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**The Anti-Tax Avoidance Directive and its
Compatibility with Primary EU Law**
(Competence: Subsidiarity and Proportionality)

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Abbreviations

ATAD – Council Directive (EU) 2016/1164 of 12 July 2016 Laying down Rules against Tax Avoidance Practices That Directly Affect the Functioning of the Internal Market

BEPS - Base Erosion and Profit Shifting

CCCTB - Common Consolidated Corporate Tax Base

CFE – CFE Fiscal Committee

OECD - The Organisation for Economic Co-operation and Development

CFC – Controlled Foreign Company

CJEU - Court of Justice of the European Union

EBITDA - Earnings Before Interest, Taxes, Depreciation and Amortization

EU – European Union

GAAR – General Anti-Avoidance Rule

MNE – Multinational Enterprise

PE – Permanent Establishment

PSD - Council Directive 2011/96/EU of 30 November 2011 on the common system of taxation applicable in the case of parent companies and Subsidiaries of different Member States

TEU - The Treaty on European Union

TFEU - Treaty on the Functioning of the European Union

Preface

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Introduction

i. Background

The current international tax framework is believed to be outdated and unable to respond to modern challenges caused by integrated national economies and markets. Accordingly, the existing system has several weak spots and results in BEPS. In 2013 G20 leaders affirmed the Action Plan on BEPS that combines the package of 13 reports and triggers reconsideration of the existing international tax standards and measures to help countries prevent BEPS.¹ The EU responded to BEPS by adopting anti-tax avoidance package. ATAD is a legislative element of anti-tax avoidance package proposed by the Commission. The Directive stipulates anti-avoidance rules and is designed to protect functioning of the internal market² of the EU. It aims to prevent tax avoidance practices and provides following anti-avoidance rules: deductibility of interest; exit taxation; GAAR; CFC rules and the framework to tackle hybrid mismatches.³ The ATAD and its implementation has raised number of legal questions under the complex labyrinth of the EU legal framework and domestic law of the Member States.

ii. Research question and thesis objective

Despite the fact that the ATAD has extremely important socio-economic objectives, adoption of the Directive raised questions regarding its compatibility with Primary EU Law. As it has been famously suggested, “no significant issue in international tax can be discussed without raising the question of sovereignty”.⁴ Regulatory autonomy in the field of direct taxation is seen as the cornerstone of the sovereignty of the Member States. On the other hand, EU institutions believe that cross-border abusive practices affect the internal market to a degree that they called for EU-wide legislation. This paper aims to determine the compatibility of the ATAD with regards to the competence-related requirements of the Primary EU Law and intends to

¹ OECD, “Explanatory Statement 2015 Final Reports,” *OECD Publishing* 2011, no. February (2015): 10–12.

² This paper applies the notions of “Internal Market” and “Single Market” interchangeably.

³ European Commission, “Proposal for a Council Directive Laying down Rules against Tax Avoidance Practices That Directly Affect the Functioning of the Internal Market,” 2016.

⁴ D.M. Ring, What’s at Stake in the Sovereign Debate? *International Tax and the Nation-State*, 49 *Virginia Journal of International Law* 1, p. 156 (2008).

investigate whether the EU institutions have exceeded their competence when they adopted the ATAD. If the EU institutions acted beyond their vested powers, it is considered as *ultra vires* and non-compatible with the Primary EU Law, which in turn serves as a legal ground for annulment of EU legislative acts.

More specifically, the paper provides legal analysis of the EU competences by elaborating on exclusive and non-exclusive competences, as well as it delves into the inherent issue of the EU's power to legislate and expounds procedural and substantive requirements thereof. It is important to determine whether the EU legislator had the competence to regulate abusive practices in the field of corporate income tax via the legal instrument of a Directive.

In order to explore the abovementioned research question, this paper intends to identify the substantive requirements of the EU competences as provided by the Primary EU Law. Article 5 TEU stipulates that in the areas which do not fall within its exclusive competence, the EU should act in compliance with principles of Subsidiarity and Proportionality. Since direct taxation does not fall within EU's exclusive competence, it is interesting to check whether the EU institutions legislated in accordance with these principles. The ATAD has *De Minimis* character and the Member States are allowed to apply a higher level of protection for domestic corporate bases, which might endanger its consistent and effective implementation. The paper intends to explore whether the standards about the domestic anti-abusive measures developed through the case law of the CJEU will work as a *De Maximis* limitation. The ineffectiveness of the Directive might question its suitability to achieve legitimate objective to prevent cross-border abusive practices and as a result, undermine its compliance with Proportionality Principle.

Furthermore, several anti-abusive measures provided by the ATAD apply in an automatic manner without considering the real economic nature of the transaction in question. Accordingly, it is important to identify how does this affect the Proportionality of the ATAD and whether the anti-abusive measures go beyond what is necessary to achieve their objectives.

iii. Methods

The research will be conducted via various legal research methods. In particular, legal dogmatic, hermeneutic, evaluative and comparative analysis methods will be employed. The multi-layered legal system of the EU will be studied by using legal dogmatic method. The research will be focused on Primary EU Law (TFEU, TEU), relevant Secondary EU Law (especially the ATAD) and the national Law. The case-law of the CJEU and the respective national judicial authorities will be given the highest consideration.⁵ The aims of the thesis will be achieved by exploiting hermeneutic method as well – the relevant legal materials, reasoning and argumentation of the courts will be

⁵ Sjoerd Douma, *Legal Research in International and EU Tax Law* (Deventer: Kluwer, 2014), 18.

analysed textually. The main question – compatibility of ATAD will be addressed by evaluative method – the legal analysis will be provided by the evaluation of compatibility.

iv. Delimitation

The research is focused on compatibility of the ATAD with Primary Law in the context of EU competences. Therefore, the compatibility assessment is delimited on the provisions of the Primary EU Law that provides the legal framework for the EU powers. According to the case law of the CJEU, violation of the competences and infringement of the Fundamental Freedoms are separate grounds of illegality of the EU legal acts. The paper does not cover the compatibility issues with regards to Fundamental Freedoms guaranteed under the Primary EU Law. The thesis does not discuss the legal remedies under EU law as well. The research does not go deeper to cover every aspect of the Directive, nor does it address specific anti-avoidance rules in greater detail. The specificities will be analysed only as much as it is necessary to answer the research question and assess the compatibility with competence provisions of the Primary EU Law.

v. Outline

The thesis comprises of three main chapters. The first chapter gives general overview of the ATAD, including its genesis, socio-economic background, and specific anti-tax avoidance rules provided by the Directive. The second chapter provides the discussion about the legal nature of the Directive, including its *De Minimis* character, specificities of the chosen legal instrument and certain aspects of its implementation. The third chapter will discuss the EU competence to legislate over anti-tax avoidance measures in direct taxation and assess the compatibility from this perspective. The competence issues will be tested against the principles of Subsidiarity and Proportionality in the respective sub-chapters.

1. General Overview of the ATAD

This chapter will provide the general overview of the directive, including its background, scope and the specific tax-avoidance rules.

1.1. Background and main causes

The modern international tax system lacks coordination and enables cross-border tax avoidance schemes that erode national tax bases and affect the functioning of the global market. Therefore, the OECD has adopted a 15-step anti-BEPS Action Plan including recommendations for the revision of national tax laws and tax treaties. Yet, the OECD Action Plan is not a binding legal instrument. Since the proper implementation of the Action Plan entails radical changes in national as well as international tax legislation, the need for hard law appears to be palpable. Cross-border tax avoidance arrangements and aggressive tax-planning affect the functioning of the internal market, which prompts the European Union to put anti-tax avoidance measures at the top of its agenda. In order to ensure that the OECD BEPS Action Plan is implemented in a coordinated manner, the Commission, on 28 January 2016, published the anti-tax avoidance package, which, among other measures, included the proposal for ATAD. Later, on 12 July 2016, the Council adopted the ATAD.⁶

The EU usually seems very reluctant to harmonise the direct tax legislation, because it is considered to be at the core of sovereignty of the Member States and thus very sensitive from a political perspective. It is hence not surprising that there are only a handful of EU Directives in the field of direct taxation. Before the ATAD, the EU had adopted only five Directives in corporate taxation:

- The EU Parent-Subsidiary-Directive (90/435) of 23 July 1990,⁴ which was recast in 2011 and revised in July 2014 and January 2015;
- The EU Merger Directive (2009/133) of 23 July 1990 which was recast on 19 October 2009;

⁶ Council, “Proposal for a COUNCIL DIRECTIVE ANNEX Amending Directive (EU) 2016/1164 as Regards Hybrid Mismatches with Third Countries” (2016); Council Directive (EU) 2016/1164 of 12 July 2016 laying down rules against tax avoidance practices that directly affect the functioning of the internal market (2016). OJ L 193/1

- The EU Interest and Royalties Directive (2003/49) of 3 June 2003 the recasting of which is still pending before the Council;
- The EU Recovery Directive (2010/24) of 16 March 2010, which replaced an old Directive dating back to 1976;
- The Directive on Administrative Cooperation in tax matters (2011/16) of 15 February 2011, which replaced an old Directive dating back to 1977 and which has already been revised three times since 2014.

The adoption of the ATAD represents a new building block of EU tax policy and helps open many new horizons.⁷

The relevant legal instruments in the area of taxation apply specific terminology that requires explanation. In particular, the notions of “tax avoidance”, “tax planning”, “aggressive tax planning”, and “abusive tax planning” are referred therein. To assess the given legal constructions properly, it is thus important to identify the meaning, as well as, difference and similarities between them. In general, “tax avoidance” is defined as unacceptable or abusive, whereas “tax planning” is acceptable and sometimes encouraged by the law.⁸

“Tax Abuse” is determined by using the following elements: (1) gaining (improper) tax benefits; (2) a conflict between the purpose of the circumvented tax law and the availability of tax savings: it must be assessed whether the legislative purpose would be frustrated if the tax benefits were granted; and (3) absence of valid commercial reasons: it should be determined whether transactions were justified by commercial motives other than tax incentives.⁹

Tax abuse is, in principle, lawful, because gaining tax benefits is within the boundaries of law, but not according to the object and purpose of the legal rules. Conversely, aggressive tax planning is not a circumvention of the law, because it does not *per se* come into conflict with the intention of the law. It does not go beyond the limits fixed by the rules, it rather goes between the rules. This gives rise to “aggressive” tax planning, which implies exploiting the gaps in the architecture of the existing tax law, mismatches and disparities within international tax system. Aggressive Tax Planning is reflected in the

⁷ Rigaut Aloys, “Anti-Tax Avoidance Directive (2016 / 1164): New EU Policy Horizons,” *European Taxation*, 2016, 497.

⁸ Christine Alves Alvarrenga, “Preventing Tax Avoidance: Is There Convergence in the Way Countries Counter Tax Avoidance?,” *Bulletin for International Taxation*, 2013, 348–63.

⁹ Paolo Piantavigna, “Tax Abuse and Aggressive Tax Planning in the Establishing a Unifying Conceptual Framework,” *World Tax Journal*, 2017, 56.

actions of “arranging”, “organising”, and “placing” for tax purposes.¹⁰

The notion of “abusive practice” was developed by the CJEU in Cadbury Schweppes case. Firstly, the Court referred to the landmark Centros¹¹ Case and stated that “the fact that the company was established in a Member State for the purpose of benefiting from more favourable legislation does not in itself suffice to constitute abuse of that freedom”.¹² Afterwards, the Court has defined “abusive practice” by emphasising that its prevention can be relied on by a Member State as a legitimate ground to justify the restriction of the freedom of establishment: “In order for a restriction on the freedom of establishment to be justified on the ground of prevention of abusive practices, the specific objective of such a restriction 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”.¹³

In short, the CJEU provides that the “abusive practice” exists when a taxpayer creates “wholly artificial arrangement”, which do not reflect economic reality to decrease a payable tax base. Importantly though, the judgment does not give relevance to the taxpayer’s intention to obtain a tax benefit nor to its significance from the moment the fundamental freedoms have been effectively exercised.¹⁴

Anti-tax avoidance and aggressive tax planning preventive measures established by the ATAD aim to guarantee a single tax principle in cross-border taxation by eliminating disparities between national tax systems, which create loopholes. These measures intervene in fiscal sovereignty of the Member States in an attempt to ensure allocation of taxing powers is based on the principle of fair taxation.¹⁵ The Commission underlines two main reasons for the adoption of the ATAD. Firstly, there is the necessity of a coordinated transposition of the OECD BEPS measures.

According to the Commission, “the unilateral and divergent implementation of BEPS by each Member State could fragment the Single Market by creating

¹⁰ Ibid. 65–66.

¹¹ C-212/97 - Centros (1999) A landmark case of the CJEU regarding freedom of establishment.

¹² Case C-196/04 - Cadbury Schweppes and Cadbury Schweppes Overseas (2006) ECLI:EU:C:2006:544, para. 37.

¹³ Ibid. 55.

¹⁴ Frans Vanistendael, “Is Tax Avoidance the Same Thing under the OECD Base Erosion and Profit Shifting Action Plan, National Tax Law and EU Law ?” *Bulletin for International Taxation* 70, no. 3 (2016): 167.

¹⁵ Ana Paula Dourado, “The EU Anti-Tax Avoidance Package: Moving Ahead of BEPS,” *Intertax* 44, no. 6,7 (2016): 441.

national policy clashes, distortions and tax obstacles for businesses in the EU. It could also create new loopholes and mismatches that could be exploited by companies seeking to avoid taxation, thereby undermining Member States' efforts to prevent such practices. It is therefore essential for the good functioning of the Single Market that Member States – as a minimum - transpose the OECD BEPS measures into their national systems in a coherent and coordinated fashion”.¹⁶

On the other hand, the Commission reaffirms its own announcement that it will re-launch the proposal for a CCCTB as “a holistic solution to creating fairer and more efficient taxation” and the Directive takes account of the outcome of Member States' discussions on these issues in the Council.¹⁷

Interestingly, some doubts are raised whether the Directive is an appropriate mechanism to transpose the OECD BEPS measures into the EU legal system. For example, the CFE has admittedly supported the conversion of OECD tax-avoidance measures into EU Legislation, but it cast doubts on the Directive by indicating that it goes beyond what is necessary to implement the OECD Action Plan. According to the Opinion Statement of the CFE, the scope of the Directive considerably exceeds the OECD agreement and endangers EU competitiveness with respect to worldwide investments. The CFE was concerned that the proposed Directive could have been unable to achieve its purpose – to implement anti-avoidance measures in a consistent way throughout the EU.¹⁸ On the other hand, even though the ATAD might go beyond the BEPS Action plan, there are some opinions in favour of the ATAD, particularly the fact that the EU law has proven to be quite effective in implementing anti-BEPS measures and MNEs will now have to consider this while designing their business models.¹⁹

Notably, the Council has been able to reach a political agreement on the ATAD in an extremely short period of less than five months. Considering the number and complexity of the articles in the proposal, such promptness is truly remarkable. This was only possible thanks to the work completed under past EU initiatives on the issues of international anti-BEPS aspects of the CCCTB proposal. In particular, the proposed anti-tax avoidance measures were familiar to the Member States, given that they had been under discussion

¹⁶ European Commission, “Proposal for a Council Directive Laying down Rules against Tax Avoidance Practices That Directly Affect the Functioning of the Internal Market,” 3–4.

¹⁷ *Ibid.* 4.

¹⁸ CFE, “Opinion Statement on the European Commission's Proposal for an Anti-Tax Avoidance Directive,” 2016, 2.

¹⁹ Sjoerd Douma and Alexia Kardachaki, “The Impact of European Union Law on the Possibilities of European Union Member States to Adapt International Tax Rules to the Business Models of Multinational,” *Intertax* 44, no. 10 (2016): 753.

since 2011. At the same time, a change in political circumstances – including the adoption of BEPS Action Plan, revelation of “LuxLeaks” and “Panama Papers” scandals helped to make the agreement possible.²⁰ These events have clearly demonstrated the urgent need of a concerted action of governments not only on a European, but on an international level to protect national budgets from the cross-border abusive practices²¹

1.2. Scope

The ATAD contains five anti-tax avoidance instruments: Interest Limitation Rule (article 4), Exit Taxation (article 5), GAAR (article 6), CFC Rule (article 7), and Hybrid Mismatches (article 9). Interest Limitation Rule corresponds to BEPS Action Plan 4.²² Respectively – CFC Rule reflects BEPS Action Plan 3²³, and Hybrid Mismatches Rule mirrors BEPS Action Plan 2.²⁴ The remaining two measures survived the discussions on international aspects of CCCTB – The Exit Taxation rule and the GAAR.

Anti-tax avoidance measures prescribed by the ATAD have to be adopted by all Member States and be applicable to “all taxpayers that are subject to corporate tax in a Member State”. It is therefore essential for the Member States to be able to choose the most suitable solution, which best corresponds with their legal systems. An important feature of the Directive is that it extends these rules to permanent establishments, including those of companies that reside outside the EU for tax purposes since they are equally part of the internal market.²⁵ On the other hand, transparent entities do not fall within the personal scope of the Directive.²⁶ The Switch-over clause was

²⁰ Aloys, “Anti-Tax Avoidance Directive (2016 / 1164): New EU Policy Horizons,” 500.

²¹ Axel Cordewener, “Anti-Abuse Measures in the Area of Direct Taxation: Towards Converging Standards under Treaty Freedoms and EU Directives?” *EC Tax Review 2* (2017): 61.

²² OECD, “Limiting Base Erosion Involving Interest Deductions and Other Financial Payments, Action 4 - 2015 Final Report,” OECD/G20 Base Erosion and Profit Shifting Project, October 5, 2015, doi:10.1787/9789264241176-en.

²³ OECD, *Designing Effective Controlled Foreign Company Rules, Action 3 - 2015 Final Report*, OECD/G20 Base Erosion and Profit Shifting Project (OECD Publishing, 2015), doi:10.1787/9789264241152-en.

²⁴ OECD, *Neutralising the Effects of Hybrid Mismatch Arrangements, Action 2 - 2015 Final Report*, OECD/G20 Base Erosion and Profit Shifting Project (OECD Publishing, 2015), doi:10.1787/9789264241138-en.

²⁵ Guglielmo 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” 45, no. 2 (2017): 121.

²⁶ Marjaana Helminen, *EU Tax Law: Direct Taxation* (IBFD, 2016), 61.

removed from the final draft, as it had seen opposition from the Member States. Prior to its deletion its scope had already been substantially reduced to avoid a situation whereby the Member States would have needed to renegotiate all their existing tax treaties with third countries, which could have even been insufficient.²⁷

Notably, several elements of the Directive regarding its personal scope seems somehow ambiguous. First, the ATAD does not define the notions of “taxpayer” and “corporate tax” and leaves their interpretation to the Member States when transposing the Directive. It is important to note, that article 7 provides the broader concept of “entity” rather than “taxpayer”, i.e. trusts and partnerships controlled by a taxpayer are covered by the CFC rule. Interestingly, it bears visible political relevance in the context of “Panama Papers” revelations. The Directive thereby causes ambiguity as to whether withholding taxes are to be covered by the concept of “corporate taxation”, which in turn influences the GAAR.²⁸ Needless to say such uncertainty might endanger a coordinated implementation of the Directive in the Member States. The CJEU needs to provide the uniform interpretation of these notions to ensure the effective implementation of the Directive in order to prevent distortion of the ATAD’s objectives,

1.3. Specific ATAD Rules

As it was noted above, the ATAD contains five anti-tax avoidance instruments: the Interest Limitation Rule, the Exit Taxation, the GAAR, the CFC Rule, and the Hybrid Mismatches. The further sub-chapters will discuss general features of each of these rules.

1.3.1. Interest Limitation Rule

Article 4 of the ATAD provides the EU-wide interest limitation rule. The provision reflects the BEPS Action Plan 4²⁹ According to the article the exceeding borrowing costs shall be deductible in the tax period in which they are incurred only up to 30 percent of the taxpayer's EBITDA. Article 4

²⁷ Aloys, “Anti-Tax Avoidance Directive (2016 / 1164): New EU Policy Horizons,” 500.

²⁸ Ibid. 501.

²⁹ OECD, “Limiting Base Erosion Involving Interest Deductions and Other Financial Payments, Action 4 - 2015 Final Report.”

follows the OECD-recommended “best practice”. The interest limitation rule covers all taxpayers and limits their right to deduct the net interest expenses (“Borrowing Costs”) to a “fixed ratio” of 30% of a taxpayer's taxable EBITDA.

The Member States can apply the ratio to a group of taxpayers instead and they can opt for an “equity escape” rule, which compares an entity’s level of equity and assets to those held by its group. In addition, the Member States can also introduce escape for the borrowing costs not exceeding 3 million, for standalone entities and public-benefit projects, and to allow carry-forward or carry-back of exceeding borrowing costs and/or unused interest capacity.³⁰

The Commission highlighted that MNEs from high-tax jurisdictions arrange to pay “inflated” interest to Subsidiaries in low-tax jurisdictions. This practice reduces tax base of MNEs, since it decreases tax base in high-tax jurisdictions while increasing it in the low-tax countries. Hence, the objective of the Interest Limitation rules is to prevent such practices and fix minimum level of protection for the single market by setting the rate for deductibility at the top of the scale (10 to 30%), as recommended by OECD. The Commission also clarified the issue about the financial institutions, explaining that there is a need for different approach towards financial undertakings due to specific character of their activity. The Commission declares the intention that despite the temporary exclusion of financial institutions, the customised rules will be adopted on the consideration of the nature of undertakings.³¹

The negotiations on Article 4 of the ATAD were especially difficult. The authors of the Directive were called upon to balance the effectiveness offered by OECD BEPS Action Plan 4, on the one hand, and the expected negative impact of the rule on the economic actors. Some Member States sought flexibility in this area as well, for instance, regarding the exclusion of tax exempt income, but this was refused, as it contradicted the OECD Report.³²

As it seems the Commission and the Council have given preference to the effectiveness of the measure. The interest limitation rule establishes mechanistic approach and does not consider whether an undertaking had a good commercial reason for financing, or it was artificial, abusive arrangement. This unfair balance was one of the main reasons why the rule was criticised by the CFE in its opinion statement. The conversion of BEPS recommendations of a “common approach” about interest limitation measures

³⁰ 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,” 121.

³¹ European Commission, “Proposal for a Council Directive Laying down Rules against Tax Avoidance Practices That Directly Affect the Functioning of the Internal Market,” 7.

³² Aloys, “Anti-Tax Avoidance Directive (2016 / 1164): New EU Policy Horizons,” 501–2.

into “hard law” goes far beyond the OECD recommendations and even exceeds what is necessary to combat abuse. The measure affects all undertakings, regardless of the fact whether they operate at an international or a local level, or whether they have a genuine external interest to finance local investment or operation for which there is no artificial arrangement. The CFE believes allowing an undertaking to prove that deductions were used for a sound commercial reason would create fairer conditions.³³

1.3.2. Exit Taxation

Article 5 of the ATAD provides the Exit Taxation rule. A taxpayer is subject to exit taxation at the time of transfer of one’s assets to another Member State or a third country. The Exit Taxation targets unrealised appreciation of assets to taxation based on the market value at the moment when the assets, residence or business leaves the tax jurisdiction. The market value is the amount for which an asset can be exchanged or mutual obligations can be settled between willing and unrelated buyers and sellers in a direct transaction.³⁴

It is noteworthy that this anti-avoidance measure does not directly correspond to any BEPS Action plan, as it originates from the discussions on the international aspects of the CCCTB.³⁵ However, the article 5 turned out to prompt little political debate, thereby, legal drafting of this provision was among the first to stabilise and in the absence of political opposition against the necessity of the Exit Taxation rule, the negotiations were solely focused on the technical aspects.³⁶

The Member States and other stakeholders have realised the importance of the political objective of the Exit Taxation rule. The Commission explains in the proposal that exit taxation targets the prevention of tax base erosion in the State of origin when the taxpayers try to reduce their tax bill by moving their tax residence and/or assets to a low-tax states, since such practices distort the market, erode the tax base of the State of departure and shift profits to the low-tax jurisdiction of destination.³⁷

According to Article 5 of the ATAD, the Exit Taxation covers three types of transfers: transfer of assets, business and residence. The transfer of assets entails the operation whereby a Member State loses the right to tax to the transferred assets, whilst the assets remain under the legal or economic

³³ CFE, “Opinion Statement on the European Commission's Proposal for an Anti-Tax Avoidance Directive,” 5–7.

³⁴ Helminen, *EU Tax Law: Direct Taxation*, 66.

³⁵ Aloys, “Anti-Tax Avoidance Directive (2016 / 1164): New EU Policy Horizons,” 500.

³⁶ *Ibid.* 502.

³⁷ European Commission, “Proposal for a Council Directive Laying down Rules against Tax Avoidance Practices That Directly Affect the Functioning of the Internal Market,” 7–8.

ownership of the same taxpayer.³⁸ It is interesting that the initial proposal of the Directive did not contain such clear definition and raised doubts whether it was applicable in every case when the assets were transferred, or only in case a Member State has lost the right to tax of the transfers in question. This was one of the issues raised by the CFE, stating that it was not clear from the wording of the proposed Article 5, that it should only apply where the exit state loses its taxing right (e.g. where assets are transferred to a non-treaty partner state or to a country with which the credit method is agreed).³⁹ As it seems, the Commission and the Council re-drafted the proposal by considering the comment by the CFE and re-formulated Article 1(6) in a clear manner, so that it only covers the transfer of assets provided a Member State loses their taxing right.

There are three exclusions from the transfers that are covered by the exit taxation rule. The abovementioned provision does not apply in a scenario when the assets are set to revert to the Member State of the transferor within a period of 12 months. The exclusion covers the transfers regarding financing of securities, assets posted as collateral, where the asset transfer takes place to meet prudential capital requirements or for liquidity management purposes.⁴⁰ Article 5 (2) of the ATAD grants taxpayers the right to defer the payment of any exit tax by paying it in instalments over five years, in specific circumstances. The Commission explains in the proposal that the opportunity of payment deferral ensures the application of exit taxation within the EU in compliance with the Fundamental Freedoms and Case Law of the CJEU.⁴¹

1.3.3. GAAR

Article 6 of the ATAD provides that the GAAR is designed to prevent tax-avoidance arrangements, when the special anti-avoidance rules fail. The Commission explains that the political objective of the GAAR is to close any gap in respect of existing specific anti-abusive mechanisms in this area. The Abusive Tax Planning schemes develop rapidly and the appropriate tax legislation is unable to keep up with their pace. This is why the GAAR is a useful tool in taxation to capture tax-avoidance practices despite the absence of a specific anti-avoidance rule.⁴²

Article 6 states that a Member State “For the purposes of calculating the

³⁸ Council Directive (EU) 2016/1164 of 12 July 2016 laying down rules against tax avoidance practices that directly affect the functioning of the internal market (2016). OJ L 193/1. Article 1(6).

³⁹ CFE, “Opinion Statement on the European Commission's Proposal for an Anti-Tax Avoidance Directive,” 8.

⁴⁰ Helminen, *EU Tax Law: Direct Taxation*, 67.

⁴¹ European Commission, “Proposal for a Council Directive Laying down Rules against Tax Avoidance Practices That Directly Affect the Functioning of the Internal Market,” 7–8 The Compliance with fundamental freedoms and the fact that the Commission indicates to them will be discussed in further parts of the thesis.

⁴² *Ibid.* 9.

corporate tax liability, a Member State shall ignore an arrangement or a series of arrangements which, having been put into place for the main purpose or one of the main purposes of obtaining a tax advantage that defeats the object or purpose of the applicable tax law, are not genuine having regard to all relevant facts and circumstances”. Paragraph 2 of the article clarifies that the arrangements are regarded as non-genuine to the extent that they are not put into place for valid commercial reasons, which reflect economic reality. And finally, paragraph 3 defines the legal consequences when a Member State ignores the non-genuine arrangement by stating that it should calculate the tax liability in accordance with its national law.⁴³ Interestingly, the initial proposal of the Directive formulated the paragraph 3 of Article 6 in a different manner, so that the Member States were obliged to calculate the tax liability “by reference to economic substance in accordance with national law”. This reference was in the end removed, as several Member States raised objections due to the notion of “economic substance” that was unknown in their national law. Therefore, the final formulation of Article 6 refers to national law and allows for complete flexibility as part of the national transposition process.⁴⁴

More specifically, Article 6 introduces relatively new and extremely broad terms to establish the GAAR, such as “non-genuine”, “essential purpose”, “valid economic reasons”, “and economic reality”. This helps to cause uncertainty by giving the Member States much leeway to interpret and implement them differently. The Commission and the Council were criticised for not remaining consistent with the GAAR-related concepts, which had already been defined by the CJEU Case Law and instead proposed new concepts with a vague character that might create additional legal uncertainty in terms of practical implementation of the GAAR and its disproportionate application.⁴⁵

Considering the fact, that there is no EU-wide interpretation of the abovementioned notions, a risk from the Member States to construe them in an incoherent manner remains high. Moreover, due to the fact that these notions lack clarity, they might well be interpreted extensively and restrict the taxpayers’ rights more intensively than it is necessary. On the other hand, one might argue that all the terms of the Directive will be given an autonomous interpretation by the CJEU and the Court will ensure its proper and consistent interpretation throughout the Union. Moreover, the Commission recognises the role of the CJEU case law in the application and interpretation process of the GAAR. As it is stated in the proposal – the GAAR is designed to reflect the artificiality tests of the CJEU where this is applied within the Union.⁴⁶

⁴³ Council Directive (EU) 2016/1164 of 12 July 2016 laying down rules against tax avoidance practices that directly affect the functioning of the internal market (2016). OJ L 193/1. Article 6.

⁴⁴ Aloys, “Anti-Tax Avoidance Directive (2016 / 1164): New EU Policy Horizons,” 502–3.

⁴⁵ Oliver R Hoor and Keith O Donnell, “EU Commission Releases Draft Directive on BEPS : A Critical Analysis from a Luxembourg Perspective” 4, no. May (2016): 195; CFE, “Opinion Statement on the European Commission’s Proposal for an Anti-Tax Avoidance Directive,” 7–8.

⁴⁶ European Commission, “Proposal for a Council Directive Laying down Rules against

1.3.4. CFC Rule

The CFC Rules cause re-attribution of the income of a low-tax controlled Subsidiaries to their parent companies. The parent company is taxed for this attributed income in its state of residence. Articles 7 and 8 of the ATAD include compulsory CFC Rules⁴⁷ and thus resemble with BEPS Action Plan 3.⁴⁸

Article 7 lays down preconditions for the undertakings that have to be treated as CFCs and Article 8 establishes minimum requirement of the tax consequences of CFC.⁴⁹ The political objective of this measure is to tax undertakings resident in low-tax jurisdictions when controlled by EU resident taxpayers.⁵⁰

The Commission describes in its proposal the aggressive tax-planning scheme in which taxpayers shift large amounts of profits out of the (highly-taxed) parent companies towards Subsidiaries that are subject to low taxation. The CFC rules are designed to re-attribute the income and tax the parent company on this income in its state of residence. As a result, the CFC measure aims to eradicate the incentive of shifting income, so that the income is not taxed at a low rate in another jurisdiction.⁵¹

The CFC Rule was at the centre of the ATAD negotiations and prompted considerable technical, legal and political discussions. It was clear that the CFC rule was needed for political agreement on the Directive and for the implementation of OECD BEPS Action 3. The Final Report on Action 3 turns out, however, to be unclear in many respects, which presents huge problems for its proper implementation. Nonetheless, as it is discussed below, the final ATAD CFC Rule and the BEPS Action 3 are very much aligned. Considering the intensity of the political negotiations, the fact that the ATAD in the end does include the CFC Rule in this form is indeed a remarkable political success.⁵²

As it was stated above, Article 7 provides definition of the “controlled foreign company” – an entity established in the EU or elsewhere, and which (a) is controlled by a parent company established in a Member State and (b) is subject to an “actual” corporate tax rate that is lower than the one to which it

Tax Avoidance Practices That Directly Affect the Functioning of the Internal Market,” 9.

⁴⁷ Helminen, *EU Tax Law: Direct Taxation*, 69.

⁴⁸ OECD, *Designing Effective Controlled Foreign Company Rules, Action 3 - 2015 Final Report*.

⁴⁹ Helminen, *EU Tax Law: Direct Taxation*, 69.

⁵⁰ Aloys, “Anti-Tax Avoidance Directive (2016 / 1164): New EU Policy Horizons,” 503–4.

⁵¹ European Commission, “Proposal for a Council Directive Laying down Rules against Tax Avoidance Practices That Directly Affect the Functioning of the Internal Market,” 9.

⁵² Aloys, “Anti-Tax Avoidance Directive (2016 / 1164): New EU Policy Horizons,” 503–4.

would have been subject if it were established in the same jurisdiction.⁵³ In accordance with the OECD Recommendations on BEPS Action Plan 3,⁵⁴ this definition includes PEs as well. The ATAD requires both legal and economic control, but the *de facto* control is excluded. It does not take into account the scenario when the controlling company has an effective factual influence over the controlled company's business decisions without having majority of voting rights, capital or profits. The controlling company is the one that holds directly or indirectly more than 50% of either voting rights or the capital of the entity or in any case a participates in the company, which gives entitlement to receive more than 50% of its profits.⁵⁵

The Directive defines the CFC income in accordance with BEPS Action Plan 3.⁵⁶ Accordingly, the Member States are allowed to use two different methods: a "categorical" and a "substantive" approaches. The categorical approach provides a list of income based on a legal classification – interest, royalties and intellectual property income, dividends, income financial leasing, income from financial activities, sales and services income, which are, to use the words in BEPS Action Plan 3, "more likely to be geographically mobile and therefore are likely to raise the concerns that CFC rules are designed to address".⁵⁷ The second approach invokes a "substance" standard that computes the CFC income out of all the non-distributed profits "arising from non-genuine arrangements, which have been put in place for the essential purpose of obtaining a tax advantage".⁵⁸ Once the income is computed by any of the abovementioned approaches, they are then allocated to the parent company, in accordance with Article 8 in proportion to the participation in the controlled company and included in the tax return of the taxable year in which the end of the CFC's accounting period ends.⁵⁹

1.3.5. Hybrid Mismatches

Article 9 of the ATAD establishes an anti-avoidance measure to deal with the Hybrid Mismatches. The abovementioned measure mirrors the BEPS Action Plan 2⁶⁰ and is deemed to neutralise the negative effects of hybrid mismatch

⁵³ Council Directive (EU) 2016/1164 of 12 July 2016 laying down rules against tax avoidance practices that directly affect the functioning of the internal market (2016). OJ L 193/1. Article 7.

⁵⁴ OECD, *Designing Effective Controlled Foreign Company Rules, Action 3 - 2015 Final Report*, paras. 8–9.

⁵⁵ 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," 126.

⁵⁶ OECD, *Designing Effective Controlled Foreign Company Rules, Action 3 - 2015 Final Report*, paras. 74–86.

⁵⁷ *Ibid.* para. 78.

⁵⁸ 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," para. 127.

⁵⁹ *Ibid.* 129.

⁶⁰ OECD, *Neutralising the Effects of Hybrid Mismatch Arrangements, Action 2 - 2015*

arrangements, which happen to abuse differences between tax treatments of entities or instruments in two different tax jurisdictions to get either a deduction in both jurisdictions or a deduction in one jurisdiction without inclusion in the tax base of the other.⁶¹

As it was noted above, the Hybrid Mismatches are the result of differences in the configuration of payments on financial instruments or of entities under the tax systems of two states. Such Hybrid Mismatches may lead to a double deduction (i.e. deduction in the both states) or a deduction of the payment in one state without inclusion of the corresponding income base of the other. To neutralise the effects of Hybrid Mismatch arrangements, it is necessary to lay down the rules whereby one of the two jurisdictions in a mismatch situation should deny the deduction of a payment leading to such an outcome.⁶² The Hybrid Mismatches represent a type of tax-planning arrangement that always involves two different jurisdictions. It thus follows that, by nature, it needs a consistent approach by different states, and working on the EU level to mitigate the negative effects of the Hybrid Mismatches seems to be quite an appropriate option to ensure uniformity. E.G. The CFE welcomes the solution of this problem at this level and due to the fact that a Member State is not able to do that alone, calls it “an outstanding example” of a matter that has to be resolved in an EU context. That is also implied by the OECD recommendations.⁶³

According to the Article 2(9) of the ATAD, a “hybrid mismatch” is defined as a scenario between a taxpayer in one Member State and an associated enterprise in another Member State or a structured arrangement between parties in Member States, where the following outcome is attributable to differences in the legal characterisation of a financial instrument or entity:

- (a) A deduction of the same payment, expenses or losses occurs both in the Member State in which the payment has its source, the expenses are incurred or the losses are suffered and in another Member State (“double deduction”); or
- (b) There is a deduction of a payment in the Member State in which the payment has its source without corresponding inclusion for tax purposes of the same payment in the other Member State (“deduction without inclusion”).⁶⁴

It is noteworthy that the scope of the Hybrid Mismatches rule is narrower than the general scope of the ATAD itself. The Hybrid Mismatches rule applies only to “associated enterprises” or “structured arrangements between parties”, which qualify as residents for tax purposes in a Member State. The

Final Report.

⁶¹ Aloys, “Anti-Tax Avoidance Directive (2016 / 1164): New EU Policy Horizons,” 504.

⁶² Helminen, *EU Tax Law: Direct Taxation*, 72–73.

⁶³ CFE, “Opinion Statement on the European Commission's Proposal for an Anti-Tax Avoidance Directive,” 14.

⁶⁴ Council Directive (EU) 2016/1164 of 12 July 2016 laying down rules against tax avoidance practices that directly affect the functioning of the internal market (2016). OJ L 193/1. Article 2(9).

rule does not cover the PEs.⁶⁵ This exclusion was explained by the Commission in the preamble of the Directive by declaring that “it is critical that further work is undertaken on Hybrid Mismatches between Member States and third countries, as well as on other hybrid mismatches such as those involving permanent establishment”.⁶⁶ Accordingly, the Commission has already presented the proposal amendment to the ATAD to broaden the rule and cover the third-country Hybrid Mismatch arrangements as well.⁶⁷

The ATAD regulates the legal consequence of the Hybrid Mismatches as well. According to Article 9, to the extent that a Hybrid Mismatch results in a double deduction, the deduction shall be given only in the Member State where such payment has its source. Instead, to the extent that a Hybrid Mismatch results in the deduction without inclusion, the Member State of the payer shall deny the deduction of such payment. The Hybrid Mismatch rule adjusts the situations attributable to differences in the characterisation of a financial instrument or entity and is not supposed to affect the general characteristics of a tax system of the Member States.⁶⁸

2. Legal Nature of the ATAD

In this chapter the paper provides the discussion of the legal nature of the ATAD. In particular, the subsequent sub-chapters cover the important aspects regarding the chosen legal instrument and difficulties associated with its proper implementation.

2.1. Chosen legal Instrument

The Commission states in the proposal of the ATAD that unilateral and divergent implementation of BEPS Action Plan by each Member State could fragment the Single Market by creating national policy clashes, distortions and tax obstacles for businesses in the EU.⁶⁹ The relevant EU institutions have chosen to adopt the legal instrument in the form of a Directive to achieve their policy objectives while designing anti-tax avoidance package. It is interesting

⁶⁵ 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,” 132.

⁶⁶ Council Directive (EU) 2016/1164 of 12 July 2016 laying down rules against tax avoidance practices that directly affect the functioning of the internal market (2016). OJ L 193/1. Preamble.

⁶⁷ Tomas Balco, “ATAD 2 : Anti-Tax Avoidance Directive,” *European Taxation* 1, no. April (2017): 127–36; Council, Proposal for a COUNCIL DIRECTIVE ANNEX amending Directive (EU) 2016/1164 as regards hybrid mismatches with third countries.

⁶⁸ Helminen, *EU Tax Law: Direct Taxation*, 73.

⁶⁹ European Commission, “Proposal for a Council Directive Laying down Rules against Tax Avoidance Practices That Directly Affect the Functioning of the Internal Market,” 3.

to overview the existing instruments that EU institutions are empowered to pass on and assess whether they acted in the Union's best interest when decided to legislate in the form of a Directive.

The Commission and the Council had to pick from a great variety of legal instruments. The first option was to ensure the proper implementation of BEPS Action Plans through the non-binding, "soft law" documents. Namely, the instrument of a peer review, which implies monitoring of implementation introduced by the OECD in certain BEPS Action Plan documents.⁷⁰ In this model each Member State has in principle an equal say and there are no modifications in proportion of population in any Member State. Moreover, the peer-review procedure falls outside the scope of the CJEU. Some scholars argue, the absence of possibility to challenge a peer review could have saved the implementation process from needless legal proceedings.⁷¹ In contrast, it has to be said the fact that the CJEU would not have the jurisdiction over the peer-review process as such, does not necessarily mean that the whole implementation procedure could have been left outside the scope of EU Law. Every implementation measure would potentially come under the scrutiny of EU law and respectively the CJEU would have the jurisdiction. On the other hand, any attempt of the Member States to leave a subject matter, as important as the implementation of BEPS Action Plan, outside the judicial review of the CJEU ought to be condemned, because it leaves the taxpayers without legal remedy under EU law and thus endangers protection of their Fundamental Freedoms.

Apart from non-binding "soft law" options, the Council and the Commission had another option of proceeding with "hard law" instruments. Article 288 TFEU provides following: "to exercise the Union's competences, the institutions shall adopt regulations, directives, decisions, recommendations and opinions". The recommendations and opinions do not have the binding force and the decision is not suitable either due to its normative constraint to only bind those to whom it is addressed.⁷² Implementation of BEPS Action Plans and introduction of respective anti-abusive measures require normative, legislative instrument. Thus, only Directives and Regulations appear to have proper legal nature that allow for the introduction of EU-wide anti-tax avoidance measures.

Pursuant to the Treaties, direct taxation issues can be addressed via Directive

⁷⁰ OECD, "Explanatory Statement 2015 Final Reports," 10–11.

⁷¹ Arnaud De Graaf and Klaas-jan Visser, "ATA Directive: Some Observations Regarding Formal Aspects," *EC Tax Review* 97 (2016): 201.

⁷² Consolidated version of the Treaty on the Functioning of the European Union OJ C 326. Article 288.

based on Article 115 TFEU⁷³ and via Regulation based on Article 352 TFEU. Article 115 TFEU empowers the Council to legislate in the form of a Directive for approximation of domestic laws, regulations and administrative provisions of the Member States in the field that directly affect the establishment or functioning of the Single Market. And paragraph 1 of Article 352 TFEU provides that the Council acting unanimously on a proposal from the Commission and upon the consent of the European Parliament shall adopt the appropriate measures if action by the EU is proved to be necessary within the framework of the policies defined in the Treaties.⁷⁴

Notably, the legal nature of a Directive and a Regulation differ. A regulation is binding in its entirety and directly applicable in all EU Member States, to all EU residents and public institutions or bodies who are in the personal scope of the Regulation.⁷⁵ Since a Regulation is grounded on the TFEU thanks to the principle of Supremacy of EU Law, it has a stronger footing than domestic legislation and thus, in a sense, happens to override domestic legislation and treaties entered into by a Member State.⁷⁶ The direct application of a Regulation means that its entry into force and application in favour of those subject to it are independent of any measure of reception into national law. By virtue of the obligations arising from the international treaty and assumed on ratification, the Member States are under a duty not to obstruct the direct applicability of Regulations and other rules of the Community Law.⁷⁷

In contrast, a Directive has a relatively different binding force and direct effect. Generally, it is only binding upon the EU Member States, which are free in choosing the form and methods for implementing the Directive. There are some areas where it is difficult to devise regulations with the required specificity, which are suited to have an immediate impact on the Member States, more especially because the Member States have differing legal systems, and variations in the political, administrative and social arrangements exist among the Member States.⁷⁸ The Directive, unlike to the regulation, gives freedom to the Member States to choose specific options and decide how the objective of the Directive is to be achieved. Also, public institutions are not able to directly apply the Directive against private persons – taxpayers in the case of the ATAD. Moreover, the provisions of a Directive are implemented by Domestic legal instruments. The implementation measures are of a lower ranking than provisions of any international treaties to which a Member State is party to and the Supremacy of EU Law does not cover this situation.⁷⁹ The possibility of judicial review and the legality check,

⁷³ This mechanism was used in case of ATAD

⁷⁴ Ibid. Article 352.

⁷⁵ Paul Craig and Grainne De Burca, *EU Law: Text, Cases and Materials*, Sixth Edit (Oxford: Oxford University Press, 2015), 107.

⁷⁶ Graaf and Visser, “ATA Directive: Some Observations Regarding Formal Aspects,” 201.

⁷⁷ Case C 34/73 Variola v. Amministrazione delle Finanze (1973) ECLI:EU:C:1973:101, para. 10.

⁷⁸ Craig and Burca, *EU Law: Text, Cases and Materials*, 108.

⁷⁹ Graaf and Visser, “ATA Directive: Some Observations Regarding Formal Aspects,” 201–2.

i.e. compatibility of the directives with Primary EU Law is discussed in the subsequent parts of this paper.

By the literal interpretation of Article 288 TFEU one might conclude that EU cannot legislate over the direct taxation via Directives or Regulations, because the Article mention “exercise of Union Competences”, while the direct taxation is within the competences of the Member States, not the EU. Such an interpretation of Article 288 is shared by the doctrine elaborated by E.G. Graaf and Visser, who are of the opinion that issuing a Regulation or a directive over the direct taxation seems not possible at first sight, since an EU Regulation can only be issued for matters where the EU has exclusive competence or legislates extensively. Yet, the same authors indicate to Article 352 TFEU that allows to adopt appropriate measures to attain one of the objectives set out in the Treaties even when the Treaties have not provided for the necessary powers.⁸⁰

Interestingly, the Commission believes that the legal basis for issuing ATAD is given in Article 115 TFEU, as it is referred to in the proposal.⁸¹ After systematic interpretation of Articles 115 and 352 TFEU it can be concluded that there is a possibility to rely on them both to read the competence of the EU to issue a legislative act on the direct taxation and introduce different measures to tackle abusive practices. On the other hand, such legal basis would fit both a Directive and a Regulation as well, because Article 352 does not specify the type of an appropriate measure and the Article 115 TFEU covers all legal acts, including Directives and Regulations. As it is expressed by scholars - that even though no explicit power is vested at the EU level, this article nevertheless provides a legal basis for issuing a Regulation as well.⁸² As it seems the Commission does not agree with this logic of interpretation and indicates that “the proposal is for a Directive, which is the only available instrument under the legal base of Article 115 TFEU”.⁸³ Unfortunately, there is no public information nor further argumentation why the Commission believes so, or why, in the same vein, it was not possible from legal point of view to use the same legal base for the adoption of a Regulation. Article 296 TFEU states that where the Treaties do not specify the type of act to be adopted, the institution shall select it on a case-by-case basis, in compliance with the applicable procedures and with the principle of Proportionality.⁸⁴ Thus, there is a possibility the EU institutions decided to legislate via the Directive, because it was considered as a proportional method, whereas the Regulation, in general, represents more intensive interference. Issues of Proportionality and Subsidiarity will be discussed in detail in further chapters while analysing compatibility with Primary EU Law.

⁸⁰ Ibid. 202. They make a reference to Article 288 TFEU

⁸¹ European Commission, “Proposal for a Council Directive Laying down Rules against Tax Avoidance Practices That Directly Affect the Functioning of the Internal Market,” 6.

⁸² Graaf and Visser, “ATA Directive: Some Observations Regarding Formal Aspects,” 202.

⁸³ European Commission, “Proposal for a Council Directive Laying down Rules against Tax Avoidance Practices That Directly Affect the Functioning of the Internal Market,” 5.

⁸⁴ Craig and Burca, *EU Law: Text, Cases and Materials*, 106.

By choosing the form of a Directive over a Regulation the Council and the Commission might endanger consistent and effective implementation of the BEPS project. As it was discussed above, the Directive leaves more margin of appreciation to the Member States and thus, creates the possibility for its implementation in different forms and methods at the national level. If the Member States apply the discretion in different manner, it is likely to cause inconsistent implementation of the BEPS Action Plan and might translate into problems for the Single Market, because the inconsistent application of Anti-avoidance measures normally results in asymmetric allocations of taxes and creates further loopholes. The legal act in this form might hazard the effectiveness of anti-avoidance measures if not appropriately implemented by the Member States, since the Directive is not capable to be relied on against taxpayers, and the Tax Agencies will be unable to give it direct effect.⁸⁵

On the other hand, one might put political arguments against the issuance of a Regulation too. As it was stated above, the direct taxation is at the core of the Member States' sovereignty and EU legislation over this issue bears very sensitive political burden. Thus, reaching the political agreement to issue a Regulation which, by definition, leaves no space for the Member States to make necessary adjustments, would have been much more difficult than agreeing on the adoption of a Directive, which enables wider margin of appreciation.

2.2. Implementation

The following sub-chapters will discuss the subject matters related to the implementation of the ATAD, including transposition deadlines, *De Minimis* character and other existent complications.

2.2.1. Deadlines

Article 11 of the ATAD regulates the transposition process of the Directive. According to the Article 11(1), the Member States shall adopt and publish the necessary laws, regulations and administrative provisions by 31 December 2018, and the application deadline for those provisions is 1 January 2019 respectively.⁸⁶

2.2.2. De Minimis nature

Article 3 of the ATAD establishes the *De Minimis* nature of the Directive and provides that the Directive shall not preclude the application of domestic or

⁸⁵ Graaf and Visser, "ATA Directive: Some Observations Regarding Formal Aspects," 202.

⁸⁶ Council Directive (EU) 2016/1164 of 12 July 2016 laying down rules against tax avoidance practices that directly affect the functioning of the internal market (2016). OJ L 193/1. Article 11

agreement-based provisions aimed at safeguarding a higher level of protection for domestic corporate tax bases. This means that the Directive just sets the minimum level of the tax base protection and the Member States are free to introduce higher standards of protection. It makes the ATAD an exceptional legal instrument and the most controversial, at the same time.

The discretionary authority of the Member States to introduce the higher level of protection raises various issues regarding effectiveness and clarity of the ATAD. First, such higher level of protection seems to fall out of scope and as a *prima facie* restriction needs to be tested against the fundamental freedoms and other EU Law provisions as any regular domestic income tax provision. Next, if the term introduced by the domestic legislation is based on the Directive, but the level of protection is higher, than the ATAD requires, the question arises whether the court has a final say over the scope of the terminology.⁸⁷ It is difficult in this scenario to determine which part of legislation was intended to implement the EU Law, thus, its application and interpretation issues go to the jurisdiction of the CJEU, and, on the other hand, which part of legislation is purely domestic law – about which the National Courts have exclusive jurisdiction. Notably, the CJEU already has the case law that might be useful to solve this dilemma. According to the Court's settled case-law, where, in regulating purely internal situations, domestic legislation adopts the same solutions as those adopted in EU law for the purpose, in particular, of avoiding discrimination against nationals of a Member State in question or any distortion of competition, it is clearly in the European Union's interest that, in order to forestall future differences of interpretation, provisions or concepts taken from the EU law to be interpreted uniformly, irrespective of the circumstances in which they are to apply.⁸⁸ Thus, according to the established case law of CJEU in the scenario, in case the domestic legislation applies the terminology of the ATAD but provides the higher level of protection, the CJEU will eventually have the authority to give a final interpretation.

The CFE has also expressed concerns about the *De Minimis* character of the Directive. According to its opinion, the *De Minimis* nature of the ATAD will impede the consistent and coordinated implementation of the anti-tax avoidance measures throughout the EU. Therefore, the proposal should not have only included *De Minimis* but also *De Maximis* standards. Otherwise, achievement of the purpose of the Directive will be endangered. The CFE believes that the minimum requirement standard is problematic with regard to specific anti-avoidance measures as well. This bears the risk of creating up to 28 different GAARs, causing legal uncertainty for the undertakings.⁸⁹ On the other hand, one might argue against the arguments put by the CFE. Namely, the ATAD is a mechanism of positive integration. Furthermore, the negative integration via interference of the CJEU may in fact be considered as an effective mechanism. The case law of the Court ensures that the

⁸⁷ Graaf and Visser, "ATA Directive: Some Observations Regarding Formal Aspects," 206.

⁸⁸ Case C-126/10 Foggia – SGPS (2011) ECLI:EU:C:2011:718, para. 21.

⁸⁹ CFE, "Opinion Statement on the European Commission's Proposal for an Anti-Tax Avoidance Directive."

domestic anti-tax avoidance measures are not disproportionate. Thus, if the Member States set stricter anti-avoidance rules, they will be potentially scrutinised by the CJEU and may be considered disproportionate.⁹⁰ It can therefore be asserted that the *De Maximis* standard is already established and the Commission and the Council proposed the Directive to ensure protection of only *De Minimis* requirements.

2.2.3. Possible clash with domestic constitutional law

Usually the collision with any national law provision, even if the law is of a constitutional status, is not considered as a problem for implementation and transposition of EU directives. The Supremacy of EU law is a longstanding General Principle of EU Law and is well developed through the case law of the CJEU. According to the Court, the validity of EU law can never be assessed by referring to the national law provision. The national Courts are required to give immediate effect to EU law of whatever rank during adjudication and ignore or set aside any national law, of whatever rank, which could impede the application of EU law. Thus, any norm of EU law takes precedence over any provision of national law, including the national constitutions.⁹¹ This General Principle originates from the landmark judgment on the case of *Costa v. Enel*, which underlines the importance of the Supremacy of EU Law and declares that:

“The law stemming from the Treaty, an independent source of law, could not, because of its special and original nature, be overridden by domestic legal provisions, however framed, without being deprived of its character as Community law and without the legal basis of the Community itself being called into question”.⁹²

However, it has taken some time for the national courts to “digest” the principle of Supremacy of EU law and override their own national constitutions. Most of the national courts do not accept the CJEU’s view on the Supremacy of EU law. While they accept the prerequisites of this principle in practice, in most regard, this is interpreted as flowing from their national constitutions, rather than from the authority of the EU treaties or the case law of the CJEU, and they potentially retain a power of ultimate constitutional review over the measures of EU law.⁹³

For example, the Federal Constitutional Court of Germany, which acts as the ultimate judicial body in Germany, has found unconstitutional the German domestic legislation that was enacted to transpose the EU Directive 2006/24/EC about data retention. The Constitutional Court did not assess the constitutionality of the Directive itself but declared unconstitutional its

⁹⁰ Dourado, “The EU Anti-Tax Avoidance Package : Moving Ahead of BEPS,” 442.

⁹¹ Craig and Burca, *EU Law: Text, Cases and Materials*, 266.

⁹² Case 6/64 Flaminio Costa v Enel (1964) ECLI:EU:C:1964:66.

⁹³ Craig and Burca, *EU Law: Text, Cases and Materials*, 266.

implementation into domestic provisions in a way that it was almost impossible for the national legislators to implement the Directive properly after the judgment.⁹⁴ It is believed that the Judgment was an attempt to show the red lines to the EU institutions. Because, it is easy to read from the judgment that if the EU legislation creates such data retention system, it would most probably be declared unconstitutional by the Federal Constitutional Court.⁹⁵ It is noteworthy that later the CJEU followed the line of argumentation of the German Constitutional Court and annulled the data retention Directive itself.⁹⁶

The EU institutions have number of political and legal instruments to ensure effective implementation of EU Law, in case any national court refers to national law as a basis to go against the directive, The EU is empowered to trigger the infringement procedure. But this, in reality, causes the delay and impediment of consistent implementation of the Directive and endangers achievement of its objectives. Therefore, it is important to overview the potential clashes with domestic law and see if it can be considered as the barrier to the implementation of the ATAD. It is worth to note that the CFE deems the potential collision with the domestic constitutional law as a problem of the ATAD. According to the opinion of the CFE, legal untenability of the ATAD is not merely a theoretical risk, it is important to test its compatibility with the EU law and other *high ranking*⁹⁷ Law. The FCE refers to the German Federal Finance Court's decision to refer the case to the Federal Constitutional Court, because it is of the opinion that the German interest limitation rule (Zinsschranke)⁹⁸ is unconstitutional.⁹⁹

The Federal Financial Court of Germany stated in its decision on 14 October 2015 that the German interest limitation rule was probably unconstitutional. The Court found the national provision limiting the right to deduct several expenses in fact an infringement of the ability-to-pay principle guaranteed under Article 3 of the German Basic Law. Therefore, the Federal Financial Court referred the case to the Federal Constitutional Court to pass on the constitutionality of the law in question.¹⁰⁰ The latter Court has yet to issue a final decision on that case.

The German tax law regulation on the interest limitation rule is substantively similar to the one provided by the ATAD. There are some technical

⁹⁴ Hendrik Wieduwilt, "The German Constitutional Court Puts the Data Retention Directive on Hold," *German Yearbook of International Law* 53 (2010), doi:10.1525/sp.2007.54.1.23.

⁹⁵ Anna-Bettina Kaiser, "German Federal Constitutional Court: German Data Retention Provisions Unconstitutional in Their Present Form; Decision of 2 March 2010, NJW 2010, P. 833." *European Constitutional Law Review* 6, no. 3 (2010): 503–17, doi:10.1017/S1574019610300083.

⁹⁶ Joined cases C-293/12 Digital Rights Ireland and C-594/12 Seitlinger (2014) ECLI:EU:C:2014:238.

⁹⁷ Emphasis is added by the Author.

⁹⁸ That is similar to the one provided by the Article 4 of the ATAD.

⁹⁹ CFE, "Opinion Statement on the European Commission's Proposal for an Anti-Tax Avoidance Directive," 4.

¹⁰⁰ Daniel Gutmann et al., "The Impact of the ATAD on Domestic Systems : A Comparative Survey," *European Taxation* 115, no. January (2017): 4–5.

differences, including the wording of terminology and the amount of the limit of deductible interest, but these differences, however, do not detract from the fact that the fundamental concept behind and the structure of article 4 of the Directive strongly resemble with the current German rules. Therefore, the concerns of constitutionality expressed by the Federal Fiscal Court regarding the interest barrier rule also gains relevance in respect of the Directive.¹⁰¹

The case that was referred to the Federal Constitutional Court was lodged by a corporate entity, which was refused to use its interest expense as a business expense and make deduction, because of the interest limitation rule in accordance with the German tax legislation. The undertaking was unable to carry forward the loss as well due to its corporate restructuring. The applicant challenged the constitutionality of the interest barrier rule. The Federal Fiscal Court sided with the applicant and accepted the possibility that the rule might be deemed unconstitutional in relation with Article 3 of the Basic Law.¹⁰² Thus, the case was referred to the Federal Constitutional Court for constitutional review.

Article 3 of the German Basic Law guarantees the right to equality before the law.¹⁰³ This constitutional provision gives rise to the principle of the Tax Law – ability-to-pay principle.¹⁰⁴ In general, taxation is the area, where the legislative body enjoys the wide margin of appreciation. However, the legislator is bound by the principle of equality and is required to treat similarly the substantively equal subjects and vice versa – treat differently those who are substantially non-equal. This equal protection clause is duly converted into the ability-to-pay principle in tax law. Accordingly, the tax system should be construed in a manner that takes into account the ability-to-pay principle and is consistent with the principle of equality, which requires taxpayers whose ability to pay is the same, also be taxed at the same rates.¹⁰⁵

In terms of income tax law, the German legislation has introduced the system of financial ability-to-pay based on the “objective net principle”. This principle requires the calculation of the taxpayer’s income via tax assessment, where business expenses are not taken into account.¹⁰⁶ If the legislation introduces the exception from this principle – i.e. prescribes the cases when taxpayer’s income is calculated without including business expenses, it departs from the objective net principle and thus, interferes into equal protection principle, because it would constitute an unequal treatment towards

¹⁰¹ Steffen Lampert, Till Meickmann, and Maria Reinert, “Article 4 of the EU Anti-Tax Avoidance Directive in Light of the Questionable Constitutionality of the German ‘Interest Barrier’ Rule,” *European Taxation*, 2016, 324.

¹⁰² *Ibid.* 325.

¹⁰³ “Basic Law for the Federal Republic of Germany,” accessed May 17, 2017, https://www.gesetze-im-internet.de/englisch_gg/englisch_gg.pdf. Article 3.

¹⁰⁴ Aitor Navarro, Leopoldo Parada, and Paloma Schwarz, “The Proposal for an EU Anti-Avoidance Directive: Some Preliminary Thoughts,” *EC Tax Review* 3 (2016): 119.

¹⁰⁵ Lampert, Meickmann, and Reinert, “Article 4 of the EU Anti-Tax Avoidance Directive in Light of the Questionable Constitutionality of the German ‘Interest Barrier’ Rule,” 325.

¹⁰⁶ *Ibid.*

the subjects which are not able include their business expenses.

According to the Interest Limitation Rule, the deduction of business expenses for borrowing costs is restricted at the level of the borrower's entity. Also, there are some cases when it is not possible to carry-forward the costs and somehow diminish the tax burden.¹⁰⁷ The Federal Fiscal Court believes this is a derogation from the legislator's systematic approach to apply the objective net principle, it thus interferes into equal protection right and is in need of justification. The Federal Fiscal Court scrutinised the possible objectives of the interest limitation rule. In particular, the following objectives were identified: control of economic policy, the state's financing needs and prevention of the abusive arrangements. However, the Federal Fiscal Court is of the opinion that these aims are not capable to justify the derogation from the objective net principle and hence the interest limitation rule is unconstitutional¹⁰⁸

Some scholars argue that because the Directive resembles the German legislation in terms of Interest Barrier Rule, which the Federal Fiscal Court has classified as unconstitutional, the judgment of the Federal German Constitutional Court will attract interest throughout Europe and it may well influence shaping of the future implementation of the Directive. "Ironically, it can be assumed that the Constitutional Court will not test national implementation of the EU directive against the constitution".¹⁰⁹ In this regard one might not agree with the last conclusion, because the Data Retention case clearly shows that the Federal Constitutional Court of Germany is not "afraid" to test the constitutionality of national legislation that is deemed to implement EU Directives. Accordingly, if the Federal Constitutional Court of Germany decides to declare national interest barrier rule unconstitutional, it is likely to pose a serious challenge for the effective implementation of the ATAD, considering the legal and institutional authority of the Federal Constitutional Court both in Germany and beyond. It thus follows that it would have been wiser if the Commission and the Council were to follow the CFE's recommendation and test the ATAD against constitutional requirements of the Member States.

¹⁰⁷ For example, in case of restructuring of the entity

¹⁰⁸ Ibid. 325–26.

¹⁰⁹ Ibid. 327.

3. EU's Competence to adopt the ATAD

The following sub-chapters will provide a general overview of the EU Competences, requirements of the EU Primary Law with respect to competences and assess the ATAD in light of these requirements.

3.1. General Overview

The Treaties empower the EU institutions with law-making powers, which they may exercise on the basis of predefined legal provisions laid down therein. In this way, secondary law has to find its origin in the Treaties. The Treaties fulfil the function of a validating norm, from which various manifestations of secondary law derive their own validity.¹¹⁰ Articles 263 and 267 TFEU establish the CJEU as a guardian of the legality of EU legislative acts. Those articles prescribe the legal remedies for taxpayers and the Member States to challenge the compatibility of the EU legal acts via the mechanism of national courts and Preliminary Reference procedure (Article 267) or via Direct Action (Article 263). The paper has refrained from addressing the legal remedies or possible legal consequences in case the Member States or taxpayers challenge the compatibility of the ATAD. There are four grounds of legality review prescribed in the abovementioned articles: lack of competence; infringement of an essential procedural requirement; infringement of the Treaty or any rule of law relating to its application; and misuse of power. Considering the content and specificity of the ATAD discussed above, this paper is only focused on the following aspect of legality of the Directive in question: whether the EU institutions acted within their competence to legislate over the subject matter via this legal instrument.

There are several types of the EU powers, which accordingly reflect in different legal consequences depending on the type of each competence. Article 2(1) TFEU stipulates the categories of exclusive competences of the EU, which means that only the EU can legislate in this spheres. Article 2(2) TFEU defines shared competences in the following manner:

“When the Treaties confer on the Union a competence shared with the Member States in a specific area, the Union and the Member States may legislate and adopt legally binding acts in that area. The Member States shall exercise their competence to the extent that the Union has not exercised its competence. The Member States shall again exercise their competence to the extent that the Union has decided to cease exercising its competence”.

¹¹⁰ Rita Szudoczky, “The Sources of EU Law and Their Relationships: Lessons for the Field of Taxation” (University of Amsterdam (UvA), 2013), 56–57, https://pure.uva.nl/ws/files/1701555/129841_thesis.pdf.

The areas that fall within shared competences are enumerated in Article 4 TFEU. As it was stated above, Article 2(2) TFEU provides that a Member State is entitled to exercise the shared competence only to the extent that the Union has not exercised or has decided to cease to exercise its competence within any such area. Accordingly, the Member State's action is pre-empted where the EU exercised its competence.¹¹¹

Pursuant to Article 5(3) TEU: “under the principle of Subsidiarity, in areas which do not fall within its exclusive competence, the Union shall act only if and in so far as the objectives of the proposed action cannot be sufficiently achieved by the Member States, either at central level or at regional and local level, but can rather by reason of the scale or effects of the proposed action, be better achieved at Union level”. And, respectively article 5(4) establishes that EU action should be performed in accordance with principle of Proportionality and should not exceed “what is necessary to achieve the objectives of the treaties”.

Importantly, the Commission has indicated to Article 115 TFEU in the proposal of the ATAD as a legal basis of the EU competence.¹¹² Article 115 TFEU, stipulates that the Council, acting unanimously in accordance with a special legislative procedure and after consulting the European Parliament and the Economic and Social Committee, shall issue directives for the approximation of the laws, regulations or administrative provisions of the Member States which directly affect the “establishment or functioning of the internal market”. The issuance of a Directive regarding approximation of the laws, regulations or administrative provisions of the Member States, as they affect the establishment or functioning of the internal market, is not the EU's exclusive competence established by Article 3(1) of the TFEU. Therefore, the ATAD ought to be in compliance with the requirements of the principles of Subsidiarity and Proportionality. The paper will discuss the compatibility issues with the abovementioned principles in the following sub-chapters.

3.2. Principle of Subsidiarity

The Subsidiarity embraces the following idea – if there are no good reasons for a political subject matter to be shifted up to the EU level, it should be left to the Member States to decide on. Thus, shifting the decision-making upwards requires justification beyond the claim that the overall result is attractive as a matter of substantive policy. In particular, the Subsidiarity requires to answer the question – why the substantive policy choice has to be made on the higher EU level, rather than on the lower level of the Member States. It thus somehow establishes a default presumption in favour of the lower level.¹¹³

¹¹¹ Craig and Burca, *EU Law: Text, Cases and Materials*, 84.

¹¹² European Commission, “Proposal for a Council Directive Laying down Rules against Tax Avoidance Practices That Directly Affect the Functioning of the Internal Market,” 4.

¹¹³ Mattias Kumm, “Constitutionalising Subsidiarity in Integrated Markets: The Case of

3.2.1. Standards

The Primary EU Law consists of procedural requirements to ensure the protection of Subsidiarity and Proportionality of EU's actions. The TFEU contains the Protocol (No 2) on the application of the principles of Subsidiarity and Proportionality. According to the Article 1 of the Protocol – Each institution is obliged to respect principles of Subsidiarity and Proportionality laid down in Article 5 TEU.¹¹⁴ Article 5 of the Protocol establishes that the draft legislative acts should be justified with regard to the principles of Subsidiarity and Proportionality and should contain a detailed statement enabling the appraisal of the compliance with the principles of Subsidiarity and Proportionality.¹¹⁵ Respectively, Article 4 provides that the Commission, the European Parliament and the Council should forward the draft legislative acts to national Parliaments.¹¹⁶ The national parliaments have the opportunity to object to the draft and send a reasoned opinion stating why they consider the proposed draft infringes the principles of Subsidiarity and Proportionality.¹¹⁷ Article 7 sets out the procedure to review the draft legislative act by the Commission in case of reasoned opinions by the particular number of national parliaments.¹¹⁸ And the Article 8 declares that the CJEU has jurisdiction in actions on grounds of infringement of the principle of Subsidiarity by a legislative act brought in accordance with the rules laid down in Article 263 TFEU, by Member States, or notified by them in accordance with their legal order on behalf of their national parliament.¹¹⁹

Along with the procedural requirements, it is important to discuss the standards of the judicial review of the legislative acts on the ground of Subsidiarity, and the intensity of such review. The case law of the CJEU indicates that the Court seems reluctant to annul the EU actions for infringement of Subsidiarity very often.¹²⁰ In Case of Germany v. the European Parliament and the Council, the CJEU provided the interpretation of the duty to give reasons for Subsidiarity and Proportionality. The Court held that the obligation does not entail the duty to give reasons explicitly and “an express reference to that principle cannot be required”. It is sufficient that the recitals make it clear why the EU Institutions believe the aims of a measure in question could be best attained by the EU Action.¹²¹

The Court established the similar light test for the substantive review of Subsidiarity in the Case of United Kingdom v. Council. The case was about

Tobacco Regulation in the European Union,” *European Law Journal* 12, no. 4 (2006): 519, doi:10.1111/j.1468-0386.2006.00330.x.

¹¹⁴ Treaty on the Functioning of the European Union - Protocol (No 2) on the application of the Principle of Subsidiarity and Proportionality (2008). OJ C 326. Article 1.

¹¹⁵ Ibid. Article 5.

¹¹⁶ Ibid. Article 4.

¹¹⁷ Ibid. Article 6.

¹¹⁸ Ibid. Article 7.

¹¹⁹ Ibid. Article 8.

¹²⁰ Craig and Burca, *EU Law: Text, Cases and Materials*, 100.

¹²¹ Case C-233/94 Germany v European Parliament and Council (1997) ECLI:EU:C:1997:231, paras. 26-28.

the legality of the Council Directive 93/104/EC of 23 November 1993 concerning certain aspects of the organisation of working time. The UK argued that the Directive was against the Subsidiarity principle, because it was not clear how the Community action would provide clear benefits compared to the national measures. The Court did not agree with this argumentation and held that since the Council had the responsibility to adopt minimum requirements to contribute to health and safety, and it found it necessary to improve the existing level of protection and to harmonise the law in this area, this necessarily presupposed community wide-action.¹²²

The Subsidiarity principle was also relevant in the Case of Vodafone and Others where the different mobile telephone companies challenged the legality of Regulation (EC) No 717/2007 – about roaming on public mobile telephone networks within the Community, which caps the wholesale and retail charges that terrestrial mobile operators may charge for the provision of roaming services on public mobile networks for voice calls between the Member States. The applicants challenged the legality of regulation *inter alia* on the ground of Subsidiarity.¹²³

The Court stated that the Regulation seeking to maintain competition among mobile telephone network operators, introduced a common approach to contribute to the smooth functioning of the internal market, allowing those operators to act within a single coherent regulatory framework. Interdependence of retail and wholesale charges for roaming services is considerable, so that any measure seeking to reduce retail charges alone without affecting the level of costs for the wholesale supply of [Union]-wide roaming services would have been liable to disrupt the smooth functioning of the [Union]-wide roaming market. For that reason, the [Union] legislature decided that any action would require a joint approach at the level of both wholesale charges and retail charges, to contribute to the smooth functioning of the internal market in those services. That interdependence entails that the [Union] legislature could legitimately take the view that it had to intervene at the level of retail charges as well. Thus, the Subsidiarity principle is not infringed.¹²⁴ As it seems from the Court's line of argumentation, it did not discuss the Subsidiarity and whether the objective pursued by the Regulation in question would be achieved at national level in details; the Court has just given a reference to the recitals of the Regulation and followed with brief explanation thereof.

The judicial review of Subsidiarity of EU actions, especially through substantive grounds, proves to be extremely difficult for the Court. If the CJEU does not change its line of judicial self-restraint and continues to conduct rather a light check, it is likely to be subject of criticism for making the obligation enshrined in Article 5(3) (4) TEU illusory. On the other hand, if the Court employs the stricter judicial review standards, it will have to

¹²² Case C-84/94 United Kingdom v Council (1996) ECLI:EU:C: 1996:431, paras. 46-47, 55.

¹²³ Case C-58/08 Vodafone and Others (2010) ECLI:EU:C:2010:321, para. 29.

¹²⁴ *Ibid.* Paras. 72-80.

adjudicate on a very complex socio-economic calculus concerning the most effective level of government for different regulatory tasks.¹²⁵ Adjudication on such issues always poses a challenge for the judicial organs, such as the CJEU, since the Courts are not deemed to rule on such complex subject matters of socio-political significance, which are normally seen to be an inherent part of positive policymaking.

3.2.2. Application on the ATAD

The Subsidiarity of the ATAD had been challenged by the moment when the Commission presented the proposal. Even though the ATAD has extremely important socio-economic objectives, it was not automatically accepted by the Member States. The debate involved the national parliaments as well. The ATAD proposal was sent to all national parliaments of the Member States, pursuant to the legislative procedure already discussed earlier. Four parliaments (the Czech Senate, the German Bundesrat, the Portuguese Assembleia de Republica and the Romanian Chamber of Deputies) engaged in a political dialogue with the Commission¹²⁶ and two Parliaments (The Maltese House of Representatives¹²⁷ and the Swedish Parliament¹²⁸) objected to the legislative proposal with reasoned opinions as they had concerns that the proposal infringed the principle of Subsidiarity.¹²⁹

The Swedish Parliament in general praised the objectives of the ATAD proposal in its reasoned opinion. At the same time, it emphasised the importance of taxation sovereignty for the Member States in the case of direct taxation, since it belongs to the national competence of each Member State to safeguard welfare by levying and using tax revenues in an appropriate way. The Swedish parliament further noted that the proposal was produced within a very short period and was burdened with a distinct lack of clarity. This leaves the Member States unable to determine whether the objective of the proposed measures can be achieved at the national level. Bearing this in mind, the Swedish Parliament considered that the Commission does not provide sufficient justification to support the fact that the proposal does not exceed what is necessary to attain the set objectives and thus it ran afoul of the principle of Subsidiarity.¹³⁰ The Swedish Parliament mainly raised the issue of Subsidiarity on the procedural grounds, because the Commission failed to explain the necessity and did not provide any substantial arguments.

The Maltese House of Representatives provided a more detailed reasoned

¹²⁵ Craig and Burca, *EU Law: Text, Cases and Materials*, 100.

¹²⁶ “COM/2016/0026 - Document Details Page,” accessed May 18, 2017, <http://www.ipex.eu/IPEXL-WEB/dossier/document/COM20160026.do#dossier-CNS20160011>.

¹²⁷ “CNS/2016/0011 - Maltese House of Representatives,” accessed May 18, 2017, <http://www.ipex.eu/IPEXL-WEB/scrutiny/CNS20160011/mtkam.do>.

¹²⁸ “CNS/2016/0011 - Swedish Parliament,” accessed May 18, 2017, <http://www.ipex.eu/IPEXL-WEB/scrutiny/CNS20160011/serik.do>.

¹²⁹ Anzhela Cédelle, “The EU Anti-Tax Avoidance Directive : A UK Perspective,” *British Tax Review*, 2016, 492.

¹³⁰ “CNS/2016/0011 - Swedish Parliament” Courtesy translation of the Reasoned Opinion.

opinion. In contrast with its Swedish counterpart, the House of Representatives of Malta raised both – procedural and substantive grounds of Subsidiarity. Firstly, it is stated in the opinion that the Commission did not provide a good explanation why the Directive was in line with Subsidiarity principle, as mere repeat of the statement of Article 115 TFEU - “directly affect the establishment or functioning of the internal market” - was hardly enough, because the Commission was obliged to give valid reasons on the evaluation of conformity with the principles of Subsidiarity and Proportionality pursuant to Article 5 of the Protocol 2 of TFEU. The reasoned opinion indicates to some specific Anti-Avoidance rules, such as CFC rule and points out that the Rule also covers purely internal matters and there is no explanation why it was necessary and proportionate. Furthermore, the Maltese House of Representative states that the distortion of competition needs to be significant in order to justify the adoption of measures at the Union level. The Commission is also criticised for its action to completely rely on the BEPS Project and not carrying out the necessary consultation to assess the local dimension in Malta, since Malta is not a member state of the OECD and any study performed by the OECD would not consider Malta’s circumstances.¹³¹

As it was already discussed, the Council and the EU Commission are of the view that they had the competence to regulate this area and the competence was conferred by the Member States per Treaties. Furthermore, they believe that the Subsidiarity principle is not breached. As it is indicated above, these arguments have been already tested by the National parliaments and are most likely to be tested by the taxpayers as well. The case law discussed herein demonstrates that the Court seems very reluctant to challenge the provisions of the EU Directive on the ground of Subsidiarity. But this approach has not been tested in the area of direct taxation, as the Directive has not been challenged so far based on the violation of the Subsidiarity in this field.¹³²

As it was discussed above, the ATAD is a part of the Anti-Tax Avoidance Package, proposed by the Commission. The Directive consists of several anti-tax avoidance measures and a variety of related topics. The number of measures included therein raises a question of how the Subsidiarity assessment should be employed. How should one assess whether the Directive follows the Subsidiarity principle? Could the Directive as a whole, or each measure independently be an object of the compliance test? It would seem logical to test each measure autonomously, because if the entire Directive is tested, measures not corresponding to the Subsidiarity principle might piggyback on those meeting the test.¹³³ This approach goes hand in hand with the purposes of the Subsidiarity assessment and with the general logic of the TFEU and Protocol No 2. As it was stated above, Article 5(3) TFEU establishes the principle of Subsidiarity in the fields where EU does

¹³¹ “CNS/2016/0011 - Maltese House of Representatives” Courtesy Translation of Reasoned Opinion.

¹³² Graaf and Visser, “ATA Directive: Some Observations Regarding Formal Aspects,” 204.

¹³³ *Ibid.* 205.

not have the exclusive competence. Respectively, Article 5 of the Protocol provides legislative acts should be justified with regards to the principle of Subsidiarity.¹³⁴ These articles entail the obligation of the EU institutions to follow the Subsidiarity principle. The purpose of those articles, in all likelihood, would be endangered if every measure is not tested independently.

The Commission believes that the ATAD complies with the principle of Subsidiarity, because the nature of the subject requires a common initiative across the internal market. The ATAD exists to pursue the aim of tackling cross-border tax avoidance practices and provides a common framework for implementing the BEPS project into Member States' national laws in a coordinated manner. Such aims cannot be sufficiently achieved through action undertaken by a single Member State acting on its own. Also, taking into account the fact that the anti-abuse rules have a cross-border dimension, it is necessary to balance interests within the whole internal market and consider a bigger picture to identify common objectives and solutions. And as a last argument, the Commission indicates to legal certainty as the Directive will help raise the legal certainty in this area, because the taxpayers are going to have the knowledge of the BEPS implementation.¹³⁵ However, not all anti-avoidance measures introduced by the ATAD are originated from the BEPS Project. As it was discussed above, the Exit Taxation rule and the GAAR are not included in the BEPS Action plans. The EU Commission does not give reasons why the measures not covered in the OECD BEPS Project, but included in the Directive, also meet the principle of Subsidiarity. Probably the Commission is of the view that the measures are in line with the principle as well, because they more or less cover the same areas as the BEPS recommendations, especially where the Anti-Avoidance measures aim to broaden the reduced taxable bases.¹³⁶ Moreover, it is noteworthy, as the House of Representatives of Malta stated in its Reasoned Opinion discussed above, that the Directive also covers the purely internal matters. The Commission did not provide any explanation why direct taxation of the purely internal transactions affect the internal market, so that the intervention of the EU legislation became necessary. On the other hand, as the case law of the CJEU indicates – the Commission is not obliged to give expressed explanation and it is sufficient if the recitals make it clear why the EU Institutions believe the aims of the measure in question could be best attained by the EU Action.¹³⁷

It is important to take into account the legal nature of the ATAD to assess its compatibility with Subsidiarity principle correctly. As it was noted above, ATAD is the extraordinary Directive in the field of direct taxation. The prior Directives were aimed at eliminating domestic obstacles potentially violating

¹³⁴ Treaty on the Functioning of the European Union - Protocol (No 2) on the application of the Principle of Subsidiarity and Proportionality (2008). OJ C 326. Article 5(1).

¹³⁵ European Commission, "Proposal for a Council Directive Laying down Rules against Tax Avoidance Practices That Directly Affect the Functioning of the Internal Market," 4.

¹³⁶ Graaf and Visser, "ATA Directive: Some Observations Regarding Formal Aspects," 204.

¹³⁷ Case 233/94 Germany v European Parliament and Council.

the EU fundamental freedoms. The ATAD establishes *De Minimis* requirements of the anti-abuse measures. In contrast with the previous Directives in the direct taxation, it does not transfer any rights to taxpayers. The ATAD obliges the Member States to introduce the anti-avoidance measures and prevent abusive practices. The introduced measures drastically change the way the internal market works, since they reverse the consequences of specific transactions and the subjects of the internal market, which are primarily inclined to take advantage of the differences in tax jurisdictions. This game-changing nature of the ATAD raises bar to assess whether measures included in the Directive meet the Subsidiarity and Proportionality tests. An anti-avoidance measure that has a potentially negative effect on the functioning of the internal market is only justified if it is introduced by relief for bona fide actors on the market. The Directive misses to include such safe harbour mechanisms.¹³⁸ As it was discussed above, the established anti-avoidance measures are not narrowly-tailored towards abusive, non-genuine transactions and have features of mechanistic application, and they hardly require assessment whether the transaction had economic explanation or it was entirely abusive.

Another important issue regarding the Subsidiarity is the impact assessment, since the Commission presented the ATAD proposal without having conducted any impact assessment¹³⁹ against the requirements of the Better Regulation Guidelines. Because the abovementioned guidelines, in particular Chapter III, provides that the Commission's initiatives that are likely to have significant economic, environmental or social impacts, the impact assessments should be carried out for both legislative and non-legislative initiatives as well as delegated acts and implementing measures, considering the principle of Proportionality analysis.¹⁴⁰ It goes without saying that the ATAD initiative has significant economic and social impacts. This omission apart from formal violation creates the problem for the compliance with principle of Subsidiarity, because without such impact assessment, the national parliaments do not have enough information to decide whether the Subsidiarity test is met. As it was discussed above, the Swedish and Maltese parliaments underlined this problem in their reasoned opinions.

3.3. Principle of Proportionality

The Proportionality principle as a General Principle of EU law is applied in different legal scenarios – including different types of the legality analysis of the EU and the Member States actions. This part of the thesis is focused on the Proportionality analysis with respect to competence issues of the EU institutions.

¹³⁸ Graaf and Visser, “ATA Directive: Some Observations Regarding Formal Aspects,” 205.

¹³⁹ Ibid. 205–6.

¹⁴⁰ “Better Regulation Guidelines,” 17, accessed May 18, 2017, http://ec.europa.eu/smart-regulation/guidelines/docs/swd_br_guidelines_en.pdf.

3.3.1. Standards

The Proportionality is a well-established General Principle of EU Law. In any Proportionality assessment, one should identify the relevant interests, and there will be some ascription of weight and value of the interests in question. The first step of the Proportionality enquiry is identification of the legitimate aim – the desired end, for which the measure in question is used. If there is no such aim, or the aim is not legitimate the measure should be considered as disproportionate and illegitimate. There will normally be three elements of a Proportionality test after identification of the legitimate aim: (1) Suitability – whether the measure is suitable to achieve the desired aim; (2) Necessity – whether the measure in question is necessary to achieve desired aim, or it is possible to achieve the aim with any less intensive measure and last (3) Proportionality in strict sense - whether the measure imposed a burden on the individual that was excessive in relation to the objective sought to be achieved. During the last stage, the enquirer should weigh and balance the colliding interests.¹⁴¹

The principle of Proportionality within the framework of EU Treaties gained a novel dimension in addition to the roles those it had played in the earlier case law of the CJEU. Starting from the Maastricht Treaty the principle of Proportionality is introduced as an explicit treaty provision along with principle of conferral of powers and principle of Subsidiarity (Article 5 TEU). In this field the Principle of Proportionality is employed to protect the Member States' sovereign powers from unjustified interference by the EU institutions. Thus, the Proportionality principle performs a “competence function”.¹⁴²

For example, in the above-discussed Case of Vodafone and Others A.G. Maduro raised this issue and proposed the Court to assess the legislature's decision on how to address the specific problem of high roaming charges was proportionate to achieve the policy objective of consumer protection against two interests – against the loss of autonomy on the part of Member States and against the interference with the rights of the claimants. “As assessment of Proportionality also requires the Court to consider whether the greater ability of the [Union] to achieve the goals of the relevant legislation is such as to justify the loss of Member State autonomy involved in the approach chosen by the legislature”.¹⁴³

Thus, in the context of the EU competence, the ATAD should be assessed under the principle of Proportionality against the Member State's sovereign powers. I.E. Whether it was proportionate to enact the Directive by the EU legislators in this field and regulate the matter of direct taxation via this legislative instrument. In the EU law the Proportionality principle is not

¹⁴¹ Craig and Burca, *EU Law: Text, Cases and Materials*, 551.

¹⁴² Szudoczky, “The Sources of EU Law and Their Relationships: Lessons for the Field of Taxation,” 119.

¹⁴³ Case-58/08 Vodafone and Others. Opinion of A.G., ECLI:EU:C:2009:596, paras. 36, 44.

always employed in the classical manner and not all of its stages are always checked against. Therefore, after identifying the object, scope and assessment, it is important to define the standard of review under the Proportionality principle.

Article 5(4) TEU refers only to the “necessity” part of test – “under the principle of Proportionality, the content and the form of Union action shall not exceed what is necessary to achieve the objectives of the treaties”. The CJEU uses the test in various forms. For the purposes of this research topic the paper goes on to focus on the cases where the Court assesses compatibility of the Union measures. For example, in the Case of British American Tobacco the Court employed the two-step test, as it stated:

“A restriction is permissible only if it pursues a legitimate objective compatible with the Treaty and is justified by imperative reasons in the public interest. It is further necessary, in such a case, that its application be appropriate to ensuring the attainment of the objective thus pursued and not to go beyond what is necessary to attain it”.¹⁴⁴

However, there are the instances, when the Court relies on the three-step test while assessing the Union measures. For example, in Fedesa Case the Court states:

“The Court has consistently held that the principle of Proportionality is one of the general principles of [Union] law. By virtue of that principle, the lawfulness of the prohibition of an economic activity is subject to the condition that the prohibitory measures are appropriate and necessary in order to achieve the objectives legitimately pursued by the legislation in question; when there is a choice between several appropriate measures recourse must be had to the least onerous, and the disadvantages caused must not be disproportionate to the aims pursued”.¹⁴⁵

And yet, the standard was quite different provided by the Court in Vodafone Case:

“With regard to judicial review of compliance with those conditions the Court has accepted that in the exercise of the powers conferred on it the Community legislature must be allowed a broad discretion in areas in which its action involves political, economic and social choices and in which it is called upon to undertake complex assessments and evaluations. Thus, the criterion to be applied is not whether a measure adopted in such an area was the only or the best possible measure, since its legality can be affected only if the measure is manifestly inappropriate having regard to the objective which the competent

¹⁴⁴ Case C-491/01 - British American Tobacco (Investments) and Imperial Tobacco (2002) ECLI:EU:C:2002:741, para. 122.

¹⁴⁵ Case C-331/88 The Queen v Minister of Agriculture, Fisheries and Food and Secretary of State for Health, ex parte: Fedesa and others (1990) ECLI:EU:C:1990:391, para. 13.

institution is seeking to pursue”.¹⁴⁶

As it seems, when the principle of Proportionality is used to balance the EU institutions’ competence against the sovereign powers of the Member States, the Court employs the lighter test and rejects the claim, unless there is a manifest error of assessment. This observation is shared by the major scholars, who study the Proportionality principle in the EU.¹⁴⁷ However, in the legal doctrine there are some views about what kind of test the Court should apply in such cases. For example, Mattias Kumm suggests that the appropriate test that the Court of Justice would do well to apply consists of three steps: federal intervention to legislate at the EU level has to have legitimate purposes, has to be necessary in the sense of being narrowly tailored to achieve that purpose and has to be proportionate with regard to costs or disadvantages relating to the loss of Member States’ regulatory autonomy.¹⁴⁸

3.3.2. Application on the ATAD

As it was stated above, there have not yet been a challenge to a Directive in the area of direct taxation against principles of Proportionality and Subsidiarity.¹⁴⁹ In the case of the Proportionality of the ATAD, notably what comes at the stake here is the Member States’ fiscal sovereignty, regulatory autonomy to legislate over the direct taxation matters and an excessively extensive application of TFEU rules laying down the EU legislative competences, which will eventually lead to an erosion of the Member States’ sovereignty as regards levying and maintaining sufficient tax revenue in order to finance welfare.¹⁵⁰

It is generally believed that all sovereign states possess the supreme power to design the means and content for governing themselves and satisfying their needs. Designing the tax system in this regard performs a fundamental function, as it provides the economic means to a considerable extent to support this. Having the sovereign power to tax is reflected in the design of a tax system, which is basically determined to establish the method for sharing the public economic burden among those who should bear it based on tax principles within the limits of sovereignty.¹⁵¹ The ATAD regulates important aspects of the direct taxation. To some extent the provided mechanism forces the Member States to tax certain transactions in order to avoid the double non-taxation, for example. Taxation is a strong policy instrument related to budget

¹⁴⁶ Case-58/08 Vodafone and Others Para. 52.

¹⁴⁷ Szudoczky, “The Sources of EU Law and Their Relationships: Lessons for the Field of Taxation,” 125–29.

¹⁴⁸ Kumm, “Constitutionalising Subsidiarity in Integrated Markets: The Case of Tobacco Regulation in the European Union,” 519.

¹⁴⁹ Graaf and Visser, “ATA Directive: Some Observations Regarding Formal Aspects,” 204.

¹⁵⁰ “CNS/2016/0011 - Swedish Parliament” Courtesy Translation of Reasoned Opinion.

¹⁵¹ Felix Daniel Martinez Laguna, “Abuse and Aggressive Tax Planning : Between OECD and EU Initiatives – The Dividing Line between Intended and Unintended Double Non-Taxation,” *World Tax Journal* 9, no. 2 (2017): 2.

revenues and important economic and non-economic public interests of the state. Thus, refraining from taxation, i.e. non-taxation should also be understood as another type of exercising sovereign powers. In this sense, non-taxation is always intended as stemming from both economic and non-economic policy choices. But there are some scenarios, when the non-taxation is not part of intended policy choice, but a result of the characteristics of a tax design. In the latter case, the non-taxation is less related to the exercising of sovereign taxing powers. However, it is always difficult to distinguish when non-taxation is intended and when – accidental.¹⁵² Therefore, in general, non-taxation bears highest importance as a sovereign state power and a policy instrument for the Member State.

Thus, considering the importance of the regulated field, it would be reasonable if the CJEU did not use the lenient test and could assess the Proportionality of the ATAD employing the three-step test, including suitability, necessity and Proportionality in strict sense elements. Accordingly, this paper will focus on these elements of the assessment.

3.3.2.1. Legitimate purpose

At first, the legitimate purpose should be identified for the intervention into the Member States' power to regulate. As it was proposed by the Scholar Matthias Kumm – the legitimate purpose for the intervention exists only if the action of individual Member States is structurally tainted by collective action problems. The only scenario when the Member States cannot sufficiently achieve the relevant objective are situations involving collective action problems.¹⁵³ This approach follows the logic of the TEU and TFEU and the whole constitutional architecture of the EU. If the EU has exclusive and non-exclusive competences and acting through the non-exclusive competences is preconditioned by the principles of Subsidiarity and Proportionality it seems clear that the objective by nature should be difficult to achieve by a sole Member State, otherwise the Member States would rather do it at the national level.

In case of the ATAD the purpose of enacting the Directive, according to the Commission, was to tackle cross-border tax avoidance practices and provide a common framework for implementing the outputs of BEPS into Member States' national laws in a coordinated manner.¹⁵⁴ The cross-border tax avoidance practices, in general, are of the nature that they need transnational approach. That is the main spirit of the BEPS project itself. As it is stated in every BEPS project document, the problem needs international cooperation.¹⁵⁵ Thus, it is the legitimate purpose that, by nature, is difficult,

¹⁵² Ibid. 3–4.

¹⁵³ Kumm, “Constitutionalising Subsidiarity in Integrated Markets: The Case of Tobacco Regulation in the European Union,” 520.

¹⁵⁴ European Commission, “Proposal for a Council Directive Laying down Rules against Tax Avoidance Practices That Directly Affect the Functioning of the Internal Market,” 4.

¹⁵⁵ See E.G. OECD, *Neutralising the Effects of Hybrid Mismatch Arrangements, Action 2 - 2015 Final Report*.

almost impossible to be achieved by the individual Member States without cooperation.

3.3.2.2. Suitability

As it was mentioned above, another element of the Proportionality analysis is suitability. In the context of the ATAD Proportionality assessment, it is important to identify whether the Directive is suitable to achieve the legitimate purpose – prevention of abusive practices and provide the EU-wide legislative framework for consistent implementation of the BEPS Action Plans. If the ATAD has such legal characteristics that it is unable to achieve its legitimate purpose, the intervention into the Member States’ regulatory autonomy should be considered as unavailing and disproportionate.

The Commission and the Council have adopted the ATAD and established different anti-abusive measures. But as it was noted above, the Directive has *De Minimis* character. Therefore, the Member States are allowed to apply domestic or agreement-based provisions to safeguard a higher level of protection for domestic corporate bases.¹⁵⁶ The *De Minimis* nature leaves margin of appreciation to the Member States and, thus, creates a possibility to apply different levels of protection throughout the Union. Such an opportunity endangers consistent implementation of the proposed anti-abusive measures. If there are different levels of protection in different Member States, it will open the opportunities for the taxpayers to abuse this asymmetry and circumvent the rules. The CFE recommended that the anti-abusive measures should not be only a *De Minimis* but a *De Maximis* as well.¹⁵⁷ Such an approach would have solved the abovementioned problem, because only *De Minimis* standard raises questions about the effectiveness of the ATAD and its compliance with principle of Proportionality as well, because if the ATAD does not provide effective and consistent protection against abusive practices, it can be considered as not suitable to achieve the legitimate purpose.

One might argue that the long-standing case law of the CJEU regarding domestic anti-abusive measures and Fundamental Freedoms may be considered as *De Maximis* standard, if the Member States apply the stricter anti-abusive measures. According to the argument, the threshold established by the CJEU would work as an equaliser and would prevent the inconsistent application of anti-abusive measures throughout the EU. The latter leads to the conclusion that the effectiveness of the ATAD may not be endangered. There is still a problem that gives rise to the question of effective and consistent implementation of the ATAD and, respectively, the abusive measures. The CJEU establishes the standard for the anti-abusive measures

¹⁵⁶ Council Directive (EU) 2016/1164 of 12 July 2016 laying down rules against tax avoidance practices that directly affect the functioning of the internal market (2016). OJ L 193/1. Article 3.

¹⁵⁷ CFE, “Opinion Statement on the European Commission’s Proposal for an Anti-Tax Avoidance Directive,” 2.

that is required by the Fundamental Freedoms.¹⁵⁸ This does not necessarily exclude the opportunity that there is still the margin of appreciation for the Member States between the *De Minimis* provided by the ATAD and *De Maximis* established by the CJEU. The abovementioned margin helps to create the risk of asymmetric implementation of the ATAD, which could threaten its effectiveness.

3.3.2.3. Necessity

Furthermore, besides a legitimate purpose and suitability, the specific measure should also be necessary to achieve that purpose and the legislation must be narrowly tailored.¹⁵⁹ For example, in the Case of Tobacco Advertising, the CJEU found that the Directive that prohibited all types of Tobacco advertisements had the legitimate purpose of eliminating obstacles to trade, to some extent. But the Directive was unnecessarily broad in that it contained prohibitions that clearly were unnecessary and even counter-productive to the legitimate purpose. The Court held that the general prohibition of products such as parasols and ashtrays that advertised tobacco products, for example, was not necessary to achieve the legitimate aim.¹⁶⁰

Accordingly, the ATAD should be in line with the necessity requirement as well. I.E. the measures provided by the Directive should not be more restrictive than they are needed to achieve the legitimate purpose in question. As it was discussed above, the ATAD introduces several anti-avoidance measures and it is reasonable to review the necessity of the relevant ones individually.

For example, Interest Limitation Rule, covers all taxpayers are covered and limits their right to deduct the net interest expenses (“Borrowing costs”) to a “fixed ratio” of 30% of a taxpayer's taxable EBITDA. If the criteria exist, the Interest Limitation Rule applies in the automatic manner, without further examination.

It is noteworthy that the CJEU has a well-established case law regarding national Interest Limitation Rules and Fundamental Freedoms. Despite the fact that this part of the thesis does not assess the ATAD's compatibility with Fundamental Freedoms, and the ATAD is the EU-wide measure – not the national one, it is relevant to consider the abovementioned case law. Apart from the differences of the nature of adjudication and the measures in question in both types of proceedings, the CJEU employs the Proportionality

¹⁵⁸ See E.G. Case C-196/04 - Cadbury Schweppes and Cadbury Schweppes Overseas (2006) ECLI:EU:C:2006:544

¹⁵⁹ Kumm, “Constitutionalising Subsidiarity in Integrated Markets: The Case of Tobacco Regulation in the European Union,” 521.

¹⁶⁰ Case C-376/98 - Germany v Parliament and Council (2000) ECLI:EU:C:2000:544.

principle, whereby the necessity element means the same – whether it is possible to achieve the legitimate aims via less restrictive measures.

In the Case of Test Claimants in the Thin Cap Group Litigation, the CJEU provided the standard of Proportionality for the interest limitation rules. The CJEU held that the Proportionality principle is satisfied if the Interest Limitation Rule is established by the legislation that meets the following criteria: the legislation which targets only the wholly artificial arrangements, designed to circumvent the legislation, provides objective and verifiable elements in order to determine whether a transaction represents a purely artificial arrangement, so that the taxpayer, without undue administrative burden has the opportunity to provide evidence of any commercial justification and finally, where the consideration of those elements leads to the conclusion that the transaction in question represents a purely artificial arrangement without any underlying commercial justification, the re-characterisation of interest paid as a distribution is limited to the proportion of that interest which exceeds what would have been agreed had the relationship between the parties or between those parties and a third party been one at arm's length.¹⁶¹ The Court held that the legislation that does not meet the abovementioned criterions and "goes beyond what is necessary to attain that objective."

The ATAD Interest Limitation Rule applies in an automatic way if the net interest expenses exceed the "fixed ratio" of 30% of a taxpayer's taxable EBITDA. There is no possibility to assess artificiality of the transaction, the taxpayers have no opportunity to prove that there was an underlying commercial justification and the limitation is not narrowly tailored on the interest, which exceeds the amount that would have been agreed had the relationship between the parties or between those parties and a third party been one at arm's length. Thus, despite the fact that the CJEU held the abovementioned standards in the course of different types of proceedings and about the national measures – the standard is still the same – it should not to go "beyond what is necessary". As it was stated above, the purpose of the adoption of the ATAD was to tackle cross-border tax avoidance practices. Therefore, one might argue that according to the *mutatis mutandis* logic of the CJEU, the proposed anti-avoidance measure goes beyond the objectives, because it is not narrowly tailored to abusive, artificial arrangements.

As it was stated the ADAT contains CFC Rule, which causes re-attribution of income of a low-tax controlled Subsidiaries to their parent companies.

The CJEU held in Case of Cadbury Schweppes, that in order for a restriction on the freedom of establishment to be justified on the ground of prevention of abusive practices, the specific objective of such a restriction 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

¹⁶¹ Case C-524/04 Test Claimants in the Thin Cap Group Litigation (2004) ECLI:EU:C:2007:161, paras. 78-83.

normally due on the profits generated by activities carried out on national territory¹⁶² and the taxpayer resident company, must be given an opportunity to produce evidence that the CFC is actually established and that its activities are genuine.¹⁶³ Thus, in terms of the CFC rule, the Court has the “wholly artificial arrangement” standard and requirement that the taxpayer has a chance to give evidence that CFC is actually established and its activities are genuine. This is the general standard of CJEU in the field of abusive practices in tax law. Otherwise, the rule is disproportionate – i.e. goes beyond what is necessary to achieve the purpose.

It is explicitly indicated in the preamble of the Directive that “To comply with the fundamental freedoms, the income categories should be combined with a substance carve-out aimed to limit, within the Union, the impact of the rules to cases where the CFC does not carry on a substantive economic activity”¹⁶⁴ The CFC rule provided by the ATAD seems to be in line with the both requirements of the CJEU case law, since – it requires the CFC to be engaged in a “substantive economic activity” – which resembles the “wholly artificial arrangement” standard and it has to be supported by the “relevant facts and circumstances” implying the existence of a principle of adversarial process between the taxpayer and the tax agencies.¹⁶⁵ In the author’s opinion, the CFC rule is in line with the necessity requirement.

Article 9 of the ATAD establishes the anti-avoidance measure to deal with the Hybrid Mismatches and is deemed to neutralise the negative tax effects of hybrid mismatch arrangements. According to the Commission, and the considering the scheme that was introduced by the Directive, the Hybrid Mismatches rule should apply in an automatic manner, without giving the opportunity to the taxpayer to prove that the hybrid payment was actually taxed at the level of the intermediary company in any given third country and that the structure had been performed for valid commercial reasons.¹⁶⁶

For example, the Commission’s Staff Working Document refers to the scheme of the Hybrid Loan structure that takes advantage of the hybrid mismatch in qualification of a financing instrument. It benefits from a deduction of the payment in the Member State “A” (e.g. as interest) in combination with no inclusion in the Member State “C” (e.g. as tax-free dividend). By inserting an intermediate company resident in a third country “B”, this structure still allows to benefit from a hybrid mismatch.¹⁶⁷ In such

¹⁶² Case C-196/04 - Cadbury Schweppes and Cadbury Schweppes Overseas (2006) ECLI:EU:C:2006:544ECLI:EU:C:2006:544, para. 55.

¹⁶³ Ibid. Para. 70.

¹⁶⁴ Council Directive (EU) 2016/1164 of 12 July 2016 laying down rules against tax avoidance practices that directly affect the functioning of the internal market (2016). OJ L 193/1. Preamble

¹⁶⁵ 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,” 129.

¹⁶⁶ Guglielmo 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” 45, no. 2 (2017): 136.

¹⁶⁷ “Communication from the Commission to the European Parliament and the Council –

cases the Hybrid Mismatch Rule, Article 9(2) of the ATAD, obliges the Member State “A” to deny deduction of such payment. This rule applies even in those cases when the hybrid payment was actually taxed in the third country and there were valid commercial reasons beyond the chain of the transactions.

As it was stated above, according to the CJEU case law, the anti-avoidance measure should be tailored only to the wholly artificial arrangements and the taxpayer should be given the real opportunity to prove that the arrangement is genuine for the commercial purposes. The Hybrid Mismatches rule does not meet with this criterion and accordingly goes beyond what is necessary to achieve the purpose.

The assessment of the Anti-avoidance measures provided by the ATAD indicates that not all of them are in line with necessity requirement of the Proportionality Principle. In general, if the measure in question does not meet to any step of the Proportionality, it is considered as disproportionate. However, to conduct the assessment properly and to see the whole picture, it is better to check the remaining step of Proportionality in strict sense.

3.3.2.4. Proportionality *stricto sensu*

Even if the measure aims at a legitimate purpose, which is the least intrusive of all equally effective means, the restriction of Member States autonomy may be disproportionate to the achieved benefits. The Proportionality in strict sense in this context raises the question whether the loss of Member States autonomy clearly outweighs the benefits achieved by the EU intervention.¹⁶⁸

It is interesting to weigh the restricted autonomy of the Member States and the benefits deemed to be achieved by the ATAD. On the one hand, the Member States lose important part of their fiscal sovereignty to freely regulate the field of direct taxation and conduct policy-making in response to the national socio-political challenges. On the other hand, it is the EU-wide interest to fight against abusive tax practices and aggressive tax-planning. This interest is closely interdependent on the international BEPS Project, which is believed to be of utmost importance. Thus, at this stage of the Proportionality assessment, it is submitted that the EU-wide interest to “tackle cross-border tax avoidance practices and provide a common framework for implementing the outputs of BEPS into Member States’ national laws in a coordinated manner” outweighs the Member States’ fiscal autonomy interest. But the objective has only to be achieved by proportionate measures and it must not go beyond what is necessary.

Anti-Tax Avoidance Package: Next Steps towards Delivering Effective Taxation and Greater Tax Transparency in the EU,” *Commission Staff Working Document*, vol. 1, 2016, doi:10.1017/CBO9781107415324.004.

¹⁶⁸ Kumm, “Constitutionalising Subsidiarity in Integrated Markets: The Case of Tobacco Regulation in the European Union,” 526.

Conclusion

The present thesis discussed the ATAD and its compatibility with the Primary EU Law by focusing on the question of competences. The research has shown that the way the ATAD was chosen by the EU institutions as a legal instrument to achieve legitimate objectives raises some questions from the perspective of the Primary Law.

The paper identified some problems regarding compatibility of the adoption of the ATAD in relation to formal requirements of the Subsidiarity principle. The research has shown that the Commission did not give the perfect explanation on the Subsidiarity and failed to conduct the proper impact assessment, so that the Member States' National Parliaments had the opportunity to assess the Subsidiarity sufficiently enough.

As the Proportionality analysis demonstrates, the ATAD aims the legitimate purpose of tackling cross-border abusive practices and consistent implementation of the BEPS Action Plans throughout the EU. The fact that the ATAD has *De Minimis* nature elevates the concern regarding its capability to attain the legitimate objectives. The ATAD does not contain any *De Maximis* rule and the Member States are allowed to apply higher level of protection for domestic corporate bases. The inconsistent application of the anti-abusive measures might result in asymmetric allocation of taxes and create further loopholes. This risk is not fully neutralised by considering the case law of the CJEU on domestic abusive measures and Fundamental Freedoms as the *De Maximis* threshold.

Furthermore, it is not clearly explained, why the instrument of the Directive was chosen over the options of “soft law” and the Regulation. Considering the legal nature of the Directive this instrument leaves wide margin of appreciation to the Member States and might not be considered as the most effective way to tackle cross-border abusive practices and to achieve consistent implementation of the BEPS Action Plans.

As the research shows that respective EU institutions have failed to test the compatibility of the ATAD against domestic constitutional provisions. This might endanger its effective implementation due to possible collision with domestic constitutional provisions. This risk is tenable on the example of Germany, as the German Federal Constitutional Court presently reviews constitutionality of the similar domestic regulation.

The paper illustrates that the necessity requirement of the Proportionality test is not completely satisfied in relation to several anti-avoidance measures provided by the ATAD – Interest Limitation Rule, CFC Rule and Hybrid Mismatches Rule. The fact that the measures apply in an automatic manner without considering the real economic nature of the transaction in question, leads to the conclusion that they go beyond what is necessary to achieve their

objectives. Nonetheless, the paper has concluded that if the necessity requirements were met the ATAD itself would be proportionate in strict sense, as the EU-wide interest to tackle cross-border abusive practices is capable to outweigh the Member States' autonomy.

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