrine developed by ECJ case law. Some view it as just a "*mini-GAAR*" reflecting the prohibition on abusing EU rights for tax avoidance purposes. Its legal status is also unclear given it's an EU directive requiring domestic implementation.

However, research shows member states have transposed Article 15(1)(a) in divergent ways. Some follow it verbatim, others modify or base presumptions on it, and some don't transpose it at all[70].

There is significant conceptual alignment between Article 15(1)(a) of the Merger Directive and the ECJ's doctrine prohibiting abuse of EU law. Both employ:

- A teleological approach, examining the purpose and aims behind the law.
- Assessing the overall economic substance of composite transactions, not just individual components.

Similarly, Article 15(1)(a) utilises objective and subjective tests like the CJEU abuse doctrine:

- An objective assessment of whether the arrangement results in tax avoidance.
- A subjective assessment of the taxpayer's intentions behind undertaking the arrangement.

In this way, Article 15(1)(a) mirrors the CJEU prohibition on abusing EU law principles by relying on purposive interpretation and analysing the substantive effect and motives of taxpayer actions.

A key challenge is distinguishing between legitimate tax planning and unacceptable tax avoidance under anti-abuse rules like Article 15(1)(a) of the Merger Directive. The CJEU case law provides guidance. First, the economic substance of composite transactions should be assessed, not just individual steps. Denying benefits requires identifying inconsistencies with the Directive's aims. Exploiting general assumptions in the law is not necessarily avoidance[71].

Second, taxpayer intention matters, not just the existence of a preordained tax-driven plan.

[70] Katrina Petrosovitch, “Abuse under the Merger Directive,” *European Taxation* 50, 12 (2010): 550.

[71] Joachim Englisch, “National measures to counter tax avoidance under the Merger Directive,” in *Movement of Persons and Tax Mobility in the EU: Changing Winds,* Ana Paula Dourado (Amsterdam: IBFD, 2013), 220.

Seeking tax savings is not enough to establish abuse - they must play a significant role versus commercial motivations. Valid business reasons can rebut assumptions of avoidance, but lack thereof suggests a wholly artificial arrangement. This allows addressing aggressive planning even if it takes advantage only of generalised law assumptions[72]. Overall, delineating improper avoidance requires weighing economic and subjective factors based on Directive principles and purposes.

Additionally, insofar as tax avoidance schemes target tax benefits granted by national law in accordance with the Directive, Art. 15 (1) (a) MD empowers Member States to combat them in order to guarantee that benefits can only be claimed in accordance with their "*spirit*" and the factors supporting their respective qualifications. The CJEU has already interpreted Art. 15 (1) (a) MD on four times, or more accurately, its predecessor with nearly identical wording. Its relevance to purposive construction has also been indirectly addressed in a fifth instance. It is therefore the one that has been covered in Court case law the most thus far out of all the few clear anti-avoidance regulations in harmonised tax legislation[73].

An examination of the Merger Directive cases suggests that the CJEU employs the subsequent investigational methodology: Is the Merger Directive relevant? Stated differently, do taxpayers qualify for tax deferral? The tests that are used are as follows: Is the reorganisation domestic or cross-border? Are the taxpayers involved eligible legal entities? Does the transaction meet the Merger Directive's definition of a reorganisation? Unless the anti-abuse rule applies, taxpayers are entitled to the advantages of the Merger Directive if all of these requirements are met. Thus, the following question is: Is there a national anti-abuse law in place? Does the national anti-abuse measure adhere to EU law, if applicable? Therefore, in any case involving potentially abusive practices, national tax authorities and the courts have the chance to address abuse from two perspectives. They can first examine whether the transaction should be considered a reorganisation for the purposes of the Merger Directive. Second, they may challenge the transaction under the anti-abuse rule even if it formally complies with the standards of a reorganisation[74].

There are also general rules that automatically exclude certain categories of operations from the benefits of the Directive on the basis of general criteria – e.g. the acquiring company does not carry on business by itself; the same person wholly owns all companies involved; or there is no joining of businesses – irrespective of whether tax evasion or tax avoidance takes place, go further than necessary for preventing tax evasion or tax avoidance and undermine the aim pursued by the

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[72] Englisch, *supra note,* 71: 230.
[73] *Ibid*., 231.
[74] Petrosovitch, *supra note*, 70: 558.

Directive. All of these factors combined cannot be regarded as decisive[75]. The benefits of the Directive may not be realised in transactions when the only motivation is tax-related, since the idea of "*a valid commercial reason*" encompasses more than just achieving a tax advantage[76]. Furthermore, tax objectives might not be the main goal if there are other goals involved.

In this context, there is no valid commercial reason if the cost savings resulting from restructuring or rationalisation are marginal compared to the level of tax benefits (e.g. the use of tax losses incurred by the merged company)[77]. However, where there are sound commercial reasons, structuring the transaction in the most tax advantageous way does not constitute an abuse under EU law[78].

However, the benefits of the Directive cannot be denied where the main purpose of the merger is to avoid taxes that fall outside the scope of the Directive. In this sense, the anti-abuse rule does not extend to tax avoidance transactions that are not covered by the Directive, even if they are carried out primarily for tax purposes[79]. Cross-border reorganisations can lead to situations of double taxation where one Member State considers a transaction to be legitimate (and therefore allows the transaction to be carried at book value), while another Member State considers the same transaction to be abusive (and therefore does not allow tax deferral). In such cases, the applicable tax treaty (if any) or arbitration agreement may impose an obligation on the Member State concerned to avoid double taxation.

After all, the Merger Directive's Article 15(a) allows denying benefits when arrangements are primarily tax driven, balanced by taxpayers' ability to provide valid commercial justifications. Extensive jurisprudence helps distinguish unacceptable avoidance from legitimate mitigation based on weighing subjective intentions against objective economic substance. However, Article 15(a)'s legal authority remains unclear given its directive status and inconsistent domestic implementation.

Article 15(a) exhibits strong conceptual alignment with the CJEU general anti-abuse principles but may still provide unique value. As a tailored measure, comprehensive analysis could elucidate Article 15(a)'s precise test and relationship to the CJEU doctrine. This can help establish clearer boundaries between improper avoidance and acceptable planning when applying the

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[75] "A. Leur-Bloem v Inspecteur der Belastingdienst/Ondernemingen Amsterdam 2, Case C-28/95," EUR-Lex, accessed 20 October 2023, https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A61995CJ0028.
[76] *Ibid*.
[77] "Foggia — Sociedade Gestora de Participações Sociais SA v Secretário de Estado dos Assuntos Fiscais, Case C-126/10," EUR-Lex, accessed 20 October 2023, https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:62010CJ0126_SUM&from=MT.
[78] "Eurowings Luftverkehrs AG and Finanzamt Dortmund-Unna, Case C-294/97," EUR-Lex, accessed 21 October 2023, https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:61997CJ0294&from=EN.
[79]" Modehuis A. Zwijnenburg BV v Staatssecretaris van Financiën, Case C-352/08, EUR-Lex, accessed 23 October 2023, https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:62008CJ0352_SUM&from=ET.

Merger Directive.

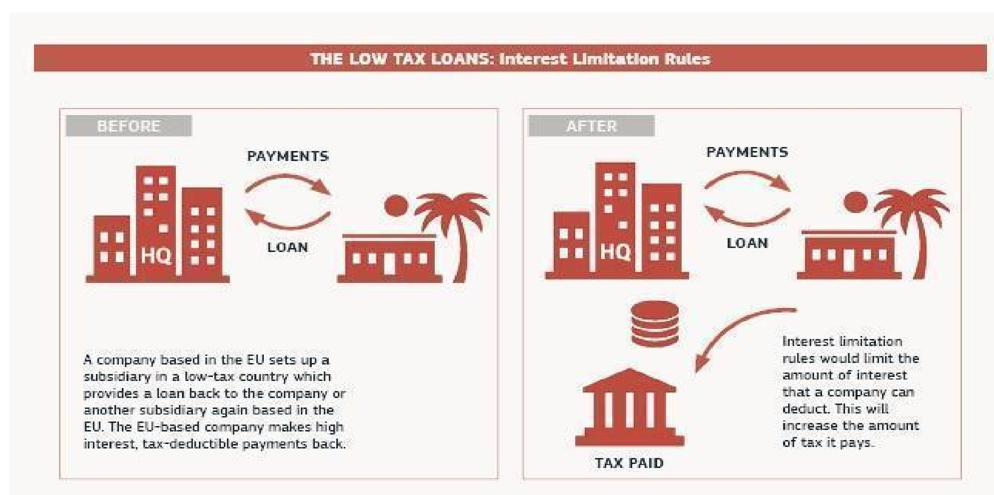
2.4. Council Directive (EU) 2016/1164 (Anti-Tax Avoidance Directive)

2.4.1. The interest limitation rule

On 12 July 2016, following a difficult negotiation process, the Economic and Financial Affairs Council configuration (ECOFIN) of the Council of the European Union adopted the Anti-Tax Avoidance Directive (ATAD I). The adoption of this Directive represented a milestone in the efforts to tackle base erosion and profit shifting within the EU. ATAD I introduced five sets of rules of minimum standards of which four (interest limitation rule, GAAR, Controlled Foreign Company – CFC – rules and hybrid mismatches) are largely consistent with the OECD's BEPS recommendations in BEPS Action Plans 2, 3, 4 and 6, and the fifth (exit taxation) goes beyond the scope of the OECD's BEPS project. Importantly, subsequent rules relating to hybrid mismatches were finalised on 29 May 2017 when the ECOFIN adopted ATAD II (which amends ATAD I but only with respect to hybrid mismatches)[80].

Recital 6 to the ATAD sets out the rationale for the introduction of the interest limitation rule (ILR). It recognises that groups of companies have increasingly shifted profits and eroded tax bases through excessive interest payments. To counter that a rule that limits deductibility of interest payments was considered necessary. The primary objective of Article 4 of the ATAD is to battle tax avoidance through excessive interest payments. Article 4 of ATAD requires EU Member States to implement an interest limitation ratio. The ratio has been designed to limit the ability of an entity to deduct net borrowing costs in a given year to a maximum of 30% of EBITDA. In other words, the ILR denies a tax deduction for the net interest expense (i.e. the gross interest expense less the interest and/or interest equivalent income) that exceeds 30% of EBITDA. While ATAD set the date for implementing the ILR as 1 January 2019 the directive included a derogation allowing Member States, that already had nationally targeted rules for preventing interest related base erosion and profit shifting risks that were equally effective to the ILR, to defer implementation until potentially as late as 1 January 2024[81]. We can see on *Figure 2* the ILR.

[80]PwC NL Tax Knowledge Centre. *Overview of the implementation of the Anti-Tax Avoidance Directive into Member States' domestic tax laws*. Amsterdam, 2019.
[81] A&L Goodbody. Implementation of the Interest Limitation Rule (the ILR) in Ireland. Dublin, 2022.



(Figure 2)[82]

Under Article 4 of the EU ATAD, a corporate taxpayer's excess borrowing expense is deductible in the tax year in which it is incurred up to (1) a maximum of 30% of the taxpayer's taxable EBIDTA (paragraph 1); or (2) a fixed maximum amount of EUR 3,000,000 for each entity or the group of which it is part[83]. Tax exempt income is excluded from EBIDTA, and therefore decreases the amount of deductible interest[84]. A Member State may include a group exception where the taxpayer is part of a group filing statutory consolidated accounts. Taxpayers may be entitled to deduct higher amounts of excess borrowing expense, by considering the indebtedness of the overall group at the worldwide level; and an equity escape provision may be included where the interest limitation rule does not apply if the company can demonstrate that its ratio of equity over total assets is broadly greater than or equal the equivalent group ratio[85].

Furthermore, a Member State may introduce rules providing for the setting off of the excess borrowing expense against unused interest deductions in prior years. A Member State may also provide for full deduction of excess borrowing expense if the taxpayer is a standalone entity; and may exclude financial undertakings' loans concluded before 17 June 2016, and loans funding a 'long-term public infra-structure project' from the scope of the rule[86]. With respect to non-deductible interests, Member States may introduce carry-forward and carry-back possibilities for an unlimited period or a maximum of 3 years, respectively. Article 4 along with the other

[82]"The Anti Tax Avoidance Directive," European Commission, accessed 30 October 2023, https://taxation-customs.ec.europa.eu/anti-tax-avoidance-directive_en.

[83] "Council Directive (EU) 2016/1164 of 12 July 2016 on laying down rules against tax avoidance practices that directly affect the functioning of the internal market," EUR-Lex, accessed 1 November 2023, https://eur-lex.europa.eu/legal-content/en/TXT/?uri=celex:32016L1164.

[84]Pieter Van Os, "Interest Limitation Under the Adopted Anti-Tax Avoidance Directive and Proportionality," *EC Tax Revenue*, 25, 4 (2016): 185, https://doi.org/10.54648/ecta2016020.

[85]Council Directive (EU) 2016/1164 , *supra note, 83:* Preamble.

[86] Van Os, *op. cit.,* 161.

provisions in the ATAD is a de minimis rule and incorporates the main recommendations from Action 4. Article 4 of the ATAD is therefore the EU regional answer to Action 4[87].

It is necessary to define the phrase "exceeding borrowing costs" first. Twenty Subparagraphs 1 and 2 of Article 2 of the ATAD specifically address this. First the term "borrowing costs" is defined in the following manner:

> *Interest expenses on all forms of debt, other costs economically equivalent to interest and expenses incurred in connection with the raising of finance as defined in national law, including, without being limited to, payments under profit participating loans, imputed interest on instruments such as convertible bonds and zero coupon bonds, amounts under alternative financing arrangements, such as Islamic finance, the finance cost element of finance lease payments, capitalised interest included in the balance sheet value of a related asset, or the amortisation of capitalised interest, amounts measured by reference to a funding return under transfer pricing rules where applicable, notional interest amounts under derivative instruments or hedging arrangements related to an entity's borrowings, certain foreign exchange gains and losses on borrowings and instruments connected with the raising of finance, guarantee fees for financing arrangements, arrangement fees and similar costs related to the borrowing of fund[88].*

The word encompasses a wide range of charges, including interest of any kind, costs that are "economically equivalent to interest," and expenses related to borrowing capital. Certain payment methods are specifically stated as included in the definition, without restriction, for the sake of greater clarity. This method of determining the expenses to which deductibility is restricted is modelled after the recommendations made in the BEPS action 4 final report as the optimal strategy. The term "exceeding borrowing costs" is defined as follows in subparagraph 2 of Article 2 of the ATAD, with reference to the term "borrowing costs":

> *The amount by which the deductible borrowing costs of a taxpayer exceed taxable interest revenues and other economically equivalent taxable revenues that the taxpayer receives according to national law. This essentially means that only the deductibility of borrowing costs that cannot be offset by income which constitutes as taxable interest revenues or other economically equivalent taxable received revenues according to national law is limited, i.e. the net borrowing costs of the taxpayer[89].*

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[87] Council Directive (EU) 2016/1164 , *supra note, 83.*
[88] *Ibid*.
[89] *Ibid.*

This effectively indicates that the taxpayer's net borrowing costs are restricted to the deductibility of borrowing costs that are not offset by income that, in accordance with national legislation, is considered taxable interest revenues or other economically equivalent taxable received revenues. This strategy also aligns with the best practise strategy recommended by the BEPS action final report.

Subparagraph 3 of Article 2 of the ATAD defines a "*tax period*" as any suitable time for tax purposes, including a tax year or calendar year. Consequently, it is reasonable to predict that determining a tax period will abide by the domestic laws of each Member State that may be applicable.

EBITDA is a financial metric commonly used to evaluate a company's operating performance. The ATAD directive endorses using EBITDA to measure a company's economic activity for purposes of limiting interest deductibility. EBITDA is considered a good indicator of profitability as it removes the effects of financing and accounting decisions. However, EBITDA is not defined under accounting standards and allows some discretion in what is included. The ATAD makes certain adjustments to EBITDA to precisely set the benchmark for deductible interest and eliminate this discretion. For instance, it requires adding back tax-adjusted amounts for exceeding borrowing costs and depreciation/amortisation to subject-to-tax income. Overall, using an EBITDA-based approach aligns with OECD recommendations for interest limitation rules to be robust against tax planning. However, EBITDA's volatility could make debt costs hard to anticipate. The ATAD's carryforward provisions help address this drawback[90].

The ATAD directive sets the maximum level of deductible exceeding borrowing costs (EBC) at 30% of earnings before interest, taxes, depreciation and amortisation. This 30% threshold aligns with recommendations from the OECD's BEPS Action 4 report, which conducted an economic study to determine an appropriate fixed ratio benchmark. Setting a proportional limit aims to ensure companies pay some tax where profits are generated rather than shifting deductions via intragroup financing. The 30% maximum provides a balance between allowing deductibility of third party interest costs for most companies while still limiting excessive deductions from intragroup financing[91].

While the fixed ratio approach is simple, the OECD notes drawbacks like not accounting for different leverage across sectors. The ATAD allows EU states discretion to set lower ratios than

[90] OECD. 'Limiting Base Erosion Involving Interest Deductions and Other Financial Payments, Action 4 - 2016 Update: Inclusive Framework on BEPS'. Paris, 2017

[91] OECD*, op. cit.,* 32.

30% for further protection against base erosion and profit shifting. In determining their specific fixed ratios between 10-30%, states can consider factors like their economic conditions and legal environments. Therefore, the ATAD's 30% EBITDA ratio attempts to strike a balance between different countries' interests while coordinating corporate tax policies to limit profit shifting in the EU. However, some flexibility remains for states to tailor the ratio based on their specific conditions[92].

The ATAD allows Member States to treat domestic groups as a single taxpayer when calculating the interest deductibility limit, considering the overall position of all group entities in the state. This effectively neutralises the impact of domestic intra-group interest payments on the limit, aligning with Recital 7. However, this may contradict the Recital's other statement that the rules should apply without distinction of domestic or cross-border costs. Determining the EBIDTA and EBC at the group level appears to introduce cross-border elements. In addition, this provision was added via a Presidency Compromise, rather than being in the initial ATAD proposal. Therefore, it may aim to preserve domestic group tax systems. However, the author questions whether this could potentially restrict freedom of establishment under TFEU Article 49, which secondary EU law cannot do. Furthermore, the lack of documentation on discussions of this addition warrants further analysis. This provision may align with some policy aims, it appears to raise issues regarding cross-border implications and EU law compliance that require more examination.

IRL allows an EBC deduction up to €3 million without limitation to reduce compliance costs, as recommended by the OECD's BEPS Action 4 report. However, Recital 8 clarifies member states can lower this threshold for more protection against BEPS. The wording "b*y derogation from paragraph 1*" implies deducting the first €3 million EBC without limit, while excess above that amount becomes subject to the cap. This interpretation promotes equitable treatment and prevents marginal effects. The *de minimis* exemption aims to balance reducing administrative burden for less risky entities against preventing large-scale base erosion and profit shifting[93]. Nevertheless, flexibility remains for member states to tighten the threshold based on their policy priorities.

Accordingly, the ATAD permits complete EBC deduction for "*standalone entities*" that meet certain criteria, such as not being a permanent establishment overseas, not being a member of an accounting consolidated group, and not having a 25%+ connected enterprise. The idea of a permanent installation complies with domestic regulations regarding taxable presence for source

[92] OECD, *supra note*, 90: 35.
[93] *Ibid*.

taxes of revenues from foreign companies. Because of their small size and lack of related parties, these firms provide less of a risk for BEPS, so the standalone exemption adheres to OECD principles. However, in order for member states to grant the exception, all three requirements must be satisfied[94]. The overall goal is to lower the cost of compliance for low-risk organisations while still adequately restricting the exemption, as it does not need membership in a group or presence abroad. Despite the general interest constraint, the multilayered definition guarantees that only totally standalone entities are eligible for fully deducting excess borrowing costs (EBC).

According to subparagraph b of Article 4(4) loans which are used to fund long term public infrastructure projects, where the operator, borrowing costs, assets and income are all within the EU, may be excluded from the scope of the general interest limitation rule. However, where the rule applies, any income arising from such projects shall also be excluded from the taxpayers EBIDTA for the purpose of setting the interest limitation benchmark and any excluded borrowing costs shall not be included in the EBC of the group when applying the group-ratio.

The ATAD provides two alternative methods for determining interest deductibility limits for consolidated groups. First, the "*equity escape*" rule allows full EBC deduction if the taxpayer's equity/assets ratio is equal to or within 2 percentage points of the group ratio, using consistent valuation methods. This considers overall group leverage and aims to avoid limiting deductions when company financing does not exceed the group level. As discussed, this promotes proportionality by exempting less risky financing.

Second, the "g*roup ratio*" rule allows deductions up to the group's consolidated EBITDA ratio multiplied by the taxpayer's EBITDA. This aims to account for sectoral leverage differences and avoid bluntly impacting more highly-leveraged groups. Therefore, this also ensures proportionality by linking limitations to actual BEPS risks. These consolidated group approaches recognize group financing may differ across industries or for business reasons unrelated to profit-shifting. By providing alternatives to the general fixed ratio, the ATAD attempts to balance effectiveness against over-inclusiveness through more targeted, proportional limitations for consolidated entities[95].

Therefore, the ATAD allows three carry-forward options for unused EBC, without compulsory time limits per Recital 6. This aims to address timing mismatches and fluctuations, as recommended by the OECD BEPS Action 4 report, preventing undue impact and double taxation. However, member states can impose stricter conditions than the ATAD to increase protection.

[94] OECD, *supra note*, 90: 43.
[95] *Ibid*.

Overall, while carry-forwards provide important relief, the lack of a consistent EU approach risks uneven taxpayer treatment. Furthermore, indefinite carry-forward of disallowed interest could perpetuate BEPS risks. Hence, the carry-forward rules exemplify the challenges in balancing flexibility versus effectiveness of the ATAD limitations.

Under Article 4 Member States can exclude financial institutions from the EBC restriction rules, even within a group. Since Recital 9 recognizes that such entities require a separate approach, the exception aims to avoid ineffectiveness until specific rules are developed; the OECD's BEPS Action 4 report also recognizes this dilemma. Presumably, given EU harmonisation in this area, the exemption would relate to financial institutions and insurance undertakings according to the EU definition. Overall, a blanket exemption could perpetuate BEPS risks, but the rationale underlines the need for proportionate rules tailored to sectoral issues. The financial business exemption thus exemplifies the difficulties in balancing comprehensive restrictions with efficiency and proportionality across different sectors. Further work is likely to be needed to develop a non-blanket approach appropriately tailored for the financial sector[96].

In conclusion, the interest limitation rules represent a significant step in EU coordination to combat base erosion and profit shifting. The 30% EBITDA threshold and other provisions align with OECD recommendations to limit excessive interest deductions. However, flexibility for Member States to tailor key parameters risks inconsistent implementation. Divergences like lower fixed ratios or de minimis thresholds could improve protection but increase fragmentation. Similarly, optional exemptions like for financial undertakings, while recognizing sectoral issues, could continue BEPS vulnerabilities.

On balance, the ATAD makes important progress but limitations remain. Efforts to balance effectiveness against proportionality and Member State discretion have led to compromises reducing consistency. Critical issues like the domestic group approach's potential EU law conflicts require further examination. Ensuring fair implementation and resolving technical uncertainties will be ongoing challenges. Ultimately, the ATAD's success will depend on supplemental anti-avoidance measures and evolution towards greater harmonisation over time. However, the rule lays the groundwork for stronger, coordinated limitations on interest deductibility within the EU.

2.4.2. The exit taxation rule

Exit taxation, or the taxation of unrealized capital gains upon the transfer of assets outside

[96]OECD, *supra note*, 90: 47.

of a nation's tax jurisdiction, is a topic covered in detail in Article 5 of the ATAD. The purpose of Article 5's measures is to stop businesses from shifting their tax residence or assets before realising any gains on those assets in order to avoid paying taxes. This article permits EU member states to postpone exit taxes in certain situations and offers guidelines for determining the value of transferred assets.

The ATAD tax applies to any entity leaving a jurisdiction, regardless of the reason for leaving, whereas the exit capital tax was adopted in the context of BEPS to prevent companies from leaving a jurisdiction for the sole purpose of tax avoidance. The exit capital tax, which is assessed by the Member State of origin and levied on capital gains, became mandatory for all Member States as of 2020.

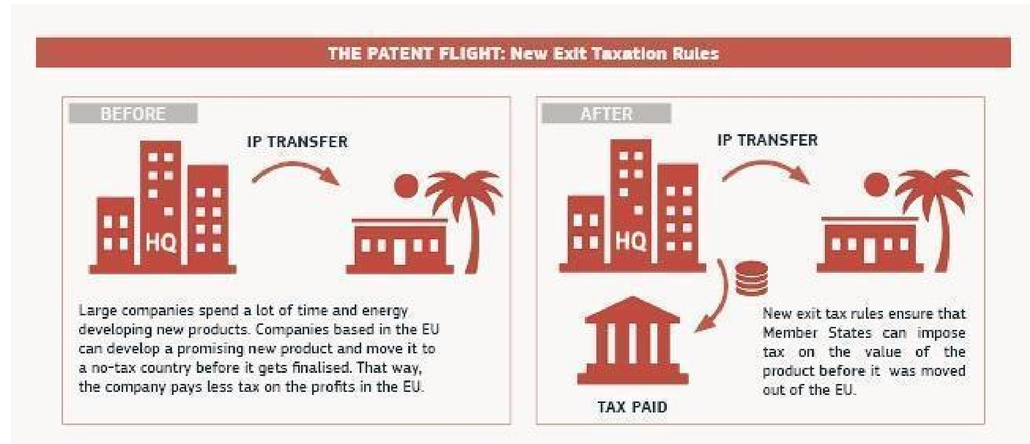
Important information about exit taxation is provided in the Preamble to the ATAD, particularly with regard to the territoriality principle and the equitable distribution of taxation rights. A withdrawing Member State can tax any economic value of unrealized capital gains generated within its jurisdiction, thanks to the exit tax. The preamble presents a rationale that aligns with the previous reasoning of the CJEU for the introduction of a single EU exit tax. This reasoning revolves around the principles of territoriality and balanced distribution of taxation rights. A capital gains tax is imposed on the capital gains accrued over the time the asset was subject to taxation in the departing Member State when a Member State loses its relationship with a taxable asset.

The exit tax rules cover certain cross-border transfers of assets or residence of companies to EU or non-EU countries. The following transactions are taxed:

- transfer of assets from the head office to a permanent establishment located in another Member State or in a third country to the extent that the Member State of the head office no longer has the right to tax the transferred assets;
- transfer of assets from a permanent establishment in a Member State to its head office or another permanent establishment located in another Member State or third country;
- transfer of the tax residence of a company to another Member State or third country, unless the assets remain connected with a permanent establishment in the Member State of origin; and
- transfer of the business carried out in a permanent establishment to another Member State[97].

[97] Vasiliki Agianni et al., *supra note*, 47: 22.

We can see the clarification of the exit tax rule on *Figure 3*.



(Figure 3)[98]

The difference between the assets' tax value and fair market value is taxed in the aforementioned situations. In addition to immediate taxation, Member States are required to allow for the possibility of a five-instalment payment plan in the event that transfers occur to non-EEA third parties or other Member States that have reached a comparable agreement to the Recovery Directive (2010/24). Deferred exit tax may be subject to guarantee arrangements in the event of a real and demonstrable risk of non recovery, and interest may be assessed in order to ensure appropriate tax collection. Under certain conditions, the tax debt may become recoverable and the payment deferral may be immediately terminated (e.g. transfers to third countries or bankruptcy of the taxpayer).

These provisions do not apply to some temporal transfers of assets (such as those pertaining to the financing of securities, collaterals, capital requirements, or liquidity management). For specific taxable transactions between Member States, a step-up rule is implemented. Therefore, unless the exit value does not represent the market value in a given situation, Member States are required to accept the exit value set by the Member State of origin.

Before and after ATAD, there have been discussions about whether the immediate tax imposed on relocating businesses violates the fundamental freedoms guaranteed by the TFEU, specifically the freedom of establishment (Article 49) and the free movement of capital and payments.

The CJEU first specifically addressed the issue of exit taxes arising on a corporate migration of tax residence within the EU in the National Grid Indus case. This decision is significant for exit tax situations of cross-border mergers. The CJEU affirmed that exit taxes on

[98] European Commission, *supra note*, 82.

unrealized capital gains of businesses departing the EU constitute a limitation on the Freedom of establishment[99].

In Portugal[100] and Spain[101], the CJEU rendered rulings pertaining to limitations on the freedom of establishment in the event of a bank transfer or other transfer of assets to a different state. In both situations, if the company's registered office and operational management were moved to another MS, latent capital gains were subject to immediate taxation in Portugal and Spain. According to the CJEU , corporation taxes imposed by national laws on businesses are considered restrictions on the right to freedom of establishment, which is generally forbidden. Additionally, the TFEU determined that the imposition of an exit tax at the time of emigration violated the principle of proportionality, as it did in National Grid Indus.

At the same time, since each MS is entitled to tax capital gains that fall within its jurisdiction to impose taxes, the rules and provisions of exit tax are currently justified by the need to ensure a balanced distribution of the power to impose taxes among MSs. The MSs must, however, use their authority to impose taxes in accordance with EU law; a national law that is based on a directive cannot violate fundamental freedoms. Even though an exit tax ensures that the country of departure has the ability to tax, the principle of proportionality—which permits the use of less costly measures—is frequently at issue[102].

The complicated ATAD exit tax legislation limits free movement inside the EU and impedes an effective internal market. When to grant a deferral or when it can be suspended is entirely up to the taxpayer. Additionally, this may result in tax disputes and double taxation, which is a pertinent issue for multinational corporations[103]. The market value is established by the country of origin and must be agreed upon by both countries, as required by ATAD Article 5. The host MS may disagree on the exit value of the transferred assets.

In light of the EU's fundamental freedoms of establishment and capital movement,

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[99] "National Grid Indus BV v Inspecteur van de Belastingdienst Rijnmond/kantoor Rotterdam, Case C-371/10," EUR-Lex, accessed 29 October 2023, https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A62010CC0371.

[100] "Amorim Energia BV v Ministério das Finanças e da Administração Pública, Case C‑38/11," EUR-Lex, accessed 31 October 2023, https://eur-lex.europa.eu/legal-content/en/TXT/?uri=CELEX:62011CO0038.

[101] "European Commission v Kingdom of Spain, Case C‑64/11," EUR-Lex, accessed 2 November 2023, https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A62011CJ0064_INF.

[102] "Communication from the Commission to the Council, the European Parliament and the European Economic and Social Committee - Exit taxation and the need for co-ordination of Member States' tax policies," EUR-Lex, accessed 2 November 2023, https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A52006DC0825.

[103] Anneli Hertsi, "Yritysten exit-vero on tehoton riesa – Järjestelyt voi toteuttaa niin, että vero ei iske," Kauppalehti, 11 July, 2019, https://www.kauppalehti.fi/uutiset/yritysten-exit-vero-on-tehoton-riesa-jarjestelyt-voi-toteuttaa-niin-etta-vero-ei-iske/e3db3078-a273-4fa8-91a3-197e039ca61f.

applicable exit taxation has generated controversy. Companies may find it more difficult to transfer money across borders or open subsidiaries or permanent establishments in other Member States as a result of exit taxes. This appears to be in conflict with the internal market's overarching goals of facilitating the free movement of economic actors within the EU. Direct taxes, such as exit taxes, are still primarily under national jurisdiction, even though the EU has concentrated on harmonising indirect taxes, such as customs duties. This leads to a conflict between the teleological interpretation of EU law that emphasises integration and open borders, and the Member States' right to defend their tax bases through exit taxes. Member State autonomy has been emphasised in CJEU case law. To appropriately balance the freedoms of the single market and national tax sovereignty, some contend, solutions should be looked for outside of the current tax structures. Some ideas include utilising blockchain technology to tax gains only when realised, taxing corporate turnover rather than capital gains, and only imposing exit taxes when assets leave the EU[104]. In general, exit taxation necessitates a challenging trade-off between EU-level priorities and Member State interests, and historically, achieving proportionality of these measures has proven challenging.

To sum up, exit taxation under Article 5 of the ATAD allows EU member states to tax unrealized capital gains when assets are transferred out of their jurisdiction. Relocating assets or changing one's tax residence before gains are realised is intended to stop tax avoidance. However, because they can prevent businesses from operating freely across borders, exit taxes may violate the EU's principles of free establishment and capital movement. The CJEU has upheld member states' authority to impose capital gains taxes domestically while ruling that exit taxes may infringe upon freedom of establishment and proportionality[105]. It has been discussed how Member State taxing rights and EU integration objectives clash.

Through permitting exit tax payments to be made later in some circumstances, the ATAD provisions aim to strike a balance between these interests. Determining asset value, allowing deferrals, and the possibility of double taxation are still unresolved matters. The discussion is ongoing that in order to align exit taxes with the single market, more fundamental solutions are required. Examples of such solutions include utilising blockchain technology, limiting exit taxes to non-EU scenarios, and taxing corporate turnover instead of gains. Thus, the EU's principles of proportionality and free movement must be balanced with the fiscal autonomy of member states

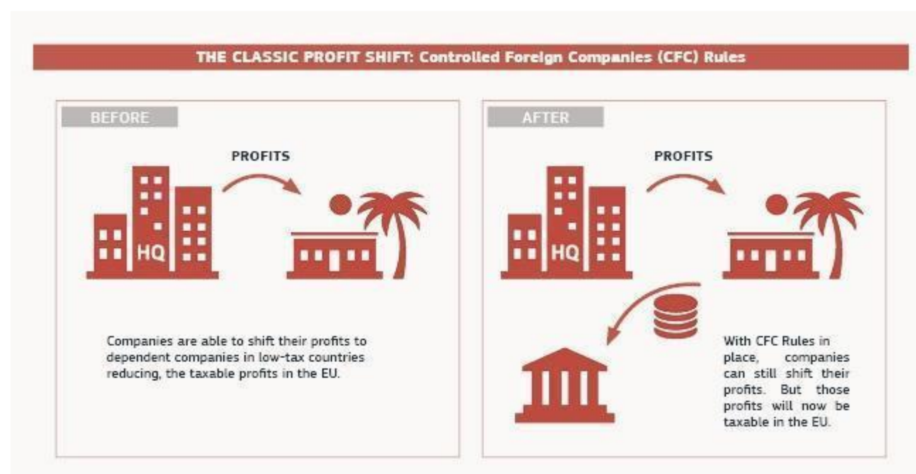
[104]Kananoja, V., "Implementation of the EU Anti-Tax Avoidance Directive (2016/1164) Exit Tax Measures in Finland," *European Taxation 60, 2/3 (2020): 312.*

[105] Case C-371/10, *supra note*, 99.

when it comes to exit taxes. The ATAD offers guidelines, but discussions about the ideal balance are still ongoing.

2.4.3. The controlled foreign company rule

CFC rules, which are described in Article 7 and Article 8, are a crucial part of ATAD. These regulations target multinational corporations' tax avoidance tactic of transferring profits to subsidiaries or permanent establishments in low- or no-tax jurisdictions. According to the CFC regulations in ATAD, Member States must tax profits held in controlled foreign entities in the same way as they would if they were earned domestically. As a result, businesses are no longer motivated to move profits for tax purposes. We can see an explanation of the CFC rule on *Figure 4*.



(Figure 4)[106]

The ATAD provides minimum standards for the treatment of controlled foreign corporations. The minimum standards are legally binding even for Member States that already have provisions regarding the treatment of CFCs[107].

Articles 7 and 8 of the ATAD may apply to entities as well as permanent establishments (PEs). If an entity meets two criteria, it is classified as a CFC: (i) the taxpayer owns more than 50% of the voting rights, capital, or entitlement to profits of the entity directly or indirectly (Control Test); and (ii) the actual corporate tax paid by the entity is less than 50% of the corporate tax it would have been charged if resident in the parent company's Member State (Low-Taxed Test). For

[106] European Commission, *supra note*, 82.
[107] Till Moser and Sven Hentschel, "The Provisions of the EU Anti-Tax Avoidance Directive Regarding Controlled Foreign Company Rules: A Critical Review Based on the Experience with the German CFC Legislation," *Intertax* 45, 10 (2017): 606.

PEs, the Low-Taxed Test is applicable, but there is no control test[108].

An entity that the taxpayer directly or indirectly owns a portion of the voting rights, capital, or entitlements to receive profits of more than 25% is referred to as an associated enterprise. Similarly, an individual or entity that owns a portion of the voting rights, capital, or entitlements to receive profits of more than 25% in the taxpayer is also considered an associated enterprise (Associated Enterprises). Any person or organisation that directly or indirectly owns a 25% or greater stake in a taxpayer and one or more entities should be considered an associated enterprise, as should the taxpayer[109].

Since corporate taxpayers are the only entities covered by Article 1 of the ATAD, individual shareholders of controlled foreign companies are not subject to the anti-avoidance provisions. While this Directive does not cover the erosion of the taxable base with regard to personal income taxes, Member States are free to enact provisions for individual shareholders in addition to the suggested framework. However, it should be noted that such an approach by ATAD may be considered a violation of the principle of neutrality

According to the ATAD, the parent company must receive credit for each CFC's income using either the transactional approach (Model B) or the categorical approach (Model A). Model A requires the taxpayer in control of the CFC to include non-distributed income from the CFC into its taxable base if the income comes from specific categories of passive income. However, in accordance with Model A, there is an escape if the CFC engages in a significant economic activity backed by personnel, tools, resources, and real estate, as shown by pertinent facts and circumstances (Substance Escape). Furthermore, there are two possible safeguard clauses (Article 7(3) Safeguards)[110].

Under the first safeguard, if a company's passive income accounts for one-third or less of its total revenue, Member States may choose not to treat the company as a CFC (De Minimis Exception). The second one (Financial Undertaking Exception) gives Member States the same choice to choose not to classify financial undertakings as CFCs if transactions with the taxpayer or its associated enterprises account for one-third or less of the passive income. The foreign income to be included in the tax base for Member States implementing Model A must be computed in compliance with the regulations of the taxpayer's resident state's corporate tax law. If the income is

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[108] Loyens & Loeff, *Implementation of the Anti-Tax Avoidance Directive in the Netherlands, Belgium and Luxembourg.* Amsterdam, 2019.
[109] *Ibid*.
[110] *Ibid*.

distributed before the end of the tax year, the CFC regulations might not apply[111].

CFC losses are not included in the tax base, but can be carried forward (Loss Carry Forward) to reduce the CFC's income in the future (in accordance with national law). Under Model B, the taxpayer controlling the CFC must include the CFC's undistributed income in its own tax base. This arrangement applies to the extent that the CFC "*"would not own the assets or would not have undertaken the risks which generate all, or part of, its income if it were not controlled by a company where the significant people functions, which are relevant to those assets and risks, are carried out and are instrumental in generating the controlled company's income*[112]", which is defined as non-essential.

In Model B, the CJEU provides that the amount of income attributable to the parent company is limited to amounts arising from assets, risks and important human functions performed by the controlled company. Therefore, attributable income must be determined on an arm's length basis. Under Model B (Article 7(4) protection), two de minimis exemptions apply: the first allows Member States to exempt companies with accounting profits below EUR 750,000 and non-trading income below EUR 75,000 from the application of Model B (Profit Escape). The other provides a similar opportunity for enterprises with accounting profits below 10% of operating expenses (Cost Escape)[113].

The ATAD includes (unrefined) provisions to avoid double taxation through the application of the CFC rules. This includes tax credits where attributable CFC income is also subject to foreign corporate tax. The EU's list of non-cooperative tax jurisdictions consists of countries that have not fulfilled their commitments to comply with the required good governance standards or have made no commitments at all (Foreign Tax Credit), where a CFC actually distributes dividends out of income already attributable to its resident shareholders under the CFC rules, or where a resident shareholder disposes of its shares in a CFC (Participation Exemption)[114].

Although the goal of the CFC regulations under ATAD is to stop profit shifting to tax havens, the question arises that the regulations go too far and could hurt companies that have legal overseas operations. First of all, the transactional approach's ambiguous definition of "genuine economic activities" makes it challenging for businesses to determine whether their overseas subsidiaries will be exempt. This unpredictability might deter outside expansion within the EU.

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[111]Loyens & Loeff, *supra note,* 108: 13.
[112] "Circular L.I.R. n°164ter/1," Administration des contributions directes, accessed 3 November 2023, https://impotsdirects.public.lu/dam-assets/fr/legislation/legi22/circulaire-lir-n164ter-1.pdf.
[113]Loyens & Loeff, *supra note,* 108: 14.
[114] *Ibid*.

Another problem is that many overseas subsidiaries might be covered by the CFC regulations if the 50% ownership threshold is set too low. Maintaining comprehensive CFC income data comes with additional compliance requirements. Lastly, there is a chance that applying CFC regulations to the same entities across several nations in a corporate chain will result in double taxation[115].

The two-option approach is without a doubt the most representative feature of the broad framework established by the ATAD, particularly in relation to the CFC provisions. The "transactional approach" or the "entity" was the option available to Member States. Furthermore, distinct carveouts are offered for each option, which restrict the reach of the CFC regulations and will ultimately result in more significant variances. Article 7(2)(a)'s predefined passive income categories seem more stringent, or at least harder to get around, at first glance. The article goes into great detail about the kinds of income that are deemed "tainted." Option B, on the other hand, gives plenty of leeway for interpretation. First, a Principal Purpose Test[116] needs to be conducted to determine whether any non-genuine arrangements have been made in order to lower the tax liability. The Directive then establishes a link between the PPT and the transfer pricing arm's length theory. Therefore, tax authorities and courts will be tasked with a difficult task in this regard, as the "correct"—or, to be more precise, accurate—application of transfer pricing rules has proven to be quite an issue. The result of the two-option proposal is a notable difference in the extent and impact of the recently enacted CFC regulations in the European Union[117].

The ATAD's Article 1 restricts the Directive's application solely to corporate taxpayers. Individual shareholders of foreign companies under control are therefore not affected by the anti-avoidance provisions. Thus, individual shareholders of controlled foreign companies are not affected by the anti-avoidance provisions. This may seem strange at first sight, but it should be remembered that the main purpose of the Directive is to ensure that national corporate tax regimes provide some protection against tax avoidance schemes[118].

It is strongly advised that Member States implement such rules in order to achieve maximum consistency and efficiency against tax avoidance practises, as failure to do so could lead to easy exploitative omissions of natural persons. Whether the controlling shareholder is subject to corporate or personal income tax should ultimately be irrelevant. We revert to domestic

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[115]Ana Paula Dourado, "The EU Anti Tax Avoidance Package: Moving Ahead of BEPS?," *Intertax* 44, 6/7 (2016): 442.
[116] OECD. *Preventing the Granting of Treaty Benefits in Inappropriate Circumstances, Action 6-2015 Final Report*. Paris, 2015.
[117]Jakob Bundgaard and Peter Koerver Schmidt, "Uncertainties Following the Final EU Anti-tax Avoidance Directive," *Kluwer International Tax Blog*, October 17, 2016, https://kluwertaxblog.com/2016/10/17/uncertainties-following-final-eu-anti-tax-avoidance-directive/.
[118] Council Directive (EU) 2016/1164, *supra note,* 83: Preamble.

anti-avoidance laws because Action 3 does not specifically address the issue of natural persons because it also refers to groups of companies. For instance, the German CFC regulations incorporate natural and juridical persons in the control test[119]. Finally, it is important to recall that the definition of associated organisation under Article 2(4) of the anti-avoidance measures includes individuals. This avoids situations where a CFC is controlled by a legal entity indirectly linked to a natural person.

There are two possible situations where double CFC liability can arise. First off, if there is a strong enough connection between the PE and the CFC, non-residents—that is, PEs of foreign companies—may also be included in the definition of taxpayer under Article 7(1)(a). Second, because indirect holdings with related enterprises are covered by Article 7(1)(a)'s control test. The purpose of the indirect control is to stop people from avoiding the CFC laws. For instance, a parent company and its subsidiary could jointly own the controlled foreign company without each meeting the 50% threshold if we assume that such a clause was absent from the ATAD.

The 2015 final report on Action 3 of the BEPS project also contains such a proposal[120]. One problem that arises when CFC income is included in a non-resident's PE and indirect holdings, and which is not resolved by Article 8(7) of the Directive on the reduction of double taxation, is that CFC income may be taxed in the hands of two (or more) taxpayers without any measures to mitigate this effect[121]. In particular, this is a case of economic double taxation because each resident state attributes CFC income to its own shareholders.

Moreover, Article 7(1)(b) refers to CIT actually paid by the controlled company on its profits, without distinguishing between active and passive income. This can be highly problematic if eligibility as a CFC depends on the corporate tax rate on active income, which may be lower than the tax rate on passive income[122]. Several approaches have been proposed under BEPS Action 3. In paragraph 71, we find a proposal for a narrowly defined calculation method based on each item of income and a broadly defined calculation method corresponding to the income of the company as a whole. Furthermore, the reference in Article 7(1)(b) to 'corporate tax actually paid' appears to exclude other taxes that countries levy on profits, which do not represent economic reality and may affect the consistent application of the CFC rules[123].

Article 7(1)(ii) of the Directive contains another unclear provision that states that when

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[119] Martin Weiss, "Recent Developments in the German Tax Treatment of CFCs," *European Taxation* 55, 9 (2015): 441.
[120] OECD. *Designing Effective Controlled Foreign Company Rules, Action 3 - 2015 Final Report*. Paris, 2015.
[121] G. Van Hulle, "Current Challenges for EU Controlled Foreign Company Rules," *Bulletin for International Taxation* 71, 12 (2017): 212.
[122] *Ibid*.
[123] Till Moser and Sven Hentschel, *supra note*, 107: 608.

evaluating whether the lower tax threshold is met, the CJEU may not consider any permanent establishment of a CFC that is not subject to tax or exemption in the controlled company's jurisdiction[124]. This clause allows for a great deal of tax planning, which may reduce the CFC regulations' efficacy.It is important to note at this point that Action 3 of the BEPS project specifies that the effective tax rate of the permanent establishment of the CFC should be calculated independently from the effective tax rate of the CFC if the CFC country/territory exempts the PE from tax[125]. In theory, the CJEU adoption of this clause appears to be in accordance with BEPS Action 3's recommendations. Nevertheless, this provision is still extremely ambiguous and the European legislator does not specifically mention a separate calculation. On the other hand, the German CFC Regulation seems to mitigate this problem by applying the low tax rate criterion separately to companies and PEs[126]. This approach seems to be more in line with the objectives of the CFC Regulation and may counteract tax planning opportunities that are not otherwise addressed.

Intellectual property-related royalties and income according to Article 7(2)(a)(ii), income from intellectual property will be added to the controlling shareholder's tax base (provided that the low-taxation requirements and control test are satisfied). Without exception, the inclusion of such sources of income raises certain pragmatic concerns and queries that require clarification[127].

In conclusion, the CFC rules in Articles 7 and 8 of ATAD aim to prevent profit shifting to low tax jurisdictions by attributing CFC income to parent companies. This approach, which does not include individuals in the scope of the rule, may be considered a violation of the neutrality principle. Some of the concerns levelled at the CFC regulations are that the definition of "genuine economic activities" is unclear, the 50% control threshold is too low, and there are coordination issues between the countries that cause double taxation. Divergence in implementation is also brought about by the two-option strategy. Other issues include the exclusion of those who control CFCs, the need for clarification regarding PE treatment, and the potential difficulty of defining IP income categories. While profit shifting is the overall goal of CFC regulations, several important areas still require coordination and improvement to guarantee proportionality and avoid unforeseen consequences.

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[124]Council Directive (EU) 2016/1164, *supra note,* 83: Subparagraph 7.

[125] Moser and Hentschel, *supra note*, 107: 610.

[126] I.M. de Groot and B. Larking, "Implementation of Controlled Foreign Company Rules under the EU Anti-Tax Avoidance Directive (2016/1164)," *European Taxation* 59, 6 (2019): 258.

[127] Jens Schönfeld Bonn, "CFC Rules and Anti-Tax Avoidance Directive," *EC Tax Review* 26, 3 (2017): 148, https://doi.org/10.54648/ecta2017016.

2.4.4. GAAR

A new GAAR was introduced at the EU level by Article 6 of the Anti-Tax Avoidance Directive (ATAD)1. For the first time, Member States are required to implement the GAAR, even in situations that are solely domestic. It reads as follows:

1. For the purposes of calculating the corporate tax liability, a Member State shall ignore an arrangement or a series of arrangements which, having been put into place for the main purpose or one of the main purposes of obtaining a tax advantage that defeats the object or purpose of the applicable tax law, are not genuine having regard to all relevant facts and circumstances. An arrangement may comprise more than one step or part.

2. For the purposes of paragraph 1, an arrangement or a series thereof shall be regarded as non-genuine to the extent that they are not put into place for valid commercial reasons which reflect economic reality.

3. Where arrangements or a series thereof are ignored in accordance with paragraph 1, the tax liability shall be calculated in accordance with national law[128].

We can see the purpose of GAAR on *Figure 5*.

(Figure 5)[129]

Therefore, the rule displays some elements of various anti-avoidance doctrines[130], such as sham, substance-over-form, and *fraus legis*[131].

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[128] Council Directive (EU) 2016/1164, *supra note,* 83: Article 6.

[129] European Commission, *supra note*, 82.

[130] Cihat Öner, "Comparative Analysis of the General Anti-Abuse Rule of the Anti-Tax Avoidance Directive: An Effective Tool to Tackle Tax Avoidance?," *EC Tax Review 29, 1 (2020): 38, https://doi.org/10.54648/ecta2020005.*

[131] D. Gutmann et al., "The Impact of the ATAD on Domestic Systems: A Comparative Survey," *European Taxation* 57, 9 (2017): 12.

By its very nature, Article 6 consists of three main elements: (i) arrangements; (ii) tax advantages; and (iii) abuse. All three are necessary for Article 6 to be triggered. The structure of Article 6 is designed to initially open the door very wide by setting a low threshold for the definition of 'arrangements' and 'tax advantages', but then narrow what should be considered 'abuse'. Nevertheless, the abusive portion of Article 6 (at least in terms of language) does not appear to be high enough or narrow enough to meet the CJEU standard of abuse and to clearly distinguish between abusive and non-abusive arrangements, which is essential to adhering to the principles of legal certainty and foreseeability[132]. This contradicts Article 6's balancing function, which is expressed in the ATAD Preamble's Recital 11 as follows: "*GAARs should be applied to non- genuine arrangements; otherwise, the taxpayer ought to be able to select the most tax-efficient structure for its business dealings*[133]".

The scope of the ATAD's general anti-abuse rule appears narrowly targeted at corporate taxpayers and their EU permanent establishments. However, most MS apply GAARs more broadly, including to individuals, partnerships and trusts. Limiting ATAD Article 6 to corporate entities risks undermining the directive's purpose of coordinated implementation of anti-BEPS measures and aggressive tax planning prevention in the EU internal market. As the Commission has recognized, BEPS behaviours are not confined to corporate taxpayers alone. A restrictive interpretation also risks fragmenting application of this minimum standard[134]. While the CJEU's jurisdiction over wider GAAR adoption per Article 3 is unclear, overall effectiveness would be better served by promoting broad, consistent application to all types of taxpayers and entities. Limiting the scope contrasts with both the aim of tackling EU-wide BEPS risks and most member states' own GAAR practices.

Article 6 contains three functional elements/tests to be determined cumulatively in order to ignore tax consequences of an arrangement or a series of arrangements: (i) 'the main purpose or one of the main purposes of obtaining a tax advantage' – the so called subjective test; (ii) 'defeats the object or purpose of the applicable tax law' – the so called objective test; and (iii) 'an arrangement or a series of arrangements which are not genuine having regard to all relevant facts and circumstance' – the so called genuine activity or economic substance test or the artificiality test

[132] A. Moreno and J. Zornoza Pérez, "The General Anti-abuse Rule Anti-tax Avoidance Directive," *in Combating Tax Avoidance in the EU: Harmonization and Cooperation in Direct Taxation,* José Manuel Almudí Cid, Jorge A. Ferreras Gutiérrez and Pablo A. Hernández GonzálezBarreda (Amsterdam:Kluwer Law International B.V., 2019), 130.
[133] Council Directive (EU) 2016/1164, *supra note,* 83: Preamble.
[134] Blazej Kuzniacki, "THE GAAR (ARTICLE 6 ATAD)," *A Guide to the Anti-Tax Avoidance Directive,* Werner Haslehner, Katerina Pantazatou, Georg Kofler, Alexander Rust (Edward Elgar Publishing, 2020), 135.

(they can be used interchangeably). However, the third test is inexorably linked with the first and the second tests so that the existence (or the absence) of artificiality may be seen as relevant to determine passing (or failing to pass) of the first two tests[135].

The first test under Article 6 has sparked a widespread criticism among scholars, who consider it to set a surprisingly low threshold of abuse that is capable of capturing sound economic arrangements[136]. The general anti-abuse rule sets a low threshold of abuse by referring to arrangements with 'one of the main purposes' of obtaining a tax advantage. This diverges from CJEU case law requiring at minimum an 'essential purpose' test for abuse. The 'one of the main purposes' wording also contrasts with most member states' own GAARs and risks enabling challenges to legitimate arrangements.

Article 6's second test necessitates a thorough analysis of the applicable tax law's intent[137]. By doing this, Article 6 assigns a different meaning to the tax law's goal and object than would be expected from an ordinary reading of the statute. According to the common interpretation, the purpose and object are just one of many factors that need to be considered, not the most important ones (in comparison to the wording and context). In contrast, Article 6 gives the tax authorities the authority to reclassify the private law transactions to which the tax law should be applied, or it permits a certain amount of analogical interpretation, which gives them far more significance[138].

However, an interpreter must remember that Article 6, like any other legal standard, forbids an excessive functional interpretation that might actually result in "legislation" or the revision of tax law[139].

Article 6 requires assessing whether an arrangement was created to obtain a tax advantage or for valid commercial reasons. This test involves evaluating the purpose and artificiality of the arrangement. The focus is on determining if the arrangement defeats the object or purpose of the specific tax provisions under which the advantage arises as well as the overall tax regime.

The purpose is linked to the legislator's intentions in the law's text. The degree of artificiality helps indicate if an arrangement defeats the purpose. However, the artificiality test does not replace evaluating purpose. Application of Article 6 is limited for provisions operating

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[135] Blazej Kuzniacki, *supra note*, 134: 136.
[136] Frederik Zimmer, "In Defence of General Anti-Avoidance Rules," *Bulletin for International Taxation* 73, 4 (2019): 125.
[137] Phillip Baker, "The Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting," *British Tax Review 50, 3* (2017): 130.
[138] Zimmer, *op. cit.,* 284.
[139] Mark Eugen Villiger, *Commentary on the 1969 Vienna Convention on the Law of Treaties*, (Amsterdam: Martinus Nijhoff Publishers, 2009), 428.

precisely and quantitatively, as changing meanings requires amending wording. Thus, courts may weigh artificiality and purpose differently in applying Article 6. The time an arrangement was created is key, and current anti-BEPS rules restrict artificial tax avoidance arrangements.

In light of the analysis presented in the previous sections, the artificiality test is said to constitute the overarching operative element of Article 6 insofar as it has an impact on the passing or not passing of the first and the second tests under that rule[140]. The outstanding task is to identify the relevant factors ('all relevant facts and circumstances') for the determination of the nature of an arrangement: when the arrangement is artificial versus when it is genuine. Because (i) the proposal of the ATAD clarifies that "*the proposed GAAR is designed to reflect the artificiality tests of the CJEU where this is applied within the Union' and (ii) 'the application of GAARs should be limited to arrangements that are "wholly artificial" (non-genuine)[141]*", it seems wise to understand the phrases 'artificial' and 'non-genuine' identically (and thus use them interchangeably) in the context of a possible application of Article 6[142]. Nevertheless, the lack of the use of the phrase 'artificial arrangement' under Article 6 is rightly criticised by scholars as it brings an unnecessary confusion[143], and, similarly to the use of the phrase 'one of the main purposes', it seems to follow from the desire of the EU Council to help the tax authorities of MSs to apply the GAARs under conditions which are easier to be met by them than those under the CJEU relevant case law ('wholly artificial arrangement').

The artificiality element under Article 6 of the EU Anti-Tax Avoidance Directive can target arrangements that are only partly instead of wholly artificial. The use of "to the extent" shows Article 6 applies if part of an arrangement lacks economic substance, despite other valid aspects. For example, a transaction between real entities can be abusive if done non-arm's length without justification[144]. Hence, it suffices that one element is wholly artificial, not the entire transaction.

Moreover, the artificiality element correlates to evaluating an arrangement's purpose. The existence of some valid commercial reasons does not preclude also having tax avoidance as a main purpose. Under Article 6, assessing valid reasons helps determine intention. Even arrangements

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[140] L. De Broe and D. Beckers, "The General Anti-Abuse Rule of the Anti-Tax Avoidance Directive: An Analysis Against the Wider Perspective European Court of Justice's Case Law on Abuse of EU Law", *EC Tax Review 26,* 3 (2017): 135.
[141] "Proposal for a COUNCIL DIRECTIVE laying down rules against tax avoidance practices that directly affect the functioning of the internal market," EUR-Lex, accessed 5 November 2023, https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=COM%3A2016%3A26%3AFIN.
[142]Weber, *supra note*, 55: 105.
[143] De Broe and Beckers, *op. cit.*, 136.
[144] Blazej Kuzniacki, *supra note*, 134: 143.

with some valid business motives can be considered abusive if a main purpose was tax advantages. Therefore, this two-pronged approach catches artificial components even in partly legitimate arrangements.

If the tests for applying Article 6 of the EU Anti-Tax Avoidance Directive are met, tax authorities must ignore the abusive arrangement and calculate tax liability per national law. The tax advantage is denied only to the extent it stems from the non-genuine arrangement, thus ensuring proportionality. However, the Directive gives no guidelines on calculating liability per domestic law. Originally it referred to economic substance, but this was removed since some Member States don't recognize that concept.

Hence, to reduce uncertainty, the legal consequences could be based on redefining the arrangement to establish economic substance and valid commercial reasons, mirroring the taxpayer behaviour Article 6 targets. Nevertheless, there is no mutual recognition of decisions under Article 6, so different Member States may disagree on abuse, consequently risking double taxation. Therefore, legislative solutions like mutual agreement procedures are needed to resolve such cross-border conflicts arising from misaligned application of Article 6[145].

In the Preamble of ATAD, however, its relationship with the other specific anti-abuse provisions is mentioned. Accordingly, GAARs have a function aimed to fill in gaps which should not affect the applicability of specific anti-abuse rules[146]. It means that Article 6 supplements rather than restricts the scope or application of a SAAR if both rules are meant to be applied in the same situation[147].

In conclusion, Article 6 aims to tackle aggressive tax planning but contains flaws in its design. While its three-part structure of arrangements, tax advantages, and abuse seems sound, the language defining abuse appears insufficiently narrow. The thresholds of "one of the main purposes" and arrangements "not genuine" are lower than existing court standards on abuse, risking targeting legitimate arrangements. This contradicts Article 6's intention to balance preventing abuse and not hindering tax-efficient business structures.

Moreover, Article 6's focus on corporate taxpayers is overly narrow given BEPS behaviours extend beyond corporations alone. Limiting it from broader application undertaken by most Member States also risks fragmenting this minimum standard and reducing effectiveness. The artificiality test's ability to target partly abusive arrangements is useful but assessing valid

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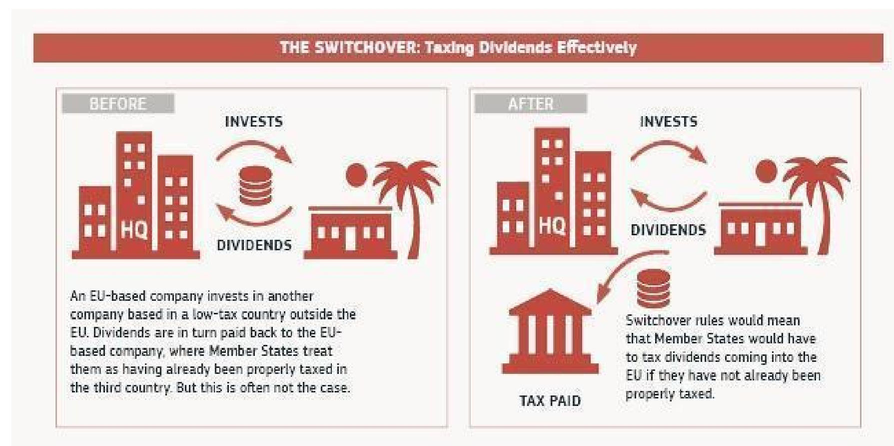
[145] Blazej Kuzniacki, *supra note*, 134: 145.
[146] Council Directive (EU) 2016/1164, *supra note,* 83: Preamble.
[147] Öner, *supra note*, 130: 42.

commercial reasons to determine purpose remains subjective. The lack of guidelines for calculating liability after denying advantages is problematic. Article 6 does not fully align with EU court case law on abuse standards and risks challenging bona fide taxpayer motivations.

2.4.5. The rules on hybrid mismatches

The objective of the provisions on hybrid mismatches is to neutralise the effects of arrangements that take advantage of differences in the tax treatment of an entity or an instrument in the laws of two or more jurisdictions. When hybrid mismatches occur, income is frequently double non-taxable—that is, taxed in no jurisdiction at all. This makes it possible for multinational corporations to use intricate cross-border agreements to significantly lower their overall tax liability. In order to counteract this, the hybrid mismatches rule requires one of the mismatched jurisdictions to either include the income or deny the deduction, thereby reintroducing taxation. We can see example of rule on hybrid mismatches on *Figure 6*.



(Figure 6)[148]

The EU Commission decided to implement the final texts of the Anti-Tax Avoidance Directive 1 ("ATAD 1") 3 and the Anti-Tax Avoidance Directive 2 ("ATAD 2") 4 dealing with hybrid mismatches resulting in either a double deduction (DD) or deduction/non-inclusion (D/NI) in July 2016 and June 2017, respectively, in response to the OECD recommendations in the BEPS Action Plan 2,2. In order to ensure that the hybrid payments are not left untaxed, these directives introduce a set of rules collectively referred to as "linking rules" because they do in fact make their

[148] European Commission, *supra note*, 82.

application contingent on the particular tax outcomes in the other state[149]. The ATAD 2 contains both rules and broadens its application to hybrid mismatches that originated with third countries outside of the EU, whereas the ATAD 1 only contains a primary response and is restricted to hybrid mismatches within the EU.

Under the ATAD (as amended by ATAD 2), hybrid mismatches concern situations in which an entity or transaction is treated differently – for tax purposes – under the laws of two Member States (or of a third country), and this difference results in:

- a double deduction of the same payment, expense or loss; or
- a deduction of a payment without the inclusion of the corresponding income for tax purposes in the payee jurisdiction.

The hybrid mismatches covered by the ATAD are related to entities, financial instruments and permanent establishments. Specifically, the ATAD covers hybrid mismatches resulting from (i) payments under a financial instrument; (ii) payments to a hybrid entity, permanent establishment or a disregarded permanent establishment; (iii) payments made by a hybrid entity to its owners; (iv) deemed payments between the head office and permanent establishment or between two or more permanent establishments; and (v) payments made by a hybrid entity or a permanent establishment. Additionally, the ATAD includes specific rules for dealing with dual residence mismatches, hybrid transfers, imported mismatches and reverse hybrid mismatches[150].

The personal scope of application of the provisions is restricted to payments between associated enterprises, between permanent establishments and their head offices and payments made under structured arrangements. The ATAD establishes primary and secondary rules under which mismatches are neutralised by one Member State. For example, when the mismatch results in a double deduction, the Member State of the investor must deny the deduction. Failing this, the deduction must be denied in the Member State of the payer jurisdiction[151].

If incorporated into national legislation, the ambiguous definition of hybrid entities in ATAD 1 might give rise to varying interpretations amongst Member States. Because of this, Article 2(9) of ATAD 2's definition of hybrid entity mismatches was updated to include the following: "(b) *a payment to a hybrid entity gives rise to a deduction without inclusion and that mismatch outcome is the result of differences in the allocation of payments made to the hybrid entity under the laws of*

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[149]Leopoldo Parada, "Hybrid Financial Instruments and Anti-Hybrid Rules in the EU ATAD," in *A Guide to the Anti-Tax Avoidance Directive,* Werner Haslehner, Katerina Pantazatou, Georg Kofler, Alexander Rust (Edward Elgar Publishing, 2020), 200.

[150] Vasiliki Agianni et al., *supra note* 47: 23.

[151] *Ibid*.

the jurisdiction where the hybrid entity is established or registered and the jurisdiction of any person with a participation in that hybrid entity;(e) a payment by a hybrid entity gives rise to a deduction without inclusion and that mismatch is the result of the fact that the payment is disregarded under the laws of the payee jurisdiction; (g) a double deduction outcome occurs[152]".

Thus, ATAD 2 addresses the reverse hybrid entity mismatches in various ways. Like BEPS Action 2 and ATAD 1, it addresses hybrid mismatches' symptoms rather than their root cause. Additionally, ATAD 2 is expanded with the secondary rule in paragraphs 1 and 2 of Article 9 to better align with the OECD Recommendations. Mismatches that lead to DD and D/NI outcomes are neutralised by both the primary and secondary rules. It also holds true for relationships with countries outside the EU[153].

In respect with reverse hybrid mismatches[154] , Article 1 of ATAD 1 is extended with paragraph (2) in ATAD 2: "*Article 9a shall also apply to all entities that are treated as transparent for tax purposes by a Member State*[155]". This new provision was essential to cover transparent entities which are not liable to CIT within the EU.

This new provision, however, only applies to reverse hybrid entities situated within the EU. In order to ensure that reverse hybrid entities situated in third countries are within the scope of ATAD, the definition "Hybrid entity" is added to article 2(9) in ATAD 2 and article 9(2) (D/NI) is equally adjusted. Article 2(9)(i) of ATAD 2 defines hybrid entities as "a*ny entity or arrangement that is regarded as a taxable entity under the laws of one jurisdiction and whose income or expenditure is treated as income or expenditure of one or more other persons under the laws of another jurisdiction*[156]". In accordance with the previously mentioned, payments to reverse hybrid entities formed or incorporated outside of the EU are made using the modified article 9(2) (D/NI)[157]. This covers non-EU scenarios and covers both hybrid and reverse hybrid arrangements. Thus, the scope of ATAD is effectively expanded to include such entities established outside the EU in addition to reverse hybrid entities within the EU.

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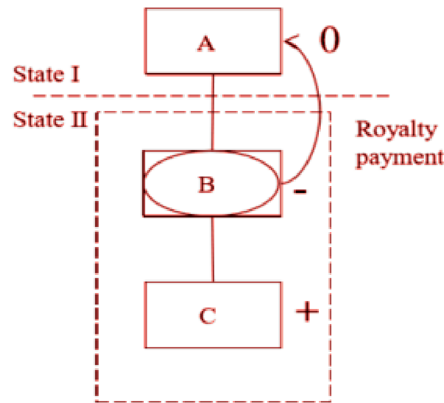
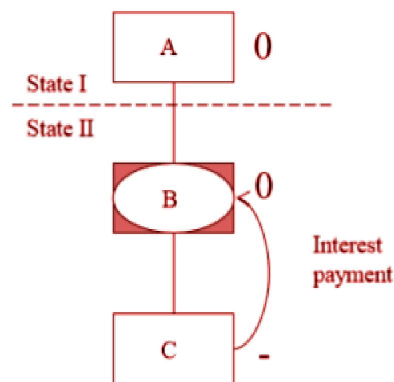
[152] Council Directive (EU) 2016/1164, *supra note,* 83: Article 2(9).
[153] Fatma Demirtas, "The effectiveness of the anti-hybrid mismatch measure under the European Anti-Tax Avoidance Directive II (ATAD 2), a Dutch view" (master's thesis, Tilburg University, 2019), 12, https://arno.uvt.nl/show.cgi?fid=149109.
[154] G.K. Fibbe and Ton Stevens, "Hybrid Mismatches Under the ATAD I and II," *EC Tax Review* 26, 3 (2017): 154, https://doi.org/10.54648/ecta2017017.
[155] Council Directive (EU) 2016/1164, *supra note,* 83: Article 1(2).
[156] *Ibid*., Article 2(9).
[157] Fibbe and Stevens, *op. cit*., 156.



(Figure 7)[158]

In one example, entities A, B and C are associated enterprises across two countries (See *Figure 7)*. B is considered a hybrid entity and used to facilitate D/NI between the two countries. ATAD 2 would first apply the primary rule for the payer jurisdiction (State II) to deny B's deduction. If that fails, the secondary rule kicks in for the parent jurisdiction (State I) to include the payment in A's income. This stops the D/NI outcome. ATAD 2 provides more details than ATAD 1 on key definitions like "*dual inclusion income*" and "*payee jurisdiction*"[159]. However, some gaps remain compared to OECD BEPS Action 2 recommendations, like the limited carry-forward period. Overall, ATAD 2 significantly strengthens the EU's defences against hybrid mismatches.

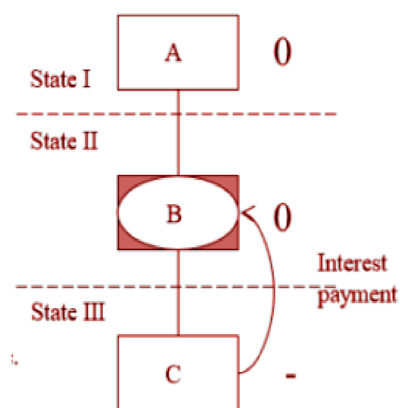


(Figure 8)[160]

An illustration of this is a reverse hybrid entity that generates outcomes for deduction/non-inclusion (D/NI). State I treats Entity B as transparent, while State II treats it as opaque. In State I, a payment made by C to B is not included in A's income but is deductible for C. States I and II do not impose taxes on the payment[161]. We can see an example on *Figure 8*.

[158] Demirtas, *supra note*, 153: 24.
[159] *Ibid*.
[160] *Ibid*., 25.
[161] *Ibid*.

In order to counter this, ATAD 2 offers two choices. The D/NI result is neutralised by Article 9(2) using the standard primary and secondary rules. In EU member states, Article 9a is a lex specialis provision pertaining to reverse hybrids. It demands that the open jurisdiction (State II) tax the hybrid's income that isn't subject to taxation elsewhere and treat it like a resident. This is in line with the recommendation made by the OECD BEPS Action 2 to remove the transparency of a reverse hybrid. Articles 9(2) and 9a, however, may be superseded in intra-EU cases by other EU laws, such as the Parent-Subsidiary Directive, according to ATAD 2[162]. In general, ATAD 2 offers more advanced tools than ATAD 1 to handle intricate hybrid mismatch situations.



(Figure 9)[163]

As an illustration, consider entity B, a reverse hybrid that is seen as opaque by third country II but transparent by EU member states I and III. Although it is not taxed in State I, interest paid by C to B in State III is deductible for C[164].

Article 9(2) of ATAD 2 corrects this deduction/non-inclusion (D/NI) result by applying the primary and secondary rules. According to the primary rule, State III ought to reject C's deduction. If not, State I may tax A according to its portion of B's income by using the secondary rule. For EU member states, the secondary rule is optional. No ATAD 2 regulations are applicable when the payer is also a third country[165].

To sum up, by eliminating inconsistencies and discrepancies between the tax systems of EU member states, the Anti-Tax Avoidance Directives (ATAD 1 and 2) seek to counteract aggressive tax planning. There are still certain holes, though, which could prevent successful application. Due to ATAD 1's limitations, ATAD 2 was expanded to include features like reverse hybrid rules. However, fundamental definitions remain ambiguous, such as the definition of a

[162] Demirtas, *supra note*, 153: 26.
[163] *Ibid.*
[164] *Ibid.*
[165] *Ibid.*

"payment". This could lead to uneven implementation. Secondary rules were introduced in ATAD 2, but the opt-out provision made them optional. More tax arbitrage is possible if members are allowed to apply regulations selectively.

Additionally, overall coordination is still difficult. Certain OECD BEPS methods are illegal under EU law, which leaves member states in the dark. Because of the minimum standards in ATAD, regulations are not applied uniformly throughout the EU. Adding third countries to ATAD 2 improved competitiveness but also brought attention to the challenges of multilateral cooperation.

Fundamentally, ATAD ignores classification discrepancies, which are the primary source of mismatches. It focuses on signs such as structures with double non-taxation. Classifying common entities and determining the location of true economic value creation—rather than merely legal form—would be preferable solutions. Proposals to tax reverse hybrids where mismatches occur, however, might not accurately reflect their true nature. For a coordinated, successful EU strategy that prevents double taxation, more reform is required.

It is important to summarise this chapter. The European Union has established a comprehensive legal framework, consisting of directives like the Interest and Royalties Directive , Parent-Subsidiary Directive, Merger Directive and Anti-Tax Avoidance Directive, to harmonise corporate taxation and address tax avoidance. The IRD incorporates a GAAR in Article 5, allowing Member States to deny benefits in cases where arrangements primarily serve as instruments for tax avoidance. However, challenges arise from the lack of specific definitions, requiring individual case analyses, and concerns persist about uneven implementation among member states. The PSD and MD also feature GAARs, introducing subjective and objective tests to identify tax avoidance arrangements. Challenges include vague terminology, potential inconsistencies in national transpositions, and the need for clarity in distinguishing legitimate planning from unacceptable avoidance. Despite ongoing challenges, the directives aim to strike a balance between preventing abusive tax arrangements and ensuring valid cross-border activities enjoy their intended benefits.

The Anti-Tax Avoidance Directive comprises five crucial rules. ILR, introduced in 2016, targets profit shifting by limiting net borrowing cost deductions to 30% of EBITDA. It offers flexibility for Member States but raises concerns about potential inconsistencies.

Exit Taxation, designed to curb tax avoidance, applies to entities leaving a jurisdiction, taxing unrealized capital gains upon asset transfer. Challenges arise regarding its compatibility with EU freedoms and ongoing debates about achieving a balance between national tax sovereignty and

EU integration objectives.

CFC rules through Articles 7 and 8, targeting multinational corporations' profit-shifting tactics to low-tax jurisdictions. These regulations mandate that Member States tax profits held in controlled foreign entities akin to domestic earnings, discouraging the motivation for businesses to transfer profits for tax purposes. While CFC rules provide two models for income attribution to parent companies, addressing concerns about profit shifting, challenges persist. These include vague definitions, a low ownership threshold, and potential issues with double taxation, raising questions about their impact on companies with legal overseas operations.

GAAR represents a significant step towards combating abusive tax arrangements, it is not without its challenges. The rule's three-part structure targeting arrangements, tax advantages, and abuse is conceptually sound, but the language defining abuse appears to be insufficiently narrow. The low threshold for abuse, with a focus on the "one of the main purposes" criterion, has drawn criticism for potentially capturing legitimate arrangements and diverging from established court standards. Furthermore, the rule's narrow focus on corporate taxpayers may limit its overall effectiveness, especially as aggressive tax planning is not confined to corporations alone. To enhance the rule's impact, adjustments may be needed, including refining the language on abuse, broadening its scope to cover a wider range of taxpayers, and providing clearer guidelines for calculating tax liability after denying tax advantages.

Hybrid mismatches rules aim to address the challenges posed by hybrid mismatches in cross-border tax arrangements. These mismatches exploit differences in the tax treatment of entities or instruments in multiple jurisdictions, leading to double non-taxation and enabling multinational corporations to reduce their overall tax liability. ATAD 2 expands on ATAD 1 by introducing rules, known as "linking rules," to counteract hybrid mismatches originating from third countries outside the EU, and it specifically addresses reverse hybrid entity mismatches. While ATAD 2 provides more advanced tools than ATAD 1 to handle intricate hybrid mismatch situations, challenges remain, including ambiguous definitions, optional secondary rules, and difficulties in overall coordination among EU Member States.

ATAD rules, while addressing critical issues, leave room for refinement in implementation and balancing flexibility with consistency.

3. CHALLENGES AND LIMITATIONS OF GENERAL AND SPECIFIC TAX ANTI-AVOIDANCE RULES IN EUROPEAN UNION

3.1. Questions on legality

The adoption of the ATAD by the EU has sparked debate about whether it exceeds the EU's competencies for tax harmonisation under the treaties. While past EU tax measures focused on breaking down barriers, the ATAD erects new obstacles. The EU relied on two justifications for the ATAD: coordinating implementation of OECD BEPS outcomes, and addressing distortions of the internal market from tax avoidance[166]. Academics have questioned these rationales and whether the ATAD complies with subsidiarity and proportionality. However, the CJEU grants the EU legislature broad discretion on these principles. Thus, while debated, no serious doubts exist about the EU's competence to adopt the ATAD[167].

However, the EU's ability to harmonise taxes remains limited by the principle of conferral and treaty rules. The ATAD arguably pushes the boundaries of the EU's tax harmonisation powers. Though likely legal, it represents a directional shift toward more centralised tax policy.

The ATAD provisions, like exit taxes and CFC rules, have been questioned as possibly violating EU freedoms by treating cross-border situations differently than domestic ones. These types of rules have existed in Member State laws and been limited by CJEU rulings. Though prescribed by EU law, ATAD rules can still be challenged for treaty compatibility. The ATAD does not establish exhaustive harmonisation that could shield national laws[168]. Even if it did, the ATAD itself as secondary EU law remains subject to primary treaty freedoms.

When the ATAD allows nondiscriminatory implementation, violations would be imputable to Member States, not the Directive itself. The CJEU may apply more lenient treaty scrutiny to secondary EU law like the ATAD versus national laws. However, it is uncertain if different standards apply. Thus, ATAD compliance with primary freedoms remains analysed based on existing case law on domestic anti-avoidance rules. Concerns exist about specific ATAD features, but can likely be resolved through CJEU jurisprudence[169].

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[166] Kofler in Panayi, Werner Haslehner and Edoardo Traversa, *Research Handbook on European Union Taxation Law* (London: Edward Elgar Publishing, 2020): 32.
[167] Werner Haslehner, "The General Scope of the ATAD and Its Position in the EU Legal Order," in *A Guide to the Anti-Tax Avoidance Directive* Werner Haslehner, Katerina Pantazatou, Georg Kofler, Alexander Rust (London: Edward Elgar Publishing, 2020), 61.
[168] Policy Department for Economic, Scientific and Quality of Life Policies at the request of the Economic and Monetary Affairs Subcommittee on tax matters. *Assessment of recent anti-tax avoidance and evasion measures.* Luxemburg, 2022.
[169] *Ibid*.

Exit taxes have been found by the CJEU to obstruct the EU freedom of establishment, as they tax cross-border relocations but not domestic moves. However, the CJEU has allowed justifying exit taxes to prevent tax loss when assets or residence shift between countries. The ATAD attempts to codify CJEU requirements for compliant exit taxes, especially from the DMC[170] and Verder Labtec cases[171].

Nevertheless, CJEU exit tax jurisprudence is inconsistent, with unexplained differences between National Grid and later rulings[172]. Recent cases on individuals' residence shifts also cast doubt on settled law. One issue is allowing collection in instalments over 5 years, when the CJEU had required deferral until realisation. It is unclear why this would be the least restrictive approach in all cases, given the discriminatory nature of exit taxes.

Another concern is permitting both interest charges and guarantees for instalment plans. Even if instalments are necessary in some situations, adding interest appears excessive compared to immediate payment. The CJEU has approved these measures, but their proportionality remains questionable given the equivalent burden imposed on taxpayers.

Like exit taxes, CFC rules have been found to restrict EU freedoms since they target foreign subsidiaries unlike domestic ones. However, the CJEU has permitted CFC rules if narrowly targeting wholly artificial arrangements, not just lower foreign tax rates.

The ATAD seeks to implement CJEU boundaries by excluding foreign CFCs with substantive economic activities from income inclusion rules. While required by primary law already, the ATAD allows excluding this exception for third country CFCs even with real economic activities[173].

Questions exist on whether the ATAD's economic substance exception adequately reflects CJEU jurisprudence[174]. However, interpreting the exception consistently with case law appears possible. Thus, the third country differential seems a bigger potential hurdle for CFC rule legality than the substantive exception itself.

Usually the collision with any national law provision, even if the law is of a constitutional status, is not considered as a problem for implementation and transposition of EU directives. The

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170 "DMC Beteiligungsgesellschaft mbH v Finanzamt Hamburg-Mitte, Case C-164/12," EUR-Lex, accessed 10 November 2023, https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A62012CJ0164.

171 "Verder LabTec GmbH & Co. KG v Finanzamt Hilden, Case C-657/13," EUR-Lex, accessed 12 November 2023, https://eur-lex.europa.eu/legal-content/EN/TXT/HTML/?uri=CELEX:62013CJ0657_SUM.

172 Case C-371/10, *supra note*, 97.

173 FISC, *supra note*, 165: 15.

174 Pasquale Pistone and Dennis Weber, *The Implementation of Anti-BEPS Rules in the EU: A Comprehensive Study* (Amsterdam: IBFD, 2018), 401, https://www.ibfd.org/shop/book/implementation-anti-beps-legislation-european-union-comprehensive-study.

Supremacy of EU law is a longstanding General Principle of EU Law and is well developed through the case law of the CJEU. According to the Court, the validity of EU law can never be assessed by referring to the national law provision. The national Courts are required to give immediate effect to EU law of whatever rank during adjudication and ignore or set aside any national law, of whatever rank, which could impede the application of EU law. Thus, any norm of EU law takes precedence over any provision of national law, including the national constitutions[175].

However, it has taken some time for the national courts to "digest" the principle of Supremacy of EU law and override their own national constitutions. Most of the national courts do not accept the CJEU's view on the Supremacy of EU law. While they accept the prerequisites of this principle in practice, in most regard, this is interpreted as flowing from their national constitutions, rather than from the authority of the EU treaties or the case law of the CJEU, and they potentially retain a power of ultimate constitutional review over the measures of EU law[176].

For example, Germany's interest limitation rule inspired the ATAD's equivalent provision. Germany's fiscal court believes its rule violates the constitution by denying deductibility of real costs, conflicting with ability-to-pay principles[177].

The court rejected that carryforwards suffice, since deduction is often unavailable. It also rejected justifications based on legislative steering of behaviour and targeting abusive debt arrangements as insufficiently focused.

Similar issues could arise in other countries like Spain and Italy with similar constitutional doctrines, though no cases are yet known[178]. However, debate continues, especially in Italy[179].

Uncertainty remains about compatibility with national equality principles. But EU law primacy likely wins out.

No right to net base taxation is recognized in the EU Charter or by the CJEU. Thus, the ATAD provision likely doesn't violate higher ranking EU law on similar grounds to Germany's court.

In conclusion, the adoption of the ATAD represents an expansion of EU tax harmonisation powers, though likely staying within legal competence. However, tensions remain between specific ATAD provisions and higher ranked EU treaty freedoms or national constitutional principles.

The CJEU grants broad discretion to the EU legislature on principles like subsidiarity. And

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[175] Paul Craig and Gráinne de Búrca, *EU Law: Text, Cases and Materials (*New York: Oxford University Press, 2015), 220.
[176] *Ibid*.
[177] FISC, *supra note*, 165: 17.
[178] *Ibid*.
[179] Giuseppe Vanz, "The Italian Interest Limitation Rule: Constitutional Issues," *European Taxation* 58, 4 (2018): 173.

the supremacy of EU law can override conflicts with national law. However, the proportionality of certain ATAD rules, like exit taxes and CFC inclusion, needs further jurisprudential development to better reconcile with EU freedoms. Additionally, some national courts may retain ultimate constitutional review powers, leading to potential challenges to ATAD measures on ability-to-pay grounds. While EU primacy will likely prevail, except regarding core constitutional rights, interpretive work remains to align the ATAD with primary EU law and fundamental national tax principles.

3.2. The challenges of coordinated implementation

ATAD aimed to consistently limit aggressive tax planning across Member States. However, in practice the path to coordinated national enactment of ATAD's legally binding anti-avoidance measures has posed substantial difficulties. Significant variation has emerged in how individual countries choose to incorporate elements of the Directive into preexisting tax codes struggling to balance complex legal principles and administrative procedures.

A number of factors present roadblocks to smooth multilateral implementation of ATAD guidelines. Discretion granted to Member States in interpreting directive scope allows room for fragmentation in adopted rules. Differing legal histories and standards around tax codes crystalize in reluctance by some national legislators. While directive guidelines serve as a common reference, navigating existing statutes and principles creates complications in determining precise compliance requirements. Such issues highlight the tensions between EU tax harmonisation goals and retaining aspects of national tax sovereignty. The result sees challenges in aligning the form of ATAD enactment across European jurisdictions.

Unlike past directives concerning European Union direct taxation, the Anti-Tax Avoidance Directive (ATAD 1 & 2) establishes detailed legislative requirements for Member States to incorporate into their domestic tax laws. Countries have reviewed existing rules for compatibility with ATAD's provisions and, based on these assessments, either introduced new rules, amended current statutes or contended that elements of their legislation already uphold ATAD standards. As is well established, consensus among all EU countries is necessary for directives touching tax legislation given the interplay with national sovereignty principles. Hence ATAD requirements take the form of directives, effectively setting common minimum regulations that national governments can reinforce with even stricter adaptations if they so choose – however they cannot countermand or

weaken ATAD compliance protocols[180].

In this sense, the implementation of ATAD directives resembles an intriguing case study in legal transplantation, whereby legislative frameworks sourced from one jurisdiction get assimilated into another. While often voluntary, the addition of systemically foreign clauses also occurs through mandated pathways like EU accession prerequisites or loan conditionality programs administered by bodies such as the International Monetary Fund. Unlike completely exogenous demands, ATAD complies with a hybrid form – EU Member States self-determine the process for integrating the common base measures into existing tax codes, exercising options to either simply mirror the directives or intensify their domestic manifestations based on native priorities and constraints, parliamentary discourse as well as policy calculations[181]. Hence the flexibility ingrained in ATAD directives enables later divergence between States in actual adopted rules, eligibility criteria for exemptions and threshold bounds in key areas like interest deductions or controlled foreign company statutes.

In its preamble, the ATAD states that it will allow the same standards to apply across the EU, preventing distortions in the fight against abuse. The ATAD aims to harmonise the measures taken by the Member States to combat abuse. This includes aggressive tax planning practises and BEPS. Nevertheless, the ATAD only stipulates minimum harmonisation (Article 3) and gives Member States more latitude to combat abuse without imposing specific limitations. This clause, therefore, undermines the possibility of harmonised anti-abuse measures because disparate standards are likely to exist throughout the EU. It is unclear how a "minimum level of protection" against aggressive tax planning in the internal market would enhance its operation or efficacy if coordinated action is not possible[182].

Determining what constitutes "*maximum*" standard in the ATAD poses additional challenges. There is no constant threshold delineating the minimum – ATAD provisions tolerate flexibility, shown in options for member states to select alternative text or differ on numerical boundaries. Minimums appear recommendations not absolutes, with the directive as a starting framework member states can intensify by expanding scope through supplementary domestic statutes or international agreements. Maximum limits remain entirely undefined with member state sovereignty allowing any additional measures deemed suitable so long as consistent with EU

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[180] Irma Johanna Mosquera Valderrama, "Critical Review of the ATAD Implementation: Foreword: The Implementation of the ATAD in the EU: The Same but not the Same," *Intertax* 49, 11 (2021): 915, https://doi.org/10.54648/taxi2021091.

[181] *Ibid*.

[182] Sriram Govind and Ivan Lazarov, "Carpet-Bombing Tax Avoidance in Europe: Examining the Validity of the ATAD Under EU Law," *Intertax* 47, 10 (2019): 852, https://doi.org/10.54648/taxi2019086.

laws[183].

Such openness attempts equalizing initial launch conditions between countries to spur equivalent tax treatment. However, identical starts do not guarantee convergence in practice, especially amidst significant discretion in implementation afforded to member states. Infringement proceedings signal in some cases a false start arising due to wide freedom[184].

In countries lacking prior statutory frameworks, ATAD likely improved defences against corporate tax avoidance. However, the impact appears less evident where similar regulations pre-date the ATAD, although some benefits may still accrue from enhanced conformity and administrative clarity for taxpayers. Still, the scope for tangible gains seems restricted by the extensive flexibility permitting divergence across Member State implementations, running counter to the ATAD's harmonisation ambitions. Consequently, several experts predict increased fragmentation of the common market compared to the pre-ATAD era based on the abundant latitude afforded to states in transposing directive guidelines.

The European Commission's 2020 implementation report also highlighted significant variability in how countries applied the multiple options offered within the ATAD, further showcasing gaps between vision and reality in achieving coordination. Nonetheless, when evaluating the success of the ATAD, such critiques warrant balanced assessment - absent the ATAD, completely uncontrolled deviation between individual country measures responding to BEPS calls for action would likely worsen heterogeneity. In that sense, the ATAD at minimum supplies common reference points, even if room for flexibility in rule formation largely persists[185].

In conclusion, ATAD aimed to increase harmonisation and coordination across EU Member States in addressing aggressive corporate tax avoidance and practices contributing to base erosion and profit shifting. However, the path to consistent adoption proves complicated by tensions between directives mandating common minimum standards while retaining flexibility allowing fragmentation in national implementations. Significant discretion and multiple options given to countries in transposing ATAD guidelines counter the stated goals of achieving unified anti-abuse measures.

While the ATAD establishes helpful common reference points absent before, the scope it allows for divergence hampers realising benefits like enhanced administrative clarity and conformity

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[183]Stoycho Dulevski, "Critical Remarks on the Implementation of the Anti-tax Avoidance Directive in the Bulgarian Legislation," in *YEARBOOK OF UNWE,* Christina Nikolova, Elka Todorova, Maya Lambovska, Todor Nedev, Dorina Kabakchieva, Paskal Zhelev (Sofia: Godishnik na UNSS, 2022), 50.
[184] *Ibid*., 51.
[185] Haslehner and Pantazatou, *supra note*, 5: 11

suggested in its rationale. Nonetheless the directive makes some positive, if incremental, steps forward in the landscape compared to completely decentralised uncoordinated evolution of country rules.

3.3. Uncertainties of interpretation

ATAD sets guidelines across various anti-avoidance areas but leaves several terms insufficiently defined. This affords for disjoint application, as evident in the emergence of fragmented rules between Member States. Uncertainties stem from phrases integral to operationalizing ATAD provisions lacking delineation to enable unanimous interpretation.

Absence of guardrails through deficient definitions material to regulatory oversight hence impedes coherence both amongst ATAD provisions designed to function in tandem as well as between country implementations claiming conformity with minimum EU standards.

Provisions around exit taxation intend mitigating risks of tax base erosion from assets transfers involving change in taxing rights, but undefined several terms create adoption gaps. Article 5 outlines exit tax guidelines without adequately qualifying phrases like "*assets*", "*value for tax purposes*", " *loss of a right to tax*", or "*residence*".

Directive do not differentiate between varieties of assets when discussing asset transfers potentially triggering tax charges. On face value, the guidelines appear applicable irrespective of whether the exiting asset constitutes immovable tangible property, financial instruments, intellectual property or other intangible rights. However, lacking specificity on assets generates adoption friction. Definitional gaps lead countries to advance contradictory perspectives based on conflicting legal histories, with some arguing for exclusive focus on fixed tangible assets while others push for inclusion of movable property and equity assets.

The ATAD also says nothing regarding the inclusion of "exempt" assets—that is, assets like qualified shareholdings that are not subject to disposition taxes—in the definition of "asset"[186].

The exit tax guidelines under Article 5 of ATAD supply an autonomous definition for the term "market value" to enable standardised asset valuation protocols for tax charges triggered by intra-EU transfers. However no associated qualifying boundaries get prescribed for the other integral term dictating value assessment - "*value for tax purposes*". This omission of a delineated meaning

[186] Paloma Schwarz, "The exit tax rule (Article 5 ATAD)," in *A Guide to the Anti-Tax Avoidance Directive*, Werner Haslehner, Katerina Pantazatou, Georg Kofler, Alexander Rust (London: Edward Elgar Publishing, 2020), 108.

for such a key phrase central to quantifying exit tax exposures leaves the methodology open to subjective interpretation by Member States based on individual administrative precedents.

The exit tax protocols under ATAD hinge on the concept of assets transfers resulting in a "*loss of right to tax*" by the source country to trigger applicable exit charges. However the Directive leaves the contours delimiting said loss of taxing rights by the state completely undefined. The phrase finds cursory mention in Article 2 venue setting definitions for an "assets transfer" though no associated boundaries of what changes sufficiently qualify get outlined. This omission leaves determining threshold conditions for "*loss of tax rights*" contingent on disparate domestic administrative and legal precedents when rules get transposed.

The exit taxation rule envisages tax residence transfers as potential triggers for imposition of exit charges. However, Article 2(7) supplies no autonomous definition delineating bounds of what constitutes residence for tax purposes in this context. Rather, incurrence of exit tax liabilities gets made contingent on the source and destination country arriving at a mutual consensus that a change in tax residency indeed occurred[187].

The anti-hybrid provisions under Articles 9, 9a and 9b of the ATAD present substantial complexity for national legislators and taxpayers in ensuring compliant understanding and application. Beyond intricate interplay between lengthy definitions and charge-triggering articles, the hybrid mismatch framework leaves multiple integral terms like "payment" and key aspects like addressing timing differences unspecified. In practise, it seems that the OECD BEPS Action 2 Report's fairly comprehensive guidelines play a major role in how the regulations are interpreted[188]. However, discussions on this issue are still ongoing. Supporters of the first position note that references to these interpretations are contained in the Directive itself. Meanwhile, others believe the guidance does not conform entirely to ATAD regulations and is not a part of EU law.

Uncertainty persists regarding the interplay between the GAAR and other specific anti-avoidance provisions in ATAD. The prevailing view in most EU member states follows general interpretation principles establishing specialised statutory anti-avoidance measures as taking priority over catch-all GAAR standards. Hence in instances of presumed abusive arrangements, analysis first tests applicability of tailored provisions demarcating certain avoidance structures, with GAAR relevance arising only when subject activity falls outside scope of said dedicated norms.

Debate intensifies around the GAAR's capacity to serve as a secondary backstop when

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[187] Schwarz, *supra note.,* 185: 15.

[188]Wolfgang Schön, "Interpreting European Law in the Light of the OECD/G20 Base Erosion and Profit Shifting Action Plan," *Bulletin for International Taxation 74, 4/5* (2020): 292.

arrangements display exploitation indicators but fail meeting requirements for invocation of pertinent targeted articles in ATAD. This friction remains unresolved in certain counties. While the GAAR retains relevance for arrangements covered under special rules, its ability to supplement such dedicated protocols stays limited as said tailored provisions conclusively outline legislative intent on what constitutes abuse in a given sphere.

In conclusion, ATAD leaves multiple terms and concepts insufficiently defined across various anti-avoidance provisions. Such definitional vagueness affords latitude for contradictory interpretation and application by Member States. This can be seen in the emergence of disjoint exit tax rules covering different asset categorization models. Conflicting reliance on external OECD guidelines also creeps in amidst ATAD vagueness. Interplay between the GAAR and other dedicated anti-avoidance rules remains debated. Inadequate specification of seminal terms and constructs intrinsic to several anti-avoidance articles within ATAD fosters divergence of rules between EU countries rather than unified understanding.

3.4. Potential inconsistency

In order to close loopholes and stop tax avoidance, ATAD aims to create harmonised, standardised corporate tax rules across EU Member States. Even though the coordination's objective is in line with the EU single market, certain ATAD measures also give rise to worries about the possibility of double taxation for entities that conduct cross-border business. In particular, if the interpretation and implementation of these rules vary, the provisions pertaining to interest limitation rules, exit taxation rule, controlled foreign company rules, and hybrid mismatches may cause the taxation of some cross-border income and deductible payments in two jurisdictions. This threatens to undermine the ability of entities to efficiently expand within the EU. Managing these double taxation risks has proven challenging amidst the complex patchwork of national tax codes and varying implementation approaches by Member States. Though ATAD was drafted to minimise such risks, lingering uncertainties continue to dampen its potential benefits for cross-border economic activity in the single market.

The *de minimus* nature of ATAD guidelines is the crux of double tax risks from interest limitations. Unilateral deduction restrictions in one state can produce cross-border impact still taxed abroad. While Article 4(6) allows carry forwards/backs to mitigate such double taxation, ATAD does not assure availability or coordination of these relief channels across Member States. Without mandated deductibility matching, costs limited locally thus remain taxed to lender states, causing

double taxation as non-deductible borrowing expense in one country still incurs full tax in another country[189].

Even when implemented, ATAD's non-binding Article 4(6) carry forward mechanisms offer no guarantee that deferred deductibility relief would materialise before losses expire - leaving enduring double tax impact. With interest caps inflating taxable income irrespective of parallel taxation abroad, the economic double tax burden stems primarily from conflicts qualifying the same payments as non-deductible costs locally and taxable income to lenders elsewhere. And as ATAD permits restrictions on domestic borrowing too, such mismatches apply internally within individual states also[190].

Despite the resulting internal market distortions, ATAD manifestly fails to require relief for double taxation from interest limitations, since it does not require Member States to implement Article 4(6) carry forwards/backs. These economic double tax conflicts burden European businesses even though they differ from traditional juridical taxation of the same payment flows in that they involve the denial of deductions locally and the inclusion of income abroad. Furthermore, the Interest Royalty Directive would not limit ATAD restrictions, resulting in economic double taxation on borrowers instead, as it only addresses juridical tax conflicts that reduce creditor income. The imposition of dual tax burdens on financing costs through ATAD interest rules by Member States is therefore still legal as long as there is no discrimination against cross-border taxpayers. Additionally, some juridical double tax risks endure as non-deductible amounts locally may still incur source state withholding taxes as "interest", before residence state income taxation too - exacerbating tax on tax[191].

EU Member States are permitted to impose taxes on corporations for unrealized capital gains pertaining to assets that are transferred outside of their tax jurisdiction through the exit taxation rule. However, taxpayers are extremely concerned about the possibility of double taxation due to the broadway exit taxation being framed under ATAD. In particular, the potential for unrealized gains that are taxed in one country upon departure to be taxed in another upon realisation creates a double taxation scenario and significantly raises expenses.

Double taxation could occur as a result of differences in the various national regulations. If the new State of residence taxes the entire capital gain from the acquisition up to the moment of actual disposal and the exit State calculates the capital gain at the moment of deemed disposal at the

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[189]Annika Soom, "Double Taxation Resulting from the ATAD: Is There A Relief?," (master's thesis, Lund University, 2019), 18.
[190] *Ibid*., 19.
[191] *Ibid.*

time the taxpayer departs the country, double taxation may result. Comparably, in the case of corporations, varying methods of asset valuation among Member States may result in unintentional non-taxation or double taxation[192]. Although the Directive expressly states that there should be no such discrepancies, it does not provide a clear method for achieving this goal in reality in the event that tax authorities in two Member States arrive at different conclusions regarding the "market value" of an asset[193].

The undefined terms and broad criteria in ATAD's CFC rules also risk double taxation for EU businesses. Allowing simultaneous application of voting rights, capital share and profit share thresholds across ownership chains to designate control can result in multiple countries deeming the same foreign entity a CFC and attributing the same income to different resident taxpayers. For example, Company A in State A indirectly controls foreign Company C via subsidiary B in State B. If both A and B's CFC thresholds are met, double economic taxation occurs as both States A and B tax the same Company C income on their respective residents. Unlike classical juridical double tax relief which covers tax paid by the CFC itself, this emerging brand of economic double taxation from conflicting CFC income attribution across countries finds no mitigation under ATAD's vague guidelines[194].

The ATAD CFC rules also risk double taxation through their narrow effective tax rate calculation approach. Basing this solely on taxes actually paid by CFC entities themselves disregards prior tiered taxation further down the ownership chain. Income taxed at subsidiary level before distribution up to the CFC remains exposed to additional threat from controlling country CFC inclusion rules later - if that two-tier tax cost doesn't dilute consolidated CFC tax rates below exemption thresholds[195].

ATAD's lack on accounting for loss carry forwards in judging CFC low taxes also enables double taxation. Income shielded abroad by prior year losses and thus showing artificially low current tax rates remains prone to controller country CFC inclusion rules. This separate home state tax liability emerges despite already diminished earnings abroad from deferred tax reliefs that should modulate global burden assessments[196].

Regarding the rule of hybrid mismatches, double taxation may arise, for example, when timing discrepancies in recognition cause a payment to be (merely) delayed in being included in the

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[192]"Communication from the Commission to the Council, the European Parliament and the European Economic and Social Committee," *supra note*, 102.
[193] Haslehner and Pantazatou, *supra note*, 5: 19.
[194] Soom, *supra note,* 188: 22.
[195] *Ibid*., 23.
[196] *Ibid*., 24.

recipient's tax base. Recital 22 of Directive 952/2017 states that these inconsistencies should only be addressed if the time difference is more than a "*reasonable time*" (12 months); however, if the recipient jurisdiction's recognition happens after that time, double taxation will also occur[197].

Another example, the one-sided nature of primary response denial of deduction rules risks economic double taxation absent coordinating relief provisions. Logically, if interest or royalty payments to a related party remain ultimately taxed as ordinary income abroad, any initial deduction restriction claiming tax base protection should be reversed afterwards by the payor jurisdiction. Otherwise double taxation from the combined impact of local deduction denial and foreign income inclusion violates equity. Unlike limitations under general interest deductibility restrictions which allow future carryforwards for amounts blocked by caps, the outright rejection of payments to uncooperative jurisdictions under primary rules provides no such contingent deferred relief tied to outcomes elsewhere[198].

Moreover, the circular linking of primary and defensive rules can exacerbate mismatches as residence countries tax perceived deductible payments from abroad unaware of initial deduction bars imposed. This multiplying effect from fragmented unilateral actions highlights the need for synchronized mechanisms and information exchange to prevent both deduction/non-inclusion and deduction/inclusion conflicts[199].

To sum up, while ATAD's standardised rules aim to close cross-border loopholes, provisions like exit taxes, interest restrictions, CFC inclusion and hybrid mismatch approaches have increased risks of double taxation for EU businesses - both from conflicting economic denial of deductions locally with income tax abroad, as well as juridical overlaps of taxing rights across countries. The prominent lack of binding reciprocal procedures across Member States to relieve the most disproportionate repercussions overreaching anti-avoidance needs.

[197] Haslehner and Pantazatou, *supra note*, 5: 26.
[198] Leopoldo Parada, "Hybrid Entity Mismatches and the International Trend of Matching Tax Outcomes: A Critical Approach," *Intertax* 46, 12 (2018): 986, https://doi.org/10.54648/taxi2018104.
[199] *Ibid*.

4. IMPROVING THE EFFECTIVENESS OF GENERAL AND SPECIFIC TAX ANTI-AVOIDANCE RULES IN EUROPEAN UNION

Tax avoidance has posed growing risks that jeopardise sustainable revenues for EU Member States. Estimates indicate the annual costs from corporate tax abuse within the EU run into the hundreds of billions. In response, the European Commission introduced the ATAD in 2016 to set common minimum standards for targeted anti-avoidance measures. However, significant scope remains for upgrading existing rules and enforcement mechanisms considering fast evolving avoidance techniques.

Attempts to harmonise defensive measures through instruments like ATAD have had limited impact given played out exceptions and uneven implementation. There remains substantial scope to improve EU-level guidelines and optimise anti-avoidance rules on a coordinated basis.

Accordingly, this chapter explores viable options for enabling general and specific anti-avoidance rules to become significantly more effective within the opportunities posed by EU law.

ATAD obliges Member States to levy an exit tax on cross-border transfers of assets when the same movements of assets strictly within the domestic jurisdiction are not taxed, thus taxing exempt capital gains solely because of the cross-border element may constitute discrimination incompatible with EU fundamental freedoms. It is therefore necessary to interpret or amend the provisions of the Directive in order to comply with the primary law.

A viable solution for reconciling the ATAD exit tax rule with EU non-discrimination laws would be to interpret the directive as excluding assets benefitting from a capital gains tax exemption under domestic tax law from the scope of the exit taxation requirement. By carving such domestically exempt asset transfers out of ATAD exit tax rules, the directive could be applied in a targeted manner focused specifically on taxing realised gains on assets that would otherwise face a domestic tax liability, thereby avoiding discrimination resulting from imposition of new taxation solely due to the cross-border element. This interpretation would align application with proportionality standards under EU primary law[200].

It is also important to note that in order to avoid gaps and overlaps in the taxation of cross-border capital gains, the following solution can be proposed, which is in the interest of States and minimally restricts the freedoms of taxpayers: transfer of the book value of assets from the outbound State to the inbound State; determination of the value of assets at the time of exit; the

[200] Haslehner and Pantazatou, *supra note*, 5: 20.

obligation of the inbound State to inform the outbound State of the subsequent realisation of capital gains and to assist in the collection of taxes on such capital gains; and the obligation of the inbound State to provide assistance to the taxpayer in order to avoid duplication and overlap in the taxation of cross-border capital gains[201].

Another solution was proposed by Loes Brilman. Under his proposal, the destination state would retain the historical book value of the assets and tax the full capital gain upon realization. Subsequently, the destination state would compensate the departure state in an amount equal to the difference between the historical book value and the value at the time of exit. This clearing system is an appealing concept since it would prevent differential treatment of domestic versus cross-border transactions. Additionally, it would facilitate a balanced division of taxing rights between the source and residence countries. By having the destination state remit a portion of the taxes back reflecting the accrued but unrealized gain at the time of exit, this approach prevents both double taxation and tax avoidance while adhering to tax sovereignty principles[202].

ATAD mandates immediate taxation of unrealized capital gains when assets are transferred cross-border, while only allowing deferred 5-year payment plans. This contrasts significantly with the treatment of domestic asset transfers within a single Member State, where latent gains are generally not taxed until realized. Consequently, taxpayers moving assets between EU countries bear a more onerous tax burden compared to those relocating domestically, facing disparate impact for equivalent commercial decisions based solely on crossing MS lines[203]. By etching these inequalities into legislation rather than pursuing greater harmonisation, Article 5 falls short of facilitating free movement and equal treatment principles.

Therefore, it seems important to prohibit the charging of interest as a disproportionate measure and to extend the payment period in appropriate cases.

The CFC rules under the Anti-Tax Avoidance Directive permit restricting freedom of establishment for foreign subsidiaries, but to comply with EU law per Court of Justice precedent, such provisions can only target wholly artificial arrangements rather than apply general assumptions that foreign entities present tax avoidance risks. While the ATAD does incorporate Court mandated exceptions for substantive economic activities in Member States, concerningly it allows countries to deny that carve-out for similarly situated entities in third states. By enabling denial of equal

[201] Johanna Hey, "Taxation of business in the EU: Special problems of crossborder losses and exit taxation," in *Research Handbook on European Union Taxation Law* HJI Panayi, Christiana; Haslehner, Werner; Traversa, Edoardo (London: Edward Elgar Publishing, 2020), 221.
[202] *Ibid*., 222.
[203] *Ibid*., 223.

exception treatment solely on the basis of non-EU jurisdiction residence even against underlying commercial substance, the Directive appears to encourage discrimination in conflict with primary freedoms.

One possible solution to this discrepancy is to change the CFC provision of the rule in accordance with the CJEU judgement in the case of X GmbH according to which the "*economic substance*" exception if the Member State of the controlled company has signed a bilateral agreement with the relevant third country establishing effective exchange of information frameworks[204].

Allowing Member States discretion under Article 3 of ATAD to unilaterally tighten anti-abuse standards beyond ATAD minimums risks creating fragmented frameworks where identical transactions elicit inconsistent tax avoidance treatment across the EU. Rather than establishing common definitions, the latitude for individual countries to impose more stringent general anti-abuse rules based on independent interpretations of acceptable tax planning means multinationals face uncertainty and disparities depending solely on location specifics. The divide between improper tax avoidance and permissible mitigation would become unharmonized. Ultimately, this could impose restrictions on free movement in conflict with proportionality.

By only establishing a "*de minimis*" floor for anti-abuse protections, ATAD grants latitude to Member States to implement asymmetric standards exceeding the minimums. Allowing country-specific rules risks enabling taxpayers to exploit these inconsistencies and circumvent the toughest regimes by shifting arrangements into more permissive jurisdictions. Rather than a patchwork of disparate defences, the ATAD should have enshrined "*de maximis*" standards to maximise harmonisation, effectiveness and proportionality. This position is also supported by the Confédération Fiscale Européenne. An argument exists that Court of Justice precedent effectively establishes "*de maximis*" standards by delineating abuse deterrence restrictions required to comply with EU freedoms. Thereby judiciary oversight could prevent fragmentation from asymmetric member state implementation exceeding ATAD minimums. However, the latitude between Directive de minimis floors and case law standards still risks inconsistent application. Even rules respecting precedent could impose differing limitations not necessitated by the freedoms when applied narrowly.

It is imperative that the ATAD be implemented and enforced uniformly throughout all member states. Periodic observation and assessment can pinpoint areas in need of improvement.

All of the Commission's open, ongoing infringement investigations seem to be related to

[204] Haslehner and Pantazatou, *supra note*, 5: 16.

suspected improper implementation rather than a lack of implementation. Based on this, we can conclude that more detailed guidelines to the implementation of the ATAD rules by the Commission can help to ensure proper implementation by Member States.

The intricate interplay between the extensive definitions in Article 2(9) and the substantive rules in Articles 9-9b poses comprehension and application difficulties for member state tax authorities. Additionally, the anti-hybrid framework leaves certain key terms like "payment" undefined.

This ambiguity has led to heavy reliance on detailed but non-binding OECD guidance for interpretation, creating uncertainty. Since these external guidelines do not constitute EU law and differ in certain aspects from ATAD, the current situation is suboptimal.

One possible solution EU can issue supplemental guidance and examples, beyond the current OECD BEPS Action 2 guidelines, tailored to the ATAD anti-hybrid rules. This can address ambiguities around interpretational reliance on non-binding recommendations from an external body.

In order to completely eliminate hybrid mismatches in the internal market, the most comprehensive solution entails a common framework for entity categorization amongst Member States, backed by reciprocal adherence to the tax characterization conferred in the host country.

The suggested approach designates an entity's country of legal organisation, or home state, as the ultimate authority for tax characterization purposes when mismatches emerge across countries. This centralised deference to the home jurisdiction provides a straightforward coordination mechanism to address disparate cross-border interpretations[205].

On further reflection, the proposal reflects pragmatic efficiency along multiple dimensions - operational simplicity in implementation, logically consistent reliance on the home state with closest association to the entity, as well as overarching honesty by covering all characterization divergences regardless of direction.

In essence, rather than determining acceptable or unacceptable deviations on a case-by-case basis, straightforward home state supremacy for tax treatment bridges characterization gaps more evenly and objectively.

Still, to guarantee this rule's useful and beneficial effects, it must be implemented globally in a uniform and consistent manner.

As mentioned earlier, the established procedural sequence involves first assessing if a given

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[205] Leopoldo Parada, "Hybrid Entity Mismatches: Exploring Three Alternatives for Coordination," *Intertax* 47, 1 (2019): 53, https://doi.org/10.54648/taxi2019003.

arrangement falls within the scope of any specialised anti-avoidance provisions. Only once excluded from such tailored norms is relevance of the catch-all GAAR examined.

Friction emerges where arrangements technically qualify under specialised rules, but fail to meet all stipulated conditions for applicability. Here the GAAR's capacity to secondarily deny benefits remains debated across certain member states.

Scope for GAAR to deny specific scheme advantages exists perhaps in select circumstances like:

- Special rule only bears illustrative non-binding character
- Arrangement facets giving rise to abuse accusation stay completely unaddressed in dedicated norm
- Taxpayer behaviour displays intentional circumvention of relevant special rule

Absent such factors, GAAR seemingly possesses limited capacity to override frameworks like exit tax statutes in denying benefits where a priori binding legislative decision-making on abuse conditions occurs via specialised rules[206].

Recital 11 of ATAD states that GAARs are meant "*to fill in gaps*" left by more focused anti-abuse regulations, with particular reference to Art. 6 ATAD. However, this can be interpreted to mean that GAARs in general also apply to the ATAD. That this "*should not affect the applicability of specific anti-abuse rules*" is further specified in the same recital. Although there is no denying the GAAR's gap-filling role, which also serves to explain and justify the use of vague and open-ended terms (such as "*one of the main purposes*," "*valid commercial reasons*," and "*economic reality*"), it does not provide an answer to the question of whether the provisions should be applied in accordance with more specific anti-avoidance rules. A possible solution to this would be a new court practice that would give a clearer understanding.

As for the double taxation that may arise from the interest limitation and CFC rules it is important to note the following.

A mechanism for carrying forward and back of non-deductible borrowing costs or unused interest capacity is anticipated by the ATAD. Nevertheless, Member States are not required to put the provision into effect. In the event that there is no carry forward and back mechanism, the economic double taxation could be resolved in accordance with Article 9 of the OECD MC, which requires the Member State to adjust its residents' profits by refusing to allow the deduction of borrowing costs. However, Member States may seek a resolution through a procedure for mutual agreement if the creditor's Member State disagrees with the corresponding adjustment.

[206] Haslehner and Pantazatou, *supra note*, 5: 21.

Provided that the tax treaty contains the mandatory arbitration clause, Member States are required to proceed with the arbitration in the event that the mutual agreement procedure proves to be unsuccessful. Article 23 of the OECD MC typically resolves cases of judicial double taxation that result from the domestic interest limitation rule not forbidding income taxation under article 11 of the MC. If the payment is exempt from the Interest and Royalty Directive, which forbids the imposition of withholding taxes on outbound interest payments, the aforementioned juridical double taxation would not occur within the EU. Furthermore, as a dispute resulting from transfer pricing adjustment, disputes regarding double taxation resulting from the interest deduction limitation rule may also be resolved under the Arbitration Convention or under the Dispute Resolution Directive as a dispute arising from the interpretation and application of a tax treaty. As the deduction of borrowing costs is restricted in the same way for both domestic and cross-border transactions, double taxation would not be addressed by EU primary law. It is crucial to remember that the Arbitration Convention, the Dispute Resolution Directive, and Article 9 of the OECD MC exclusively address cross-border loans made to related parties. Consequently, there is no way to avoid double taxation resulting from the interest deduction restriction on a loan made domestically or between unrelated parties. Moreover, loans in which one party is based outside of the EU are excluded from the application of the Dispute Resolution Directive and the Arbitration Convention[207].

Thus, one of the possible solutions to avoid double taxation would be making the carry forward and carry back mechanism mandatory in the ATAD's interest limitation rule. Binding carry forward eliminates scenarios where interest deductions disallowed in one period fail to get offset against income in future profitable years. This enables efficient unwinding of duplicated tax burdens over time. Carry back would allow current disallowed interest to be deducted from income in prior years, fast-tracking relief realisation. Together, the mechanisms provide comprehensive functionality to relieve double taxation across time periods - both forward through future taxable earnings and backwards against past profits.

Regarding possible solutions to double taxation arising from CFC rule the following can be noted.

Article 8 paragraph 3 of the ATA Directive only requires that "*...the income to be included in the tax base shall be calculated in proportion to the taxpayer´s participation in the entity as defined in point (a) of Article 7 (1)*". According to the correct interpretation of this sentence, the ATAD Article 7 paragraph 1 sentence 1 (a) criteria must be applied in order to determine the imputed income quota. That being said, it is not required to apply the same criterion that determined

[207] Soom, *supra note,* 188: 26.

the foreign company's control when determining the legal ramifications. From an economic perspective, since the shareholder only shares in the CFC's profits to that extent, it seems reasonable to base the imputed income quota on the actual profit share as stipulated by the German CFC Rules[208]. The guidelines of the EU Directive could provide consistent quotas for the imputed income amount even in the event of a parallel application of the CFC Rules of different Member States for a single case if the EU Member States applied the relevant provisions uniformly.

More detailed description about the impact of loss carry forward to the calculation of an effective tax rate can be helpful in another potential cause of double taxation is an uncertainty how the low taxation on the level of CFC resulting from loss carry forward shall be treated by the Member States.

As discussed in subchapter 3.4 even when lower tier subsidiaries face high taxation, CFC income can get additionally attributed based on the specific CFC's tax rate. Some ways to address this:

- Consolidated Filing: Allowing EU parent companies to file consolidated returns encompassing foreign CFC subsidiaries can permit comprehensive capture and crediting of taxes paid at sub-entity levels as well. This can structurally relieve double taxation.
- Expanded Credit Eligibility: The ATAD can be amended to require member states to account for and provide credits for taxes paid by subsidiary entities further down the ownership chain as well while determining CFC income amounts for attribution.

In conclusion, the challenges posed by tax avoidance within the European Union necessitate a thoughtful reassessment of existing general and specific anti-avoidance rules in ATAD. While the ATAD introduced important measures to combat cross-border tax abuse, there are evident gaps and inconsistencies that require attention. Furthermore, the need for harmonization and a more uniform approach, particularly in addressing double taxation concerns related to interest limitations and CFC rules, calls for collaborative efforts among Member States.

Moving forward, it is imperative for EU policymakers to consider these proposed solutions and engage in a comprehensive dialogue to strengthen the ATAD and associated regulations. Striking a balance between discouraging tax avoidance and ensuring a level playing field for businesses operating within the EU is crucial for fostering economic growth and preserving the integrity of the internal market.

[208] Moser and Hentschel, *supra note*, 107: 611.

CONCLUSIONS

1. Tax avoidance refers to the reduction of tax burdens through arrangements that comply with the literal text of tax laws but contravene the spirit and purpose of those laws. Tax avoiders exploit technical loopholes, interpretive ambiguities, gaps, exceptions or conflicts across rules to configure transactions or structures that are not strictly prohibited but enable payment of less tax than otherwise warranted by the commercial substance. While tax evasion involves outright illegal methods of not paying owed taxes, tax avoidance occupies a grey area between legal tax mitigation utilising exemptions as the legislature intended, and fraudulent tax evasion warranting penalties. Combating the socioeconomic harms of legal yet abusive tax avoidance while also distinguishing it from acceptable tax mitigation poses complex challenges of enforcement, regulation, and transparency. General and specific anti-avoidance rules were developed in order to combat this negative phenomenon. GAAR are overarching provisions designed to counteract a broad spectrum of potentially abusive or artificial tax arrangements. GAAR operates ex post facto, allowing tax administrators to reconstruct transactions and address tax abuse, but their application is contingent upon the identification of specific instances of abuse. On the other hand, SAARs constitute targeted measures addressing specific tax situations defined by the legislator, focusing on preventing potential tax evasion in those particular cases.

2. The analysis of various EU directives, including the Interest and Royalties Directive, Parent-Subsidiary Directive, the Merger Directive, Anti-Tax Avoidance Directives, the Merger Directive, which contains general and specific anti-avoidance rules such as interest limitation rule, exit taxation rule, controlled foreign company rule rules on hybrid mismatches, highlights the intricate challenges and potential shortcomings in the EU's approach to counteracting tax avoidance. Among the main challenges and important issues are the following:

- The adoption of the ATAD rules by the EU has triggered discussions regarding its alignment with the EU's competencies for tax harmonisation, raising concerns about potential conflicts with treaty rules and principles of subsidiarity and proportionality. While the CJEU has granted broad discretion to the EU legislature, certain ATAD provisions, particularly those related to exit taxes and CFC rules, face scrutiny for potentially infringing on EU freedoms and national constitutional principles. The ATAD's attempt to codify CJEU requirements for compliant exit taxes introduces inconsistencies, and the economic substance exception in CFC rules prompts questions about its alignment with CJEU jurisprudence. Although the supremacy of

EU law is well-established, ongoing interpretive work is needed to ensure that the ATAD aligns seamlessly with primary EU law.

- Implementation of GAAR and SAARs of ATAD has encountered complexities due to the tension between providing common minimum standards and allowing significant flexibility for national adaptations. While the ATAD introduces common reference points, the latitude granted to Member States in transposing its guidelines has led to variations in how countries address corporate tax avoidance.
- The lack of clarity in crucial terms integral to ATAD provisions hampers regulatory oversight and coherence both within the directive and across Member States. In the context of exit taxation, the undefined terms related to assets, market value, loss of a right to tax, and residence create significant adoption gaps, contributing to conflicting perspectives among countries. The absence of clear boundaries for key phrases, such as "value for tax purposes" and "loss of tax rights," allows subjective interpretation, relying on individual administrative precedents. Additionally, the interplay between GAAR and specific anti-avoidance provisions remains contentious, with unresolved debates on the GAAR's role as a secondary backstop. In essence, ATAD's definitional vagueness fosters fragmentation rather than a unified understanding, highlighting the need for more precise terminology and coordinated implementation.
- ATAD, designed to establish standardised corporate tax rules across EU Member States, faces a paradox as it seeks to curb tax avoidance but inadvertently introduces concerns about potential double taxation. The interest limitation rules, exit taxation provisions, controlled foreign company (CFC) rules, and hybrid mismatch framework within ATAD pose significant risks of taxation on cross-border income and payments in two jurisdictions. The absence of binding mechanisms for relief, especially concerning Article 4(6) of the ATAD carry forwards/backs, leaves entities vulnerable to enduring double taxation impacts, particularly in cases of interest limitations. The broad criteria and undefined terms in ATAD's CFC rules further contribute to the risk of economic double taxation, as simultaneous applications across ownership chains may lead to conflicting attributions of income in different countries. Overall, the complex and varied implementation of ATAD across Member States creates challenges in managing double taxation risks, undermining the directive's intended benefits for cross-border economic activity within the EU.

3. Concerns arise with the ATAD's exit tax provision, as it may lead to discrimination incompatible with EU fundamental freedoms. A suggested solution involves interpreting the directive to exclude assets benefiting from a domestic capital gains tax exemption, aligning it with proportionality standards. To address gaps in cross-border capital gains taxation, proposals include transferring the book value of assets, determining values at exit, and ensuring cooperation between outbound and inbound states.

The immediate taxation of unrealized cross-border capital gains under ATAD, in contrast to domestic transfers, raises concerns about disparate impacts. Prohibiting disproportionate interest CFC rules, while targeting artificial arrangements, may inadvertently encourage discrimination. A proposed solution involves aligning CFC provisions with Court of Justice judgments and promoting international cooperation.

The latitude granted to Member States to tighten anti-abuse standards beyond ATAD minimums risks creating fragmented frameworks and restricting free movement. Advocacy for "*de maximis*" standards and consistent implementation of ATAD across all member states is crucial for harmonisation. Ambiguities in Article 2(9) and reliance on non-binding OECD guidance for anti-hybrid rules call for supplemental EU guidance tailored to the ATAD.

The proposal for a common framework for entity categorization based on the home state is considered an efficient solution to eliminate hybrid mismatches. However, global uniformity is essential for its effectiveness. The General Anti-Abuse Rule (GAAR) is seen as a secondary measure to specialised anti-avoidance provisions, but its capacity to deny benefits is debated, requiring clearer court practices.

Addressing double taxation arising from interest limitation and CFC rules involves making the carry forward and back mechanism mandatory in the ATAD's interest limitation rule. This ensures efficient relief over time. Additionally, consistent application of CFC rules across EU Member States is crucial for preventing double taxation.

RECOMMENDATIONS

In the light of the findings of the conducted research, the following suggestions are made to improve the potential provided by EU law to make both general and specific anti-avoidance rules much more effective and achieve their further harmonisation and coordinated implementation:

1. A feasible approach to harmonising the ATAD exit tax rule with EU non-discrimination laws involves interpreting the directive to exempt assets enjoying a domestic capital gains tax exemption from the exit taxation requirement. This tailored interpretation would exclude domestically exempt asset transfers from ATAD exit tax rules, ensuring a focused application. The directive would then specifically target realised gains on assets that would typically be subject to domestic tax liability, mitigating the risk of discrimination arising solely from the cross-border element. Such an interpretation aligns with the proportionality standards outlined in EU primary law.

In order to reduce the possibility of this rule being recognised as discriminatory in relation to domestic situations Paragraph 2 of Article 5 the five-year period should be changed to extend the payment period in appropriate cases.

2. In order to avoid gaps and overlaps in the taxation of cross-border capital gains under exit taxation rule of ATAD the following solution can be proposed: transfer of the book value of assets from the outbound State to the inbound State; determination of the value of assets at the time of exit; the obligation of the inbound State to inform the outbound State of the subsequent realisation of capital gains and to assist in the collection of taxes on such capital gains; and the obligation of the inbound State to provide assistance to the taxpayer in order to avoid duplication and overlap in the taxation of cross-border capital gains.

3. The CFC rule may be recognised as in conflict with fundamental freedoms. The solution to this discrepancy is to change the paragraph 2 (a) of Article 7 of the ATAD provision of the CFC rule in accordance with the CJEU judgement in the case of X GmbH according to which the "*economic substance*" exception if the Member State of the controlled company has signed a bilateral agreement with the relevant third country establishing effective exchange of information frameworks.

4. The ATAD should have enshrined "*de maximis*" standards to maximise harmonisation, effectiveness and proportionality.

It is also necessary to determine periodic observation and assessment of implementation of ATAD. In addition, detailed guidelines to the implementation of the ATAD rules by the Commission

can help to ensure proper implementation by Member States.

5. The Commission should issue supplemental guidance and examples, beyond the current OECD BEPS Action 2 guidelines, tailored to the ATAD anti-hybrid rules and exit taxation rule. In order to create clearer definitions for the correct understanding of these rules.

6. To prevent hybrid mismatches within the internal market, Member States need a common characterization method that involves mutual recognition of tax characterization rules provided by the host country.

7. In order to prevent double taxation that may arise from interest limitation rule, the carry forward and carry back mechanism specified in paragraph 6 of Article 4 of ATAD should be made mandatory for implementation by Member States.

8. The ATAD Article 7 paragraph 1 sentence 1 (a) criteria must be applied in order to determine the imputed income quota. That said, it's not necessary to use the same criterion for determining control of the foreign company when assessing legal consequences. From an economic standpoint, considering that the shareholder only participates in the CFC's profits to a certain extent, it makes sense to calculate the imputed income quota based on the actual profit share, as outlined in the German CFC Rules. This will help to avoid double taxation in a scenario of a parallel application of the CFC Rules of different Member States.

To avoid the potential for double taxation due to loss carry forwards from previous tax periods and as a result, a lower effective tax rate in the current assessment year – with such situation potentially being estimated as low taxation on the level of CFC – a detailed description in ATAD about the impact of loss carry forward on the calculation of an effective tax rate is needed.

Enabling parent companies in the EU to file consolidated returns that include foreign CFC subsidiaries may also enable the complete collection and crediting of taxes paid at the sub-entity level. Double taxation may be structurally avoided as a result.

In determining CFC income amounts for attribution, the ATAD should be amended to require Member States to account for and provide credits for taxes paid by subsidiary entities further down the ownership chain.

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ABSTRACT

This study represents a comprehensive analysis of the general and specific tax anti-avoidance rules in the European Union. The examination delves into key directives, including GAAR of Interest and Royalties Directive, GAAR of Merger Directive, GAAR Parent-Subsidiary Directive and rules of Anti-Tax Avoidance Directive.

Based on the analysis identified challenges encompass legal questions, coordinated implementation hurdles, interpretational uncertainties, and potential inconsistencies. The study determines the main problems that arise in connection with the rules provided by the Anti-Tax Avoidance Directive and suggests possible ways to solve them and increase the effectiveness of the rules to combat tax avoidance.

Key words: *tax avoidance, GAAR, SAAR, ATAD, abuse of law, interest limitation rule, exit taxation, CFC rule, hybrid mismatches*

SUMMARY

This master's thesis on the topic of "General and specific tax anti-avoidance rules in the European Union" is devoted to complex research of the tax anti-avoidance rules in the European Union.

The aim of this study is to conduct a comprehensive analysis of the General Anti-Avoidance Rules and Specific Anti-Avoidance Rules in the European Union, examining their practical implementation, associated issues, and potential future developments.

For the accomplishment of this aim, the following objectives were fulfilled. Firstly, to disclose and discover the legal nature of the GAAR and SAAR. Secondly, to analyse main EU legislation related to tax avoidance. Finally, to provide a proposal for solving problems and increasing the efficiency and unification of GAAR and SAAR in the EU, based on the legal analysis carried out in this master's thesis.

The work is structured into four interrelated parts. The first part provides background on the concept of tax avoidance and the legal nature of GAAR and SAAR. It examines the judicial doctrine of "abuse of law" developed by the Court of Justice of the European Union. It also analyses the OECD/G20 BEPS project and its impact on EU tax avoidance rules.

The second part conducts an in-depth analysis of EU legislation related to tax avoidance, including the GAAR provisions in the Interest and Royalties Directive, Merger Directive, Parent-Subsidiary Directive and the Anti-Tax Avoidance Directive. The key elements studied are the interest limitation rule, exit taxation rule, controlled foreign company rule, GAAR, and rules on hybrid mismatches in the ATAD.

The third part evaluates the challenges and limitations in the implementation of GAAR and SAAR in the EU. It examines issues relating to legality, coordinated implementation, uncertainties in interpretation, and potential inconsistencies that can lead to double taxation.

The fourth part, proposals and recommendations are provided for enhancing the effectiveness and unification of GAAR and SAAR in the EU. It suggests specific solutions to issues identified in the third part.

The general result of the study can be summarised in the statement that the existing GAAR and SAAR in EU and Member State law are not efficient and unified enough and require further refinement.