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To what extent the Anti-abuse measures concerning the interest limitation rule can be introduced into Member States without breaching EU law?

by

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Table of contents

Summary………………………………………………………………… 3
Abbreviation list…………………………………………………………4
1 Introduction…………………………………………………………5
1.1 Background (topic/legal issue)……………………………………..6
1.2 Aim (subject/purpose)……………………………………………...6
1.3 Method and material………………………………………………..7
1.4 Delimitation………………………………………………………...8
1.5 Outline……………………………………………………………...8
2. Interest deduction limitation…………………………………………9
2.1 Introduction………………………………………………………...9
2.2 Debt/Equity………………………………………………………...9
2.3 Thin Capitalisation………………………………………………..10
2.4 BEPS Action 4- Interest deduction limitation rules …………….. 11
2.4.1 The best approach recommended by the OECD……………. 13
2.4.2 Addressing double taxation………………………………… 14
3. The Anti-Avoidance Directive Proposal on Interest deduction limitation
3.1 Background……………………………………,…………..15
3.2 Article 4: Interest Limitation rule…………………………………16
4. Compatibility with European Union Law
4.1 General note………………………………………………………16
4.2 EU tax law and the relationship to EU law test…………………..17
4.2.1 Case C-324/00 Lankhort-Hohorst GmbH…………………..17
4.2.2 Case Cadbury Schewepps…………………………………..18
4.2.3 Case C-524/04 Test Claimants in the Thin Cap Group……..20
4.2.4 Case C-593/14 Damixa……………………………………...21
4.3 The Justification Assessment……………………………………....23
5. ATAD on Domestic Law……………………………………………..27
5.1 The Netherlands……………………………………………………27
5.2 Germany…………………………………………………………..29
5.3 Article 11 (6) ATA Directive………………………………………31
6. Conclusion……………………………………………………………32
Appendix A…………………………………………………………….. 34
Bibliography... … 36
Table of Cases 39

Summary

One of the most difficult legal questions in the field of international taxation law is how to prevent the existence of abusive practices. Whereas, the prevention will not obstruct the free movements of the Member Stated framed by the Treaties of European Union. On the one hand, the Member States exercise their rights by legislating the provisions to combat harmful tax practices. On the other hand, the Court of Justice play its role by ensuring EU law is interpreted and applied in EU countries similarly.

The crucial substances from court judgments are core of this research. Together with the question rise up in the author's point of view, how far have the Member States learnt from the implementation of Anti-abusive approaches? Specifically, the approaches concerning the interest deduction limitation rules.

The recent ATAD covers the interest limitation rule which is in line with the OECD/G20 BEPS Action 4. This means that the issue of limitation on interest is important. Due to the differential treatment between debt and equity. There is a possibility of an abuse through aggressive tax planning which the group of companies may take advantage from. Therefore, the aim of this research is to determine the requirements from EU law in order to apply the domestic legislation without breaching the fundamental freedoms.

The paper discusses whether the current interest limitation deduction rules in Member States follow the recommendations from the BEPS Action 4. The major similarity and the minor different with the suggested best approach will be discussed. Also, the possibility of transportation of ATAD to Member States' domestic laws will be argued.
Together with present the disputes concerning the compatibility between the national law and EU law.

Abbreviation list

Art.	Article
ATAD	Anti-Tax Avoidance Directive
BEPS	Base Erosion and Profit Shifting
CITA	the Dutch Corporate Income Tax Act 1969
Ch.	Chapter
CJEU	Court of Justice of the European Union
EBITDA	Earnings before Interest, Taxes, Depreciation and Amortization
EBIT	Earnings before interest and tax
EFTA	European Free Trade Association States
EU	European Union
G20	Group of 20
Ibid.	Ibidem
MNE	Multi-National Enterprise
MNEs	Multi-National Enterprises
no.	number
OECD	Organisation for Economic Co-operation and Development
p.	page
para.	paragraph
TEU	Treaty on European Union
TFEU	Treaty on the Functioning of the European Union
vs.	versus
Vol.	Volume

1. Introduction

1.1 Background

In an era of digital and mobile globalisation, the current economic environment and tax law practices require improvement. It is widely known that multinational companies (MNEs) create business models and corporate structures which are complex and allow companies to maximise profit and manipulate an ability to tax of the Member States in cross-border situations.[1] Some negative company structures cause a number of tax consequences. To combat and tackle a rapid growth of MNEs' tax planning and tax avoidance, without the hominisation at the level of domestic jurisdiction, Member States are recommended to follow the guidelines issued by the European Commission and the Organisation for Economic Co-Operation and Development (OECD). At the same time, the domestic provisions must be in line with the EU primary law, especially, the fundamentals freedom.

A financial structure amongst group companies commonly capitalised through a mixture of debt and equity. A different proportion of debt and equity can be adjusted by the shareholders as they desire. This is due to a different tax treatment of dividend and interest as a return of equity and debt respectively. The interest is categorised as tax-deductible at a level of debtor while a dividend is not commonly deductible. As a result, the intra-group companies prefer to finance its subsidiaries through loans or credit.
Considering the tax-related consequences of the debt financing, it must be mentioned that debt financing is more advantageous to the MNEs than equity financing.[2] Moreover, the debt financing might lead to a situation of allocation of a company's profit. Once a profit is transferred to another lower rate of taxation in the form of loans which resulted in the amount are taxed in lower rate or no tax at all.[3] Abusive financing structure is one method of aggressive tax planning used in cross-border situations. This issue can be dealt with in a number of ways The thin capitalisation rules, debt to equity ratio, an arm's length principle and interest deduction limitation rules, one of the measures introduced by the Member States.

On 20 June 2016, the council reached a political agreement on ***the Council Directive (EU) 2016/1164 laying down rules against tax avoidance practices that directly affect the functioning of the internal market*** (also known as **ATAD**). The ATAD contains "legally-binding anti-abuse measures, which all Member States should apply against common forms of aggressive tax planning".[4] The aim of the ATAD is to prevent aggressive tax planning through the measures align with the OECD BEPS conclusions. First of all, to

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[1] The European Commission; COMMISSION STAFF WORKING DOCUMENT, final version, 28 January 2016 (SWD) 2016. P.4

[2] D. Gajewski, *Tax-related and Economic Consequences of Selecting the Method of Debt Financing of Companies with Regard to Thin Capitalisation in OECD Member Countries*, Contemporary Economics Journal Vol.7, Issue 2, 2013, P.77-83

[3] K. Von Brocke & E. Garcia Perez, *Group Financing: From Thin Capitalization to Interest Deduction Limitation Rules*, 16 Intl. Transfer Pricing J.1 (2009), Journals IBFD

[4] http://ec.europa.eu/taxation_customs/business/company-tax/anti-tax-avoidance-package/anti-tax-avoidance-directive_en

ensure that the profits are taxed where the profits are generated with general applicable anti-avoidance rules within the Member States. Secondly, a level playing field should be actively promoted in the Single Market. Lastly, there is no risk of double taxation to adopt the provisions to domestic legislations. An aggressive tax planning, from a policy perspective, causes numerous problems to International Tax law. Double non taxation is well-known as one of the undesirable results from an aggressive tax planning. Consequently, it affects Member States' revenue, creates distortion of competition, leads to an economic efficiency and hampers transparency and fairness.[5] Therefore, the Member States are obliged to introduce the measures into their domestic legislation before 1 January 2019. The ATAD covers key points on Hybrid mismatches, the Controlled foreign company (CFC) rule, Exit taxation, General anti-abuse rule and Interest limitation. With regards to the interest deduction limitation rules, the EU implementation of the G20/OECD BEPS Action 4 is established in light of the provision in Article 4 of the ATAD.[6]

The ATAD also has its objectives to set out minimum standards to protect Member States from corporate tax avoidance, while assuring "a fairer and more stable environment for businesses".[7]

Additionally, this research examines the essential practices from the EC law which resulted in the development of thin capitalisation rules and interest deduction limitation rules. The compatibility of the rules with Community Law will also be determined. And to what extent the requirements of justification by the Court on EU case law test can be fulfilled. At the same time, while the countries are preparing to introduce or having the rules recommended by ATAD, this research analyses possibilities that the implementation of interest limitation rules follow consistently the ATAD in Member States can be considered to be incompatibility with EU law. As both the domestic law and the fundamental freedoms need to be consistent with each other. To what extent an adoption of Member States will be challenged to breach EU law.

1.2 Aim

This purpose of this research is to explore the anti-abuse measures in Member States in the light of CJEU decisions. To what extent the domestic legislations will be considered as an obstacle to the Freedom of establishment? Also, if there are possible circumstances that such infringement can be justified. As the Court judgements can influence Member States to adopt their legislation to be in line with EU Law.

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[5] L. De Broe, *At Last, Some Output on the Fight against Double Non-taxation* EC TAX REVIEW 2014/6, Kluwer law

[6] G. Ginevra, *The EU Anti-Tax Avoidance Directive and the Base Erosion and Profit Shifting (BEPS) Action Plan: Necessity and Adequacy of the Measures at EU level*, INTERTAX, Volume 45, Issue 2

[7] European commission- Anti tax avoidance package- http://ec.europa.eu/taxation_customs/business/company-tax/anti-tax-avoidance-package_en

In addition, in the light of newly agreed Anti-Tax Avoidance Directive, Member States are alert to adopt new measures and/or to amend their current rules to be in line with the ATAD. This research aims to represent the current domestic interest limitation rules and reflect the compatibility of the rules with EU law, fundamental freedoms. At the same time, to investigate if there are the legal concerns appearing in relation to the infringement of domestic anti-abuse measures to Fundamental freedoms or Constitutional law. The legal concerns may affect how the Member States will adopt the measures under the ATAD in the near future. whether the adoption to domestic law can create a potential infringement to EU Law will be considered.

To overcome the obstacles, the essential practices from the EC law as the law as it stands, play their crucial role. In order to achieve the aims, this research will analyse the approaches which the countries have been implemented and present some reflections from the CJEU and the ECJ case law. The legacy from what the court left behind is a core of this research.

1.3 Method and material

This thesis will conduct a traditional comparative law analysis, firstly by identifying the evaluation of thin-capitalisation rules from the case laws. Secondly, by studying how the Member States have chosen different legislative implementation to tackle the tax avoidance and protect their tax base. Also, by considering if those legislative measures were successful.
On the point of the compatibility with EU law, the analysis will be based on the settled case laws involving thin-capitalisation rules and interest deduction limitation rules.

The ECJ cases law in the research are chosen for the reason to describe the restrictions of Interest limitation rules applied in Member States. The cases represent the standard of the court applied to examine the justification and proportionality in resident and non-resident situations. The cases are shown in a chronological sequence. Due to the languages barrier, secondary sources of law are referred, mainly IBFD and Intertax, when the interest limitation rules in each Member States are mentioned. In practice, the Member States have chosen a various measure to limit the deduction of interest, therefore, the explaining of current domestic rules aims to provide the leaders how the Member States have applied the rules.

In this research will analyse the BEPS action 4, exclusively, the suggested best approaches. The BEPS action 4 will provide the reader a clarification regarding the suggested best approach as a source of information. The reader should be aware that the BEPS is a project and it is not a source of law. Accordingly, the BEPS Action 4 will be referred as a legal source only for the reader’s understanding on the suggest best approaches. Also, the BEPS action 4 will be presented in comparison to the ATA Directive.

The purposed ATAD will be explained in this research as a resulted of its transportation to domestic law of Member States and the compatibility to the fundamental freedoms. The major similarity and the minor different with the

suggested best approach will be discussed. The Member States are chosen in this research for representing the similarity and different to the ATAD.

Moreover, other materials, such as preparatory work and scholars' and practitioners' articles, devoted to the topic in order to assess the compatibility of the rules and enable a critical comparison will be taken into account in the analysis of this research.

1.4 Delimitation

The author has limited the study to the area of corporate tax focusing on the debt financial among the multinational companies without making economic analysis and accounting assessment on debt to equity ratio.
The author acknowledges that not the whole picture of interest deduction limitation rules can be covered. The definition of "interest" under the domestic legislation is not in the scope of this research. The fundamental freedom under the TFEU, in this paper, mainly the freedom of establishment will be discussed.
Also, as the tax treaties between the Member States are not part of EU law, they will not be discussed in this paper. It is not in the scope of this paper to discuss whether the Interest and Royalties Directive or the Parent and Subsidiary Directive are in line with the interest limitation rules. The research will not discuss in depth on the Arm's length principle only the concerns with the interest deduction limitation and debt financing matters. The hybrid mismatches will not be included in this research. The BEPS action 4 is one of the essential parts in this research, however, the interaction with other BEPS Action plans will not be mentioned.

In this research, the term "interest limitation rules" will be refer to the rules which limit interest deductions, generally by referring to a debt to equity ratio or an arm's length comparable. Other synonyms are "interest barrier rules", "thin capitalization rules" and "earnings stripping rules". Even though thin capitalisation legislations by themselves, are not similar to interest deduction limitation, they are response to the same problem. In some member states, the introduction of the interest deduction limitation replaced the thin capitalisation rules.[8] Consequently, for the aim of this research, the term "thin capitalisation (rules)" will also include "interest deduction limitation"

The author is aware that there would be possibility of newly updated materials afterwards. However, the research is based on research until ***5 June 2017*** and therefore considers only material published up to that date.

1.5 Outline

The general overview of interest deduction limitation will be presented in *Chapter 2*, consisting of the involving issues to interest deduction limitation

[8] For example; interest barrier was first introduced to German domestic law in 2007

namely, debt and equity, thin capitalisation and Base Erosion and Profit Shifting project. The best practice approach will be stressed in this chapter. Following this, *Chapter 3*, will present the proposed Anti-Avoidance Directive (2016/1164), specifically, Article 4 concerning interest limitation rule. In *chapter 4*, the assessment of the compatibility with EU law will be conducted. An essential parts of the selected EU case law concerning interest deduction limitation will be presented and underlined. Chapter 5, the current applicable interest limitation rules in selected Member States will be discussed together with the legal dispute concerning the compatibility to EU law of such rules. Additionally, this section includes the observation on the noticeable provision of the ATAD. Finally, the author's conclusions will be presented in *Chapter 6*.

2. Interest limitation rules

2.1 General note

On 19 July 2013, the OECD released the Action Plan on Base Erosion and Profit Shifting Report.[9] The BEPS project is expected to provide the recommendations to the G20.[10] The Report covers key pressure points containing "the tax treatment of related-party, debt-financing, captive insurance and other intra-group financing transactions". In this section, Action 4 of the BEPS Action Plan highlights the best practices, the rules designed to pursue an aim to prevent base erosion and profit shifting by using interest and other financial payments economically equivalent to interest.[11]

2.2 Debt & Equity

Under the EU primary law, the free movement of capital allows an intra-group companies to freely create their own combination of debt and equity financing structure. The dividend distribution as a return on an equity structures taxable profit of the company while the return on a loan i.e. an interest payment is considered as deductible expense for company's taxable profit. The different treatment in term of taxation appears.[12] In general, debt financing gives an opportunity to the debtor to deduct interest expenses from their taxable income, however, interest payments received by the creditor are taxed as income of the company. Meanwhile, the treatment on equity financial is difference. The dividend payment is commonly determined as a company's contribution of taxable profit. It is therefore non-deductible. "Thus, debt financing broadly results in a transfer of income from the borrower to the debt holder".[13]

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[9] OECD, Action Plan on Base Erosion and Profit Shifting (2013), International Orgnizations' Documentation IBFD.

[10] R. S.Avi-Yonah: *Advanced Inroduction to International Tax Law* (first published 2015, Edward Elger) P. 90

[11] Ibid. (no.9) at 31

[12] T.J.C. van Dongen, *Thin Capitalization Legislation and the EU Corporate Tax Directives*, 52 Eur. Taxn. 1 (2012), Journals IBFD. P.20-28, P.20

[13] C P Knöller, *'The Efficacy of Thin Capitalization Rules and Their Barriers: An Analysis from the UK and German Perspective*', INTERTAX, vol. 39, no. 6/7, 2011, p. 319

The different treatment relating to the taxation of debt and equity between EU countries become an importance issue. The concern express when there are rooms for arrangements, inside multinational group companies, "which are somewhere in between of tax avoidance and tax evasion".[14] The hybrid financing structures may lead to either double taxation or non-taxation can arise. The possibility that the income can be taxed twice. For example, the return on equity investment is taxable at the level of the debtor and once again at the level of the creditor as a distribution. Number of researchers believe that the distinction between debt and equity is significant in fiscal consequences.[15] The distinction will result in a different ways of tax treatment in relation to the company income or expense.[16]
Number of researchers believe that the distinction between debt and equity is significant in fiscal consequences.[17] The distinction will result in a different ways of tax treatment in relation to the company income or expense.[18]
Therefore, in domestic law, the definition terms of debt, equity, dividend and interest need to be clearly clarified for tax purposes.

2.3 Thin capitalisation

"The term 'thin capitalisation' simply refers to a company's capital structure which is characterised by a high proportion of debt to equity"[19]
A number of approaches have been applied by the Member states, for the tax purposes, against thin capitalisation of cross-broader firms.[20] Some of them apply specific rules in regards to equity and debt ratio. Other companies use an arm's length principle or some are following anti-abuse or anti-avoidance approach recommended by the OECD. However, the major key concept of thin capitalisation rules is **to limit the amount of interest deductions** together with an attempt to prevent a loss of taxable income in the source country and to detect disproportionate use of debt financial in relation to a cross-border financing structures. In other words, thin capitalisation rules aim to avoid the issues of abusive debt financing and to balance the taxing right of the Member States.[21]

In the early days, thin capitalisation approaches were recognised only to the cross-border settings. Afterward, the scopes of the rules were broadened due to the EU Law's improvements, (e.g. the decisions of the European Courts). The rules concluded both resident and non-resident taxpayers. The measures to combat thin capitalisation were implemented in Member States in various

[14] B. Seminogovas, *Taxation of Hybrid Instruments, Procedia - Social and Behavioural Sciences'*, Volume 213, 2015, Pages 299-303, ISSN 1877-0428,
[15] P. Essers; G. Michielse; G. de Bont; R. Offermanns '*Some Fiscal aspects of financing structures within a group of companies and Thin Capitalization approaches in Europe'* EC Tax Review: 1994/4; (1994/4)
[16] Ibid. (n.14) Pages 299-303, ISSN 1877-0428,
[17] Ibid. (n.15)
[18] Ibid. (n.14) Pages 299-303, ISSN 1877-0428,
[19] K., Margret, *The Consequences of Hybrid Finance in Thin Capitalization Situations: An Analysis of the Substantive Scope of National Thin Capitalization Rules with Special Emphasis on Hybrid Financial Instruments (April 2007)*. Available at SSRN: https://ssrn.com/abstract=1137591 or http://dx.doi.org/10.2139/ssrn.1137591
[20] D. Luthi, *Thin capitalisation of companies in international tax law*, (1991), 19 Intertax, Issue 10,pp.446-453
[21] Ibid. (n.3) P.29

ways. However, they serve the same purpose of limiting the interest deduction.

In Germany, the approach concerning the thin capitalisation was first implemented in 2000 with the enforced rules concerning the deductibility of interest expense obtaining from intra-group company. The rule targeted the repayment in respect of the loan to the debtor. If the amount exceeded EUR 250,000 (25% of the shares), the interest payments were reclassified as a deemed dividend distribution.[22] Except the concerned loan can be provided to the company limited by shares at arm's length principle by a third party under the same circumstances. The company's debt to equity ratio was set at 1:5:1. It is notable that the first German thin capitalisation rule only applied to abusive financial structures in which the creditor resides outside of the Germany. This issue led to the infringement of EU law ruled by the ECJ in Lankhorst later. Consequently, the remarkable decision by the ECJ concerning non-discrimination, the German interest deduction limitation rule has been revised.[23]

Afterward, *an interest barrier* (Zinsschranke) was introduced to replace the old approach in 2007.[24] The interest barrier rule disallows the deduction of excessive interest expense, without recharacterising non-deductible interest in taxable dividends. Basically, "the new rule changes the approach to regulate thin capitalisation by choosing profit-based determinations of artificial and harmful capital structures." [25]
It comes to the author's mind that there are a number of factors driving the development of interest deduction limitation rules. As shown above in the situation of the Germany, for tax purposes, there is a need to combat and tackle excessive financing structures within MNEs. At the same time, for business purposes, the Member States also need to encourage businesses in their territory, as the debt financing can be an effective approach for investment. However, the Member States need to keep in mind that the implementation of domestic law need to be in line with fundamental freedoms and can be challenged by the Court.

2.4 BEPS Action 4- Interest deduction limitation rules

In 2013, the OECD started the BEPS Action 4 project with an effort to address base erosion and profit shifting using interest as deductible payments. A number of key areas were addressed. The opening move in the action 4 is the introduction of *the best practice* which is an outline of regulations to prevent base erosion and profit shifting using the interest and other financial payments.[26]

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[22] Ibid. (n.12) P.323
[23] Ibid. (n.3) P.30
[24] The introduction of sec. 4H by the 2008 corporate tax reform of 14 Aug 2007 into DE: Income Tax Act (Einkommensteuergesetz, EStG), BGBI I, 1912 (2007)
[25] Ibid. (n.12) P.323
[26] R.H.M.J. Offermanns et al., *BEPS Action 4: Policy Considerations and Implementation Status*, 57 Eur. Taxn. 2/3 (2017), Journals IBFD. P.48

Regarding the funding investment with debt, on BEPS Action 4 final report concerns the structure which is influenced by the multinational group companies or third parties financed their subsidiaries with debt in high tax countries in order to take an advantage from the interest limitation rules. The debtor companies lean to make excessive interest payments in a high-tax country to a creditor parent company in a low-tax country. *It results in the reduction of profit and a lower of tax base.* In the executive summary of the final report, Base Erosion and Profit Shifting basic scenarios between group companies may arise as followings:

- Groups placing higher levels of third party debt in high tax countries.
- Groups using intragroup loans to generate interest deductions in excess of the group's actual third party interest expense.
- Groups using third party or intragroup financing to fund the generation of tax exempt income. [27]

The recommendations in the final report are recognised to address the above-mentioned risks, as well as, to address practices that artificially separate taxable income from the activities that generate it- one of the aims of the BEPS project. [28] The recommendations encourage groups to introduce funding structure "whereby: (i) the net interest expense of an entity is linked to the overall net interest expense of the group: and (ii) the distribution of a group's net interest expense should be linked to income-producing activities."[29]

When it comes to identifying which entities the recommended best practice approach should apply to, the OECD highlights that the BEPS risks can arise where the entities are part of a multinational group (when it conducts the business in more than one country)[30], where entities are part of a domestic group (where it operates its business within a single country), or where entities are outside of a group (standalone company).[31] It is optional to the Member States to implement the recommendations under BEPS Action 4 to standalone entities.[32] Due to the fact that a standalone company create much less of BEPS risk. Nevertheless, the event of large standalone entities operates under complex structure with the same investor, mostly involving trusts or partnerships. It can pose the similar BEPS risk as those of a multinational group.[33] It is noteworthy that the interest deduction limitation is seen to be an MNEs related problems. As the OECD target the groups' financial structures, thus, the best approach is suggested to apply to a multinational group. As the MNEs are considered to pose the main BEPS risk.

[27] Final report on BEPS Action 4- 2016, P.13
[28] Ibid (n.27), P.41
[29] Ibid (n.27), P.22
[30] A permanent establishment is included.
[31] Final report on BEPS Action 4-2016, P.43-45
[32] Final report on BEPS Action 4-2016, P.52-53
[33] V. Sigurvaldadottir, *The Newly Implemented Interest DeductionLimitation Rule*, 57 Eur. Taxn. 2/3 (2017), Journals IBFD.

Another interesting point made in the recent report is an aim to reform the current approaches. Due to the following matters, the OECD believe the existing measures are not satisfying the need to combat BEPS. Firstly, a currently fixed ratios are too high which becomes ineffective in addressing base erosion. Secondly, targeted anti-avoidance rules are not enough to overtake the expansion of profit shifting opportunities. Thirdly, in some situations of withholding tax enforced under tax treaties, an interest payment can be reduced (even to zero).[34]

2.4.1 The OECD's best practice approach

The recent Action 4 of the BEPS action plan proposes a fixed ratio rule; an entity is allowed to deduct partial interest expenses up to a set percentage of its earnings before interest, tax, depreciation and amortisation (EBITDA) within a range between 10-30%. Ensuring that the remaining profit is accountable to tax. This approach is considered relatively easy to apply and directly linked to economic activity and thus believed to decrease base erosion. Alternatively, countries may also apply this rule up to a benchmark of earnings before interest and tax (EBIT).

> "Earnings before Interest, Taxes, Depreciation and Amortization (EBITDA) is a financial measure used in the approximation of operating cash flow by the investment community and its computation method may vary between analysts."[35]

The calculation of EBITDA, according to the final report, should depend on the domestic taxation law of each country. It is suggested by the OECD on how EBITDA of an entity should be calculated. Tax exempt income will be excluded.[36] To introduce the rule, a country is required to set its own benchmark fixed ratio and the fixed ratio can be introduced regardless of a company or group companies' current rate. Consequently, the rule benefit tax administrator to govern the application and favor the companies to simply apply such rule. Since a fixed ratio can be only applied without taking into account "the fact that groups operating in different sectors may require different amounts of leverage." [37]

Another suggested approach is *a group's ratio rules*, which practically the rules are recommended to jointly apply with the fixed ratio rules. The rule is recognised by the OECD that group of companies operate their business in different sectors, the leverage will distinct. Therefore, the rule will be affected each group of companies differently. To make the best use of a group's ratio rules, it should be use complementary with a fixed ratio. Under the group ratio rule, in the situation where a company having high leverage group will be allowed to deduct net interest expense above the fixed amount under fixed ratio rule. Accordingly, a country using the above rule should apply a low benchmark fixed ratio which would be absorbed by the group ratio rule.[38]

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[34] R.H.M.J. Offermanns et al., *BEPS Action 4: Policy Considerations and Implementation Status*, 57 Eur. Taxn. 2/3 (2017), Journals IBFD. P.51

[35] Reuters Fundamentals Glossary, Dated 28 August 2016; Thomson Reuters, P.933

[36] Final report on BEPS Action 4- 2016, P.52

[37] Final report on BEPS Action 4- 2016, P.51

[38] Final report on BEPS Action 4-2016, P.61-63

The rule allows an entity to deduct net interest expenses up to its group's net interest/EBITDA ratio, if this is higher than the benchmark fixed ratio.[39] An uplift of up to 10% also allows to apply in order to calculate the group ratio i.e. after deduction of third-party interest expenses.[40]

Moreover, the OECD also express concern on the targeted rules.[41] As both a fixed ratio rule and group's ratio rule are considered to be general interest limitation rules. Some BEPS issued can be dealt effectively with targeted rules.[42] However, in the OECD's point of view, the targeted rule should be applied together with the general rules such as complementary. Due to the fact that the disadvantages of target rules cause the complexity, compliance and administrative workloads. The OECD stresses that the combination of general rules as a main approach and targeted rules as an addition in key areas. Such combined rule will assure the countries that "the main risks posed by base erosion and profit shifting are addressed, while ensuring that groups are able to obtain relief for their real net third party interest expense."[43]

2.4.2 Addressing double taxation

Another topic that deserves to mentioned is the OECD's concern on an existence of potential double taxation.[44] The OECD targets the countries which allow disallowed interest expense and unused interest capacity to be carried forward or carried backward, such portions can be used in other periods of time- a timing mismatch. The OECD believes that it does give rise to potential base erosion and profit shifting risks. For instance, an amount of interest deductibility at the stage of debtor is denied and that amount afterward is levied as a deemed distribution (Corporate income tax charged in the source state, with the possibility of potential Withholding tax in the source state and Corporate income tax in the recipient state).[45] Consequently, if the source state use a carry-forward rule and allow the portion to be deducted in later years. It is an unclear situation. The OECD comes to the statements that under the best practice approach, there is no condition for Member States to allow a company to carry-back or carry-forward interest expense or unused interest. At least the OECD recommend to strict the rules if the carry-back or carry-forward rules are active in the country.

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[39] Final report on BEPS Action 4-2016, P.61 Para 117
[40] Final report on BEPS Action 4-2016, P.66 Para 66
[41] Final report on BEPS Action 4-2016, P.75-78, Chapter 9 Target rules
[42] Final report on BEPS Action 4-2016, P.51
[43] Final report on BEPS Action 4-2016, P.75
[44] Final report on BEPS Action 4-2016, Chapter 8 Addressing volatility and double taxation
[45] E. Nuku, *International Fiscal Association Research Paper: Recent Trends in the Taxation of Corporate Distributions*, dated 25 January 2017,

3. The Anti-Tax Avoidance Directive Proposal on interest deduction limitation

3.1 Background

The ECOFIN formation of the Council of the European Union (Council) adopted the Anti-Tax Avoidance Directive (2016/1164) on 12 July 2016.[46]
The ATAD is the crucial part of "Anti-Tax Avoidance Package" presented by the European Commission with its purpose to reform an existing anti-avoidance rules. introduce measures against 'aggressive' As mentioned in the preamble of the ATAD, the scope of the provisions in the ATAD is to enhance effective taxation in the internal market by implementing approaches against aggressive tax-planning that are "consistent with the OECD BEPS conclusions"[47]. In order to fulfill the scope, the ATAD measures will be considered as a preferred vehicle. The ATAD will grant a uniform and coordinated application of the recommendations and best practices, creating a 'minimum level of protection for national corporate tax systems against tax avoidance practices across the Union'.[48]

A significant character of the ATAD is "Flexibility". All twenty-eight Member States are obliged to adopt the measures thus they will be applicable to "all taxpayers that are subject to corporate tax in a Member State". The countries, however, are capable to choose the approach which "fits best"[49] with their particular domestic legal systems.[50] It is notable that the measures in ATAD broaden to be applied to a permanent establishment, as well as, the permanent establishments of companies residing outside the EU. It is important aim to be mentioned because for tax purposes they play the part of EU internal market.[51] Furthermore, the ATAD lay down that once the Member States introduce new regulation in their jurisdictions. The legislation should not produce any possibility of double taxation. Due to the fact that double taxation may hinder the success of the internal market; if the same item of income is taxed twice. Member States are entitled to give a relief for the taxation that already paid in other Member States.[52]
In this section, the measures lay down in Article 4- the interest imitation rule of the ATAD that refers explicitly to the OECD/G20 BEPS Project Action 4 will be discussed.

3.2 Article 4 of the ATAD

Article 4 of the ATAD regarding an interest limitation rule contains the consistent provisions to the OECD BEPS Report on Action 4. The comparison between ATAD and OECD interest limitation rule is illustrated in Appendix A (Table 1 in Appendix A). The illustration shows that both the

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[46] A. Rigaut, *Anti-Tax Avoidance Directive (2016/1164): New EU Policy Horizons*, 56 Eur. Taxn.11 (2016), Journals IBFD.
[47] Council Directive 2016/1164/EU of 12 July 2016, OJ L 193
[48] Ibid, para 2-3 of the Preamble to the Directive
[49] G. Ginevra, *The EU Anti-Tax Avoidance Directive and the Base Erosion and Profit Shifting (BEPS) Action Plan: Necessity and Adequacy of the Measures at EU level*, INTERTAX, Volume 45, Issue 2 P.120
[50] Ibid, (n.47) Para 2-3 of the Preamble to the Directive
[51] Ibid, (n.47) Para 4 of the Preamble to the Directive
[52] Ibid, (n.47) Para 5 of the Preamble to the Directive

ATAD and the BEPS Action 4 are very much aligned. Two key points are the 10% uplift and the EBITDA multi-year averages.[53] First, the OECD allow a country which enforces a group ratio rule to also apply an uplift of up to 10% to the group's net interest expense of third party.[54] Second, the possibility to apply EBITDA multi-year average within a group ratio rule in some specific situations. As the rules are stricter than those of the ATAD rule, due to the hierarchy of law, "they would presumably not be allowed".[55]

The fundamental principle of Article 4, in accordance with an interest limitation rule, allows the corporate taxpayers to only deduct exceeding 'borrowing expenses' incurred up to 30% of the taxpayers' EBITDA within the tax period.[56] The term of borrowing expenses is used in the ATAD with regard to the definition of interest expenses in the BEPS Action 4.[57] In order to provide relief to the Member States from the limitation rules, the ATAD also contains the optional rules. The Member States may apply, according to Article 4 (3), a de minimis threshold up to EUR 3 million to deduct exceeding borrowing costs.[58] The same article further a country may allow 'a standalone company' to fully deduct exceeding borrowing costs.[59] A Member State may rule "a grandfathering clause" [60] which the loans concluded before 17 June 2017 and loans relating to a long-term public infrastructure can be excluded.[61] Additionally, an escape clause can be implemented under the equity asset ratio rule.[62] Lastly, a Member State is freely to provide a carry-forward or carry back of exceeding borrowing cost with or without time limitation.[63]

4. Compatibility with European Union Law

4.1 General note

This section deals with the domestic anti-abuse measures in the area of direct taxation. It begins with a couple of remarkable decisions from the Court of Justice of the European Union (CJEU) where 'a case law test' has been developed. It is important to highlight the developments from settled case law, as it is arguable that the EU policy maker takes into consideration the decisions ruled by the CJEU.[64] In particular, there are the decision on CFC rules in *Cadbury Schweppes* and the decision on interest limitation in Test Claimants in the *Thin Cap Group Litigation*. The case law test leads to a set

[53] Ibid (n.46) P.501
[54] Final report on BEPS Action 4- 2016, P.25
[55] Ibid (n.46) P.501
[56] Ibid (n.47) Art.4 (1)
[57] Ibid (n.46) P.502
[58] Ibid (n.47) Art.4 (3) (a)
[59] Ibid (n.47) Art.4 (3) (b)
[60] D. Gutmann et al., *The Impact of the ATAD on DomesticSystems: A Comparative Survey*, 57 Eur. Taxn. 1 (2017), Journals IBFD. P.3
[61] Ibid (n.47) Art.4 (4)
[62] Ibid (n.47) Art.4 (5)
[63] Ibid (n.47) Art.4 (6)
[64] Ibid (n.46) P.498

of principles which the Member States have to consider in order to apply compatible anti-abuse rules with the EU law.[65]

The CJEU rendered its judgements concerning below settled cases as an infringement to the free movement provisions of the Treaty on the Functioning of the European Union (TFEU). However, the Court is challenged to balance the effective domestic tax system and maintain the capacity of free movement of individuals and companies in the EU single market "by accepting that restrictions upon movement are sometimes justified".[66] The reasoning aspects to pass the case law test will be discussed. Correspondingly, the Court is asked to comply the same reasoning assessment with respect to domestic anti-Directive rules. 'A coherent approach by the court' will take a crucial part for the interpretation of the coming adoption of the ATAD.[67]

4.2 EU tax law and the relationship to EU law test

The compatibility of domestic tax law with the community law is first recognised by the Court in "Avoir Fiscal"[68] that the national law can be examined whether if it comply with community law , especially, the fundamental freedoms.[69] Consequently, the Court mentioned in Lankhorst once again that even though direct taxation falls within the scope of the domestic taxation of Member States, a country must none the less rule the legislations consistently with Community Law- the prohibition of discrimination on grounds of nationality. [70]

4.2.1 Lankhorst-Hohorst GmbH v Finanzamt Steinfurt, Case C-324/00

The case is brought up when the compatibility of Thin capitalisation and non-discrimination principles is mentioned. As it was the first case that the Court dealt with the issue of the compatibility of national thin capitalisation rule with Community law.[71] It can be said that the decision on Lankhorst-Hohorst affected the change of Thin capitalisation approaches in Member States later.

Lankhorst-Hohorst was a German company where its Dutch grandparent company granted a loan without securities over a ten-year period. Under the loan Agreement, the Dutch grandparent company issued a "letter of support" to waive the repayment of interest in case any third party creditors made claims against Lankhorst-Hohorst. These led to the tax authorities' argument

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[65] A. Corderwener, *Anti-Abuse Measures in the Area of Direct Taxation: Towards Converging Standards under Trety Freedons and EU Directives?* EC Tax Review 2017/2, P.60

[66] M. Hilling, *Justifications and Proportionality: An Analysis of the ECJ's Asessment of National Rules for the Prevention of Tax Avoidance*, Intertax, Volume 41 Issue 5, Page 294-307 P.294; Cordewener et al., The Clash Between European Freedoms and National Direct Tax Law: Public Interest Defences Available to the Member States, Com.Mkt. L. Rev. 1951 (2009).

[67] A. Cordewener, *Anti-Abuse Measures in the Area of Direct Taxation: Towards Converging Standards under Trety Freedons and EU Directives?* EC Tax Review 2017/2, P.60

[68] C-270/83, European Commission v. French Republic (Avoir Fiscal) ECLI:EU:C:1986:37

[69] Ibid. (n.68) para 36

[70] C-324/00, Lankhorst-Hohorst GmbH v Finanzamt Steinfurt, ECLI:EU:C:2002:749

[71] D. Gutmann and L. Hinmekens, *The lankhorst-Hohorst case. The ECJ finds German thin capitalization rules incompatible with freedom of establishment*, EC Tax reviw (2003-2)

that the loan in practice is truly equity not debt.[72] The Finance structure under the loan agreement was considered to be a thinly capitalised structure. Therefore, the interest payments were recharacterised under concerned German provision for tax purposes to be treated as a covert dividend and taxed at a rate of 30%. The reclassification required the interest payments on a loan which the company received from a shareholder who are not entitled to corporate tax credit in Germany. Also, the loan capital with the significant debt to equity ratio 3:1 needed to be acquired from a third party creditor on equivalent term (an arm's length principle). These rules only applied to companies with non-resident shareholders.[73]

The Court found that the German thin capitalisation rules were not in line with fundamental freedom, specifically, freedom of establishment. The rules were applied in general to any circumstances where the parent company of domestic subsidiary situated in another Member State.[74] Therefore, the only reason to consider the effectiveness of the rule was "the resident of the parent company".[75] The justification argued by German authorities could not have been fulfilled. The Court did not find if a specific purpose of preventing "wholly artificial arrangement" was applied and the direct link concerning to the cohesion of the tax system was dismissed by the Court.[76] According to the Court, Thin capitalization rules must contain specific purpose to prevent the risk of tax evasion but the Germen rules applied to the situation in which the non-residence parent company has its seat. Such applicable reason did not entail the prevention of tax evasion. Also, the rules were not included the direct link to present that the German Government offered any tax advantage to offset the less favorable tax treatment. As a result, the Court found the rules were discriminatory and could not be justified.

4.2.2 Cadbury Schweppes C-194/04[77]

The case concerned the UK Controlled Foreign Corporations rules (CFC) and the compatibility with freedom of establishment. A UK resident corporation, Cadbury Schweppes plc, established its subsidiaries in Dublin under the International Financial Services Centre regime (IFSC). Such regime gave a benefit to the companies which carried on a financial services trade to be levied corporate income tax at the rate of 10% under specific period of time.[78]

The concerned CFC legislation taxed the UK parent company for the foreign profits generated by subsidiaries residing outside the UK, particularly, in a lower tax jurisdiction.[79] A 'lower level of taxation' in another state is

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[72] C-324/00, *Lankhorst-Hohorst GmbH v Finanzamt Steinfurt*, ECLI:EU:C:2002:749 Para 6-8, 11-14
[73] Ibid. (n.72) Para 3-4
[74] Ibid. (n.72) Para 22-24
[75] Ibid. (n.72) Para 27-28
[76] Ibid. (n.72) Para 37
[77] C-194/04 Cadbury Schweppes plc and Cadbury Schweppes Overseas Ltd v Commissioners of Inland Revenue. ECLI:EU:C:2006:544
[78] G. T.K. Meussen, *Cadbury Schweppes: The ECJ Significantly Limits the Application of CFC Rules in the Member States*, European Taxation, IBFD 2007, P.13
[79] Ibid (n.77) Para 6

determined in comparison to the UK level of levy. Therefore, the CFC rules made it possible to tax profits that the non-resident subsidiaries attained in the United Kingdom. The Court held that the UK CFC rules restricted the free movement of establishment since the application applied neither to the companies established in the UK nor the non-resident companies established outside the UK "where the profit was not taxed at a rate that was lower than 75% of the UK rate."[80]

Para 45 "That difference in treatment creates a tax disadvantage for the resident company to which the legislation on CFCs is applicable. Even taking into account, as suggested by the ………., the fact referred to by the national court that such a resident company does not pay, on the profits of a CFC within the scope of application of that legislation, more tax than that which would have been payable on those profits if they had been made by a subsidiary established in the United Kingdom, the fact remains that under such legislation the resident company is taxed on profits of another legal person. That is not the case for a resident company with a subsidiary taxed in the United Kingdom or a subsidiary established outside that Member State which is not subject to a lower level of taxation."[81]

Additionally, an aim to prevent losses is not enough reason to justify the restriction. The justifications were on the grounds of preventing of abusive practices, with the court stating that "the specific objective of the measure must be to prevent conduct involving the creation of wholly artificial arrangements which do not reflect economic reality with a view to escaping the tax normally due on the profits generated by activities carried out on national territory."[82] Also, the restriction must be "proportionate in relation to that objective."[83] Under these circumstances, the Court ruled that the difference treatment created the restriction. The question subsequently was whether or not the restriction was justified on the basis that it was specifically aimed at combatting wholly artificial constructions.

The UK CFC was determined by the court that it went beyond what was required to combat tax avoidance schemes. A company may choose to operate the business in a member state for the purpose of benefiting from more favorable legislation does not constitute an abuse of the freedom of establishment.[84]

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[80] D. (Dennis) Weber, *Abuse of Law in European Tax Law: An Overview and Some Recent Trends in the Direct and Indirect Tax Case Law of the ECJ – Part 2*, 53 Eur. Taxn. 7 (2013), Journals IBFD.
[81] Ibid (n.77) para 45
[82] Ibid (n.77) Para 55
[83] Ibid (n.77) Para 57
[84] Ibid (n.77) Para 53

4.2.3 Test Claimants in the Thin Cap Group Litigation v. Commissioners of Inland Revenue, Case C-532/04[85]

The UK's thin capitalization rules were challenged by the Court in 2014. Between 1995 and 2004, interest paid between the members of the same group of companies was treated as *a distributed profit* which is non-deductible from taxable profits of the company. Under the condition that the amount of distributed profit paid between the companies is greater than the amount that would have been paid at arm's length.[86] However, those rules did not apply to the companies which pay interest to another residence company. The main question referred to the Court was the compatibility of UK thin capitalisation with EU law.

The rules were applicable only when the interest payment was made to related non-resident company (creditor company) by a borrowing company resided in the UK. Conversely, a borrowing company resided in the UK and received the loan from resident creditor company was not applied to the UK thin capitalisation rules at the time. Therefore, the rules made less advantageous situation compared to the situation where the loan was provided between resident group companies. As the rules were applicable if the creditor was established abroad. The Court thus ruled that the UK Thin capitalisation rules constituted a contravention on the Freedom of establishment.

Also, The Court held that a concerned approach made it less attractive for companies residing outside of the UK, which created the obstacle under the freedom of establishment.[87] Nevertheless, the restriction can be justified "only if it is justified by overriding reasons of public interest", and the application of the restriction was "appropriate to ensuring the attainment of the objective in question and not go beyond what is necessary to attain it". [88] The UK argued that the provisions were designed on the grounds of 1) the cohesion of the national tax system and 2) the prevention of tax avoidance. It is, therefore, justifiable.[89] For the first argument, the Court did not find the "direct link" between the tax advantage and the offsetting of such advantage by a particular way of tax collection. For the second argument, it is noteworthy that the Court point out "the principle of proportionate" into the consideration. The Court highlighted that to achieve the purpose of preventing abusive tax avoidance, if a concerned transaction did not satisfy the arm's length test (the re-characterisation of interest paid) the rules must allow the taxpayer to provide an evidence for commercial justification.[90]

[85] C-532/04 *Test Claimants in the Thin Cap Group Litigation v. Commissioners of Inland Revenue* ECLI:EU:C:2006:774
[86] Ibid (n.85); para 3, 5, 7-8
[87] Ibid (n.85); para 54
[88] Ibid (n.85); para 71
[89] Ibid (n.85); para 65-66
[90] Ibid (n.85); para 68

4.2.4 Masco Denmark ApS, Damixa Aps v. Skatteministeriet - Case C-593/14[91]

On December 21, 2016 the Court of Justice of the European Union ("the Court") rendered its judgment on the dispute concerning Danish Thin capitalisation rules. The questions referred to the Court concerned the difference treatment on interest exemption from the loan given by the Danish parent company to finance its resident and foreign subsidiaries, depending on the subsidiaries' entitlement to a tax deduction for the corresponding interest expenditure.[92] The Court was requested to clarify if such differences in treatment were contrary with the EU freedom of establishment principle (Article 49 of the Treaty on the Functioning of the EU (TFEU))[93] Once again, freedom of establishment was an issue in this case.

Damixa ApS, the Danish parent company financed its wholly-owned subsidiary in Germany, Damixa Armaturen GmbH by granting a loan. Under German interest deduction rules, the debt-to-equity of more than 1:5:1 was considered to be thin capitalised.[94] Therefore, the interest payment on the loan was reclassified to the dividend payments and it was not allowed to deduct. Consequently, the corresponding interest was denied the exemption in Denmark because it was paid by foreign subsidiaries. Contrary, in a purely domestic situation, when the Danish Thin capitalisation rules applied to a Danish subsidiary, tax deduction on interest payment was not allowed but the Danish parent company would be granted a tax exemption.

The Court stated that the Danish law constituted a tax disadvantage to the Danish parent company to establish the subsidiaries in other Member States than in Denmark for the privilege on interest exemption.[95] It makes less attractive for resident group companies. The difference treatments on interest exemption from the loan with which the parent company financed its subsidiaries depending on the residency of subsidiary was in breach of freedom of establishment.

The question presented was, will this rule be justifiable or not? The rule can be justified under two circumstances that. Either the rule relates to situations which are objectively comparable, or there is an overriding reason in the general interest.[96] During the proceedings, Denmark argued that the difference in treatment can be justified. They believed there was a need to ensure a balanced allocation of taxing powers between the Member States, and also a need to prevent tax avoidance. The rules were acceptable to safeguard the balanced allocation of taxing right between Member States. As Member States are enable to issue a limitation rule concerning tax exemption on interest paid by a resident subsidiary to ensure the taxation power in their territory- the symmetry of taxation powers- as stated below.

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[91] C-593/14 *Masco Denmark ApS and Damixa ApS v. Skatteministeriet.* ECLI:EU:C:2016:984
[92] Ibid (n.91); Para 22
[93] Ibid (n.91); *Para 21*
[94] Ibid (n.91); para. 9-11
[95] Ibid (n.91);. *Para 25-27*
[96] Ibid (n.91); *Para 28*

"In the present case, it must be held that legislation of a Member State, such as that at issue in the main proceedings, which limits the tax exemption in question solely to interest paid by a resident subsidiary appropriately ensures a balanced allocation of the power to impose taxes between the Member States concerned. By allowing a resident company which has granted a loan to a subsidiary resident in another Member State to deduct all interest paid by its subsidiary where that subsidiary is not entitled to deduct that interest expenditure under the thin capitalisation rules of that other Member State, the Member State in which the parent company is resident would be foregoing, on the basis of the choice made by companies having relationships of interdependence, its right to tax the interest income received by the parent company depending on the rules on thin capitalisation adopted by the Member State of residence of the subsidiary, which is what the legislation at issue in the main proceedings seeks to avoid."[97]

The Court believed that legislation went beyond what is required in order to attain those objectives. [98] Regarding an aim to prevent tax avoidance, the rules does not contain the specific purpose of preventing wholly artificial arrangements and were applied generally to all resident companies which provide a loan to 'a thinly capitalised affiliated company' resided in another Member State from attracting the tax benefits.[99]

Conversely, AG Kokott addressed her opinion on this case stating that there *was no infringement* on the freedom of establishment. AG Kokott's opinions should be underlined as follows. Firstly, she referred to "*the principle of autonomy"* as the legislation of domestic law does not required the Member States to take into account, for tax purposes, another Member States' legislation in order to prevent any disparity arising from national tax rules. Secondly, she referred to the same practice, under the freedom of establishment, in the number of settled case-law.[100] Thirdly, she believed that tax regime of each Member State should be viewed autonomously. Lastly, if Denmark needed to rule their domestic law depending on the thin capitalisation rule of other Member State.

This would be considered as a breach of the principle of autonomy. The Court, however, only agreed with the AG's opinion on the point of the relationship between the domestic law of Member States and freedom of establishment.
The Court stated it is unquestionably that the freedom of establishment cannot affect a Member State to design their domestic legislations on the basis of those rules in another Member State "in order to ensure taxation which removes any disparities arising from national tax rules." [101] Accordingly, in the present case, freedom of establishment cannot cause Denmark, the Member State of residence of a parent company which granted a loan to a foreign affiliated company "to go beyond according a tax exemption to that parent company for the amount of interest expenditure which could not be

[97] Ibid (n.91); Para 38
[98] Ibid (n.91); *Para 38-39*
[99] Ibid (n.91); Para 44-45
[100] C-157/07 Krankenheim Ruhesitz am Wannsee-Seniorenheimstatt ECLI:EU:C:2008:588 para 49
[101] Ibid (n.91), Para 40

deducted by the subsidiary if the thin capitalisation rules of the first Member State were to be applied."[102]

Eventually, the Court ruled that the Denish thin capitalisation rules represented a restriction on freedom of establishment and such restriction cannot be justified.

4.3 The justification assessment

It can be seen from the previous section that the domestic provision targets *anti-abusive measures namely, thin capitalisation rule, CFC, interest deduction limitation* can be challenged as a situation of *tax discrimination*. The sequence of the cases in section 4.2 are chosen orderly. To show how the Court conduct the justification assessment and its development. Lankhorst was decided in 2003, the court first time mentioned on 'wholly artificial construction'. Next, in 2005, Cadburry Scheweppes appeared a doctrine which is stricter. Followed by the Thin Cap Group Litigation case in 2007, the proportionality test was added. To allow the taxpayer to provide commercial evidence to prove the genuine activity, the Court represented more general measure to examine a discriminatory on domestic anti-abuse rules. Lastly, the currently settled case law in Damixa, which the Court continues to apply the specification of thin capitalisation rule which must regulate to target wholly artificial arrangements.

In Lankhorst, it is settled issue that a Member State could not treat domestic and foreign parent companies differently since such difference constitute a hindrance to the right of establishment. It should be pointed out that the Court's judgment on the case at hand regarding the freedom of establishment created 'a second generation' view of the legal nature of the freedom of establishment.[103] The first generation regards to a formal prohibition against discrimination. The discrimination between domestic and foreign companies cannot exist. Turning to a second generation, the scope of meaning of the freedom of establishment widened. Neither a Member State may treat foreign companies differently from domestic companies nor make it too difficult or less attractive for a company to establish itself. As a result, a Member State's measures may fall into both the prohibition against discrimination and the prohibition against restrictions.[104]

Next to the justification, as previously stated, the Court dismissed all main arguments brought up by the Germany. The arguments built on grounds of protecting the tax revenue of the country against tax avoidance as well as the necessity to ensure the coherence and symmetry of tax system. The Court argued that the measures did not meet the requirement of justification because the reduction in revenue does not establish 'an overriding reason' in the public

[102] Ibid (n.91), Para 41

[103] N. Vinther and Prof. E. Werlaff, *The need for fresh thinking about tax rules on thin capitalization: the consequences of the judgment of the ECJ in Lankhorst-Hohorst*, EC Tax Review 2003-2

[104] Ibid (n.103) P.100

interest.[105] It seems to be clear that "the budgetary concerns are no acceptable ground for justification."[106] Also, the appropriateness of the rules was refused, as the rules did not serve "the purpose of denying the company a tax advantage in cases where company uses *wholly artificial arrangements designed to circumvent German tax legislation*."[107] As the rules focused on the location of the parent company, specifically, outside Germany. To such extent, the Court did see the location of operation create a risk of tax avoidance because the Company is liable to tax in that country where it situates. According to the decision, anti-abuse measures are allowed to be introduced to domestic law, however, they needed more 'well-tailored' and 'fine-tuned drafting' rules.[108] Under all these circumstances, the thin capitalisation rules were shaped.

Following the Cadbury Schweppes case, the justification assessment was developed into 'a doctrine'[109] concerning the abuse of law in field of direct taxation. In order for the restriction in question to be justified. The restriction must include the specific objectives i.e. to prevent an arrangement concerning the creation of wholly artificial arrangement which do not reflect economic reality, with no intention to escape payable tax. In this case, the intention of an incorporation to obtain a tax advantage, from the court point of view, the incorporation must reflect 'economic reality' and "corresponding with an actual establishment intended to carry on genuine economic activities in the host Member State."[110] The objective factors must be presented, for instance , premises, staff and equipment. The Court once again take the (objective) criterion of a wholly artificial arrangement into consideration.[111] However, the Court extended its scope of application in this regard. In conclusion, a wholly artificial arrangement becomes the Court's standard procedure for justification assessment of national anti-abuse measures forming hindrances to freedom of establishment.

In its landmark decision in Thin Cap Group Litigation case, an arm's length principle play a crucial role in the decision. The UK argued that the Thin Capitalisation rule targeted a specific form of tax avoidance, "which consists in the adoption of artificial arrangements designed to circumvent the tax legislation in the State in which the borrowing company is resident."[112] Correspondingly the ECJ made the point which is accord to the decision in

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[105] C-324/00, *Lankhorst-Hohorst GmbH v Finanzamt Steinfurt*, ECLI:EU:C:2002:749 Para 36

[106] D. Gutmann and L. Hinmekens, *The lankhorst-Hohorst case. The ECJ finds German thin capitalization rules incompatible with freedom of establishment*, EC Tax Review 2003-2

[107] Ibid (n.103) P.101

[108] D. Gutmann and L. Hinmekens, *The lankhorst-Hohorst case. The ECJ finds German thin capitalization rules incompatible with freedom of establishment*, EC Tax Review 2003-P.95

[109] A. Cordewener, *Anti-Abuse Measures in the Area of Direct Taxation: Towards Converging Standards under Trety Freedons and EU Directives?* EC Tax Review 2017/2, P.60

[110] C-194/04 Cadbury Schweppes plc and Cadbury Schweppes Overseas Ltd v Commissioners of Inland Revenue. ECLI:EU:C:2006:544 para 64- 66

[111] Ibid (n.109), P.62

[112] C-532/04 *Test Claimants in the Thin Cap Group Litigation v. Commissioners of Inland Revenue* ECLI:EU:C:2006:774 para 71

Cadbury Schweppes. This means that, the justification could be succeeded only if the rules target wholly artificial arrangements created to avoid the domestic legislation.[113] The assessment of the court once again repeated. In this situation, the Court found the UK thin capitalisation rule to be justified in order to fulfill the need to prevent tax avoidance. However, the Court held that the UK Thin capitalisation rule is not harmonious with proportionality principle. The UK rules failed the proportionality test.

Under the concerned measures, interest payments could only be treated as a distribution, if the payment exceeded the amount would have been agreed under arm's length basis between those companies.[114] The reference of the court to the third party transaction by mean of 'commercial justifications' deserved to be mentioned. The domestic measures can be included by the definition of wholly artificial arrangement, "as it is only economically ungrounded arrangement that are considered tax avoidance."[115] Additionally, in Thin Cap Group Litigation case, a Member State must provide the opportunity to the taxpayer to present evidence of genuine economic motivations regarding the company's transactions-the proportionality test. Regarding the proportionality test, it is the last step of assessment after the concerned rule is considered to be justified.[116] The development on proportionality is seen more important by Court as the Court decreases an intention to accept justifications for restricted national law.[117]

Lastly, regarding the justification assessment related to the Damixa case. The Court pointed out that the Danish argument to overcome the justification test by the Court, there are two conditions to be fulfiled. The Thin capitalization rule must contain its specific purpose "to prevent *wholly artificial arrangements* that do not bear any relation to economic reality and are designed to avoid payment of the tax normally due on the profits generated by activities carried out in the national territory."[118] However, the Court , in Damixa case, ruled that to safeguard the balanced allocation of taxation right, Denmark should not apply stricter rules as the current applicable thin capitalisaion rules on cross-border situation. [119] That is to say, the less restriction rule should be applied, by allowing tax exemption for interest paid by an affiliated company up to the amount that affiliated company is not allowed to deduct under Thin Capitalisation rules of other Member State.

One of the aims of anti-abuse measures in question is to balance an allocation of taxation power between Member States, it represents the symmetry of international taxation. While the State of borrowing company allows the

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[113] Ibid (n.112) para 72

[114] Ibid (n.112) para 80

[115] M. Hilling, *Justifications and Proportionality: An Analysis of the ECJ's Asessment of National Rules for the Prevention of Tax Avoidance*, Intertax, Volume 41 Issue 5, Page 294-307 P.297

[116] Ibid (n.115) P.302

[117] Lang, *Recent Case Law of the ECJ in Direct Taxation: Trends, Tension, and Contradictions,* EC tax Rev.106-108 (2009) and Helminen, EU Tax Law (IBFD 2011) 110.

[118] C-593/14 *Masco Denmark ApS,* opinion of AG Kokott, ECLI:EU:C:2016:336 Para 44

[119] Ibid (n.118) para 43

interest to be deducted, the State of lender company shall exclude that deducted amount from calculation of taxable income.

From all the above, it comes to the author's mind that the court, in the future, will take the standard into consideration when the discriminatory dispute concerning the domestic anti-abuse rules is brought to the interpretation. Therefore, the Member States may learn from the judgments and observe their own national legislations before any disputes arrive.

To sum up, to pass the ECJ test, domestic anti-abuse measures must conform the following remarks. Firstly, if the rule is applied only to cross border situations (i.e. oversea parent company, the creditor residing outside member state) and is likely to produce less favorable treatment than the domestic situation, the rule will confidently be determined to be a restriction to free movement. Secondly, the national anti-abuse measures must be ruled only to target artificial arrangements. Thirdly, there are two conditions to be fulfilled to qualify an artificial arrangement: "an objective element – which may consist in the absence of a genuine establishment; and a subjective element-which consist in an intention to achieve a tax advantage by artificial means."[120] Lastly, the opportunity to provide an evidence under commercial circumstances must be included.

As far as the CJEU's justification assessment is concerned. It should be pointed out that the EFTA-Court also takes similar test into consideration under the parallel rules on an infringement of the freedom of establishment under Article 31 of the European Economic Area (EEA) Agreement.[121] Recently, the court rendered the decision together with the observations and reasoned opinion documents from Norwegian government. The decision found the restriction in differential treatment concerning the Norwegian interest cap rules which impacted the domestic firm's decision to establish cross-border groups with affiliated group members in other EEA States. In contrast, the rules deterred the foreign companies from EEA states to do so.[122] The restriction was based on two circumstances; firstly, the group contribution rules, under the Norwegian interest cap rule, favor the Norwegian based groups to pay less tax than a company owned by groups based in other EEA states. Secondly, the Norwegian based companies conducted cross-border activities by operating an EEA based branch are affected by the rules, in the way that the rule made it less attractive for Norwegian companies to exercise their freedom of establishment by creating a Norwegian subsidiary in other EEA States.[123]

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[120] M. Hilling, *Justifications and Proportionality: An Analysis of the ECJ's Asessment of National Rules for the Prevention of Tax Avoidance*, Intertax, Volume 41 Issue 5, Page 294-307 P.297

[121] A. Cordewener, *Anti-Abuse Measures in the Area of Direct Taxation: Towards Converging Standards under Trety Freedons and EU Directives?* EC Tax Review 2017/2, P.62

[122] EFTA Surveillance Authority Reasoned Opinion, case no.76153, Document No.818742, Decision No. 192/16/COL

[123] EFTA Surveillance Authority Reasoned Opinion, case no.76153, Document No.818742, Decision No. 192/16/COL P.10

The EFTA- Court applied the case law test, the restricted provision must be ruled to prevent wholly artificial arrangements designed to prevent tax avoidance.[124] The rules affect the companies arrangement in general. This criterion is dismissed. Also, the escape clause, to provide the commercial justification is excluded from the rules. Such absence resulted in the unjustifiability.

5. ATA Directive on Domestic Law

Under the limited timeframe to introduce the proposed interest limitation rule of the Anti-Tax Avoidance Directive (2016/1164), it is crucial to take notice on how Member States' current legislations will be influenced by the upcoming implementation.

5.1 The Netherlands

The Netherlands has a large number of anti-abuse approaches in order to prevent inappropriate use of interest deduction, causing the erosion of the tax base.[125] However, there is still no enforcement of general EBITDA-based limitation rule[126] as proposed in the ATAD or any forms of best practice approach recommended by the BEPS Action 4 in the Netherlands.

To distinguish the type of funding as debt or equity, not only Corporate Income Tax Law but also the Dutch Civil Law are taken into account. As a general rule, the qualification of a funding determines as a loan under civil law, the same qualification applies under tax law. However, there are three exceptions ruled by the Dutch Supreme Court. First of all, 'a sham loan' is a loan agreed by the parties by its form but in fact the parties intended to provide an equity. Secondly, 'a bottomless pit loan' is granted to the debtor with an acknowledgment of the creditor that the repayment cannot fully or partially repay. Lastly, 'a participating loan', the loan is granted under some certain conditions that the creditor is likely to favor the debtor's company. Even through, under the civil law, these circumstances are considered as a loan, for tax purposes, they will be treated as equity capital.[127]

An interesting provision of Dutch interest deduction limitation rule should be remarked is ***Article 10A of the CITA***- Anti base erosion rule. The provision limits the deduction on interest from company's taxable profit of "a Dutch taxpayer, by a related company which is subject to corporate income tax in the Netherlands or a natural person residing in the Netherlands"[128], as far as the transactions are deemed to be tainted under certain conditions and the debts (loan) are involved to the following transactions. First, the debt relates to a profit distribution or return of capital to a related entity. Secondly, there

[124] C-532/04 *Test Claimants in the Thin Cap Group Litigation v. Commissioners of Inland Revenue* ECLI:EU:C:2006:774 para 74

[125] A. Bobeldijk, T. Hendrinks, *Interest Deduction in the Netherlands; Tax Aspects of the Different Interest Deduction Limitation Rules*, INTERTAX, Volume 45, Issue 4, Page 322-332, P.322

[126] D. Gutmann et al., *The Impact of the ATAD on Domestic Systems: A Comparative Survey*, 57 Eur. Taxn. 1 (2017), Journals IBFD. P.3

[127] Ibid (n.125); P.322

[128] Ibid (n.125); P.326

is a capital contribution to a related company in the same group and thirdly, an equity interest in an entity which become a related party after the acquisition or expansion appears.[129] It is notable that this rule does not contain the threshold of interest to be taken into consider only the objective circumstances matter. Additionally, there is an exceptional clause in order to allow the deduction of interest. In the event of a taxpayer can present a reasonable explanation when there is a debt is considered to be tainted transaction provided to a related entity under (a) 'Business Reasons Exception' presented that the debt is based on business reason of the entities and (b) 'Reasonable Taxation Exception' which shows that the interest will be levied, at creditor level, under an effective income tax rate that is acceptable and reasonable to the standard of Dutch taxation law.

The author believes that Dutch legislator enacted the law which relied on the ECJ judgment concerning the interest limitation rules. As the concerned article covers the transactions between resident and non-resident companies in the same group, to drive the cross-border businesses and prevent the erosion of the Dutch tax base, there is a need to control the deductibility of interest. Also, the provision represents an attempt to balance allocation of taxation powers together with providing a taxpayer to demonstrate a commercial evidence. As it appears on the ECJ assessment when the proportionality test can be succeeded.

However, it appears that Article 10A create an obstacle with the freedom of establishment under EU law to foreign creditor in connection to the fiscal unity structure. Even The Dutch Supreme Court found the provision is well constructed i.e. the provisions aims to target any acts which is completely artificial arrangement and intended to avoid taxes generated in the Netherlands and the limitation of interest in full can be considered to a proportionality. The Supreme Court also added "Article 10a remains within the boundaries set under EU law for legal provision which restricts the right to establishment."[130] However, The ECJ is asked for a preliminary ruling regarding the fiscal unity regime combined with Article 10a, whether it is in infringement to the freedom of establishment. The case is now pending.

Due to the unique character of Netherland's corporation structure a so-called 'fiscal unity' treats the domestic companies in the same groups differs from the domestic firms that operate oversea subsidiaries. The fiscal unity allows the transactions between the parent company and its subsidiaries locating in the Netherlands to be unseen from a taxation point of view.[131] Under Article 10A, if the domestic group provided 'a capital contribution' within the group, such contribution will not be considered as 'a tainted transaction. In contrary, if the Dutch parent company distributed a capital contribution to the foreign subsidiary (a subsidiary establish in Italy)[132], the transaction will fall within the scope of Article 10A resulted in the limitation of interest. As a consequence, the ECJ was asked by the Dutch Supreme Court, the question

[129] Ibid (n.125); P.326
[130] Ibid (n.125); P.328
[131] Ibid (n.125); P.328
[132] Ibid ; Hoge Raad, 8 July 2016, no. 15/00194, FurD 2016-1694

of whether the difference in applicability of national provision resulted in an unjustification obstacle of the freedom of establishment and/or the free movement of capital under the TFEU.[133] The Dutch supreme Court assessed the dispute in the light of settle case laws.[134]

Furthermore, the Dutch State Secretary raise the concerned after the proposed ATAD finally launched.[135] The current interest deduction limitation rules, "with a view to preventing overlap, overkill and complicated concurrence" [136] to the ATAD, will need to be polished or abolished.

The author strongly believes that the Netherlands is required to adopt the general rule under the EBITDA-based rule to their national law as a German principle. For other provisions, consider a case by case basis must be considered. However, to make the article in question comply with EU Law, the rule needs a narrow scope and the differential treatments between domestic and foreign companies need to be eliminated.

5.2 Germany

First of all, current German interest limitation rules or so-called 'Interest Barrier', are considered by some critics that these rules should serve as a blueprint for the interest limitation rule stipulated in article 4 of the ATAD.[137] The principle provision allows the interest expenses exceeding interest income are only deductible up to 30% of a taxpayer's EBITDA[138] which the number is not greater than the threshold proposed by the ATAD. Moreover, the national rules provide a number of alternatives which are in accordance with the escape clauses in the ATAD. De minimis threshold in Article 3 (a) of the ATAD, provides Member States to deduct exceeding borrowing costs up to EUR 3 million. While under section 4h (2) (a) of the German law, if the exceeding interest costs are less than EUR 3 million, they are deductible 'in full'.

On the contrary, if the net interest payments are more than EUR 3 million then they fall into the limitation rule. The limitation of deductibility will be applied by the 30% EBITDA-based rule. Moreover, the German law also covers stand-alone escape clause (not part of the ATAD), an alternative based

[133] Ibid (n.125); P.328

[134] Test Claimants in the Thin Cap Group Litigation (C-524/04) and Cadbury Schweppes and Cadbury Scheweppes Oversea (C-194/04)

[135] Letter of the State Secretary for Finance, 29 Apr. 2016, 'Vragen over het Pakket anti-belastingontwijking, no.AFP/2016/394

[136] A. Bobeldijk, T. Hendrinks, Interest Deduction in the Netherlands; Tax Aspects of the Different Interest Deduction Limitation Rules, Intertax, Volume 45, Issue 4, Page 322-332, P.332

[137] S. Lampert, T. Meickmann & M. Reinert, *Article 4 of the EUAnti Tax Avoidance Directive in Light of the Questionable Constitutionality of the German "Interest Barrier" Rule*, 56 Eur. Taxn. 8 (2016), Journals IBFD.P.323; D. Gutmann et al., *The Impact of the ATAD on DomesticSystems: A Comparative Survey*, 57 Eur. Taxn. 1 (2017), Journals IBFD. P.4

[138] DE: Income Tax Act (Einkommensteuergesetz, EStG), sec. 4h, National Legislation IBFD, DE: Corporate Income Tax Act (Korperchaftsteuergesetz, SKtG) sec. 8a, National Legislation IBFD

on the ratio of the taxpayer's equity over total assets (Article 4 (5)(a) of the ATAD) and the mixture of carry-forward and carry-back of exceeding borrowing cost and unused interest capacity provisions (Article 4 (6) of the ATAD). They are mostly in line with the ATAD. The consistency between the ATAD and German interest deductible rule is outstanding.

However, the internal situation in Germany regarding the compatibility of German interest barrier rules with the equal treatment principle, Article 3 of the German Constitution arise. The decision rendered by the German Federal Tax Court ("Bundesfinanzhof") on 10 February 2016 in relation to the German interest limitation rule in breach of the equal treatment principle. The mattered concerned the German firm which was limited the deductibility on interest under the interest barrier rule. Pursuant to the provision, it was formed under the ability to pay doctrine in light of the equal treatment principle. That means taxpayers should pay tax equally depending on their financial ability to pay. Additionally, the German Constitutional Court also ruled "the objective net principle" concerned the corporate income tax which allow 'a business cost' of the corporate company to be deductible from taxable net profit. In the present case, the taxpayer is claimed under the purely domestic situation. [139]

Under the German law, the interest expenses are qualified as business cost therefore it must be deductible under the above principle. However, the interest barrier rules limit the deduction of interest. From the legislator perspective, the rest of the non-deductible interest can be carried forward to the future year which is applicable to the 30% EBITDA support the justification. However, under these circumstances, the German Federal Tax Court rendered its decision that the interest barrier rule was unconstitutional and it was not justifiable.

The Court pointed out that the possibility to carry forward the interest expense can initiate the losses due to a commercial restructuring measures.[140] The carry-forward approach may favor the losses more than business expenses, An ability to pay affected losses and expenses differently. "Therefore, the German Federal Tax Court finds that the situation of interest carry-forward and loss carry-forward are not comparable."[141]

However, there is an interesting point to justify the violation of the objective net principle. On the one side, to limit the scope of interest barrier to only cross-border situation may remove this issue. On the other side, to limit the scope may cause the discrimination under the EU law.[142] The tightened scope

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[139] Taxpayers should be taxed equally, considering their financial ability to pay taxes.

[140] S. Lampert, T. Meickmann & M. Reinert, *Article 4 of the EUAnti Tax Avoidance Directive in Light of the Questionable Constitutionality of the German "Interest Barrier" Rule*, 56 Eur. Taxn. 8 (2016), Journals IBFD.P.323;

[141] A.Breuer, 'The Interest Limitation Rule of the Proposed EU Anti-Tax Avoidance Directive: A Violation of the German Constitution?', Kluwer International Tax Blog, March 2 2016,

[142] S. Lampert, T. Meickmann & M. Reinert, *Article 4 of the EUAnti Tax Avoidance*

can be applicable in light of pervious settled cases[143] concerning the abusive tax avoidance and proportionality test.

The matters lead to the author's interest on what will happen next regarding to the transition from the proposed ATAD. As it seemed to the author that the majority of rules of German interest limitation rules are in line with the ATAD. Even the carry-forward rule in question is also consistence to Article 4 (6) of the ATAD except the minor forces under the National law.

5.3 Article 11 (6) ATA Directive

"Article 11 Transposition (6) By way of derogation from Article 4, Member States which have national targeted rules for preventing BEPS risks at 8 August 2016, which are 'equally effective' to the interest limitation rule set out in this Directive, may apply these targeted rules until the end of the first full fiscal year following the date of publication of the agreement between the OECD members on the official website on a minimum standard with regard to BEPS Action 4, but at least until 1 January 2024"[144]

A targeted rule, during the negotiation, was the most discussed topic.[145] As mentioned in section 2.4.1 in this research, a targeted rule (such as thin capitalisation rules) should be applied only as a supplement to the recommended general rules. Therefore, by way of transposition from Article 4, a Member State that has a domestic targeted rule enforced in the territory may continue to use the old rule instead of introducing Article 4. The unclear wordings in this article may provide cause for confusion. In this case, the Polish provisions limiting the deductibility of interest contain an interesting escape clause.[146] The alternative rule provides the different method on how to calculate the allowable deductible level of interest. The use of EBIT to limit the excess amount, is different from the ATAD. However, it is doubtable on the calculation and application of EBIT and EBITDA.[147]

However, this can be related to the interpretation under Article 11 (6), the contrary of the domestic provision can possibly considered to be "equally effective to the interest limitation rule set out in this Directive"[148] in the light of article 11 (6) of the ATAD. "Equally effective" may be interpreted to broaden or narrow from the logic of Article 4. It remains unclear how the European Commission who is in charge of the compliance of ATAD implementation will apply this article.[149]

Directive in Light of the Questionable Constitutionality of the German "Interest Barrier" Rule, 56 Eur. Taxn. 8 (2016), Journals IBFD.P.327

[143] Test Claimants in the Thin Cap Group Litigation (C-524/04) and Cadbury Schweppes and Cadbury Scheweppes Oversea (C-194/04)

[144] Council Directive 2016/1164/EU of 12 July 2016, OJ L 193 Art.11 (6)

[145] Ibid (n.46) P.502

[146] Art. 15c CITA

[147] D. Gutmann et al., *The Impact of the ATAD on Domestic Systems: A Comparative Survey*, 57 Eur. Taxn. 1 (2017), Journals IBFD. P.6

[148] Ibid (n.147); P.3-4

[149] Ibid (n.147); P.19

To sum up, Member States may use this opening clause not to apply the anti-abuse measures under ATAD which result in unsolved difference treatments and the aim of the ATAD to reform the current anti-abuse measures will not be pursued.

6. Conclusion

Under the BEPS action 4, the suggested best approach gives guidelines on how Member States can implement the interest limitation rules. The variation of rules and exceptions can facilitate the Member States to introduce the rules or at the same time can expand a gap of an implementation of domestic rules which is not harmonised. However, since the ATAD is in force. Due to the coming deadline to introduce the ATAD, the flexibility offered by the ATAD allows the Member States, on their own discretion, to choose the suitable ways. Nonetheless, the flexibility may raise some future concerns. The ATAD plays its role to ensure that the Member States do not impose too strict or too loose rules on the limitation of interest deduction. As it shows in this research, the countries have applied different approaches to combat the aggressive tax planning on debt investment. Nevertheless, the approaches can be challenges as an obstacle to a freedom of establishment in the EU level or in the national level as an infringement to Constitutional law.

The CJEU is asked to interpret the complication and guarantee that the Member States are in boundaries of EU Law. To answer the question as an aim of this research, there are a number of requirements ruled by the Court in which the domestic legislation containing anti-abuse measures to be compatible with fundamental freedoms. The movements of the court on the decision seem to be consistent in earlier settled case law. To pass the ECJ test, the domestic interest limitation rules need to contain the specific purpose of preventing completely artificial arrangements which do not have any connection to the economic reality, and those arrangements are intended to avoid taxes which are normally due. Also, the domestic legislations must allow a taxpayer to provide economic evidence once the transactions are brought to question. Additionally, the rules must be applied equally to resident entities and foreign entities in cross-border situation. The rules must not favor national firms greater than foreign firms. At the same time, the rules that limit the freedom of establishment of national firms to operate their business in other Member States are not allowed.

The author believes that the decision on pending cases regarding the infringement of interest limitation rules will not go beyond the standards set by the Court. As it seemed to imply that where the anti-abusive measures introduce into the domestic law, it creates a possibility to obstacle the fundamental freedoms. However, the Court has assessed the justification method with careful.

Additionally, due to a lack of introduction of thin capitalisation rules in some countries. For example, Thailand, a concept on the control of an investment by debt or thin capitalisation is not clearly defined. It is doubtable how to implement the rules? When most of the countries with Thin capitalisation rules and interest deduction, so far, preparing for adoption the ATAD. The

author wish to contribute an awareness to countries where it lacks of the implementation of interest limitation rules to prepare for the possible future challenges.

A. Rigaut, *Anti-Tax Avoidance Directive (2016/1164): New EU Policy Horizons*, 56 Eur. Taxn.11 (2016), Journals IBFD P.501

Appendix A

Table 1: Comparison between ATAD and OECD interest limitation rule		
ATAD Article 4	OECD BEPS Report on Action 4	Added during negotiations
Recital 6: possibility of using a stricter EBIT ratio instead of EBITDA.	This is also allowed by the OECD (paragraph 84).	Yes
Paragraph 1.1: possibility to opt for a lower fixed ratio than 30% EBITDA (“up to”).	The OECD recommends a range of 10% to 30% EBITDA: *see* paragraph 97.	
Paragraph 1.2: neutrality with regard to national group taxation systems (consolidated group vs. separate entity taxation systems).	The OECD allows for the same neutrality, *see* paragraphs 196 to 198.	Yes
Paragraph 3.a and recital 8: introduction of a safe harbour rule of a (maximum)[1] of EUR 3 million.	This is what the OECD refers to as the “de minimis monetary threshold” (*see* paragraphs 54-56); it does not, however, recommend any specific amount.	Increased from EUR 1 to 3 million
Paragraph 3.1.b: possible exclusion of standalone entities, as defined in paragraph 3.3. Some delegations wanted the possibility of also excluding domestic groups, but this was deemed too challenging from an EU law perspective.	OECD also does not mandate covering standalone entities (*see* paragraphs 52-53), but its definition differs since the absence of any related party (“associated enterprise” in ATAD terminology) or PE is not part of that definition.	Yes
Paragraph 4.a: possible introduction of an indefinite grandfathering clause for all loans concluded before17 June 2016. In the event the loans are modified (e.g.higher amount), the grandfathering does not extend to the modification (e.g. additional amount).	This is also allowed by the OECD (*see* paragraph 195), which allows such grandfathering “either for a fixed period or indefinitely” and recommends that it be“primarily” (i.e. not exclusively) restricted to third-party loans.	Yes
Paragraph 4.b: possible exemption of “long-term public infrastructure projects”. The conditions for such exemptions are limited, but Member States remain bound by EU State aid rules (*see* last sentence of recital 8).	OECD allows for the exemption of “public benefit projects” (*see* paragraphs 64 to 71). The definition is nevertheless at the same time wider (not just infrastructure projects) and stricter (more conditions) than the ATAD rule.	Yes
Paragraph 5.a: possible “equity escape” provision for accounting groups.[2]	The OECD presents such a rule as a best practice in Annex C (equity escape rule).	
Paragraph 5.b: possible EBITDA-based group carve-out rule for accounting groups.	The OECD report includes such a group ratio option (*see* chapter 7).	Yes

Paragraph 6: possible carry-back and carry-forward of exceeding borrowing costs and/or unused interest capacity, with some time limitations (three and five years: *see* paragraphs 6.b and 6.c).	These options are also allowed by the OECD Report in order to address volatility issues (*see* paragraphs 159 to 167). Time limitations are also explicitly recommended in paragraph 165, but without a precise number of years.	Yes
Paragraph 7: possible exclusion of financial undertakings.	The OECD allows such exclusion and has committed itself to further work on this topic (*see* chapter 10).	
1. Based on article 3, minimum level of protection. 2. Article 4 of the ATAD uses two definitions of groups: tax groups (para. 1.2) and accounting groups (para. 8).		

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