THE ADVANCED DIPLOMA IN INTERNATIONAL TAXATION

December 2022

MODULE 3.01 – EU DIRECT TAX OPTION

SUGGESTED SOLUTIONS

PART A

Question 1

Part 1

The ideal answer should follow the analysis/sequence of the CJEU.

The fact that only domestic (Homeland) companies can make use of the group consolidation regime establishes a difference in treatment (or a restriction – depending on which line of case law is cited) between resident and non-resident subsidiaries, and is, thus, incompatible with Article 49 TFEU. With regard to the comparability between the two, the Court noted in Marks & Spencer (C-446/03), and on several other occasions thereof, that the fact that resident and non-resident subsidiaries are not in comparable tax situations (from a territoriality perspective) is of no relevance, as otherwise freedom of establishment would be completely deprived of its meaning. The Marks and Spencer judgment referred to group relief, whereas the X Holding judgment (C-337/08) specifically dealt with the (Dutch) fiscal consolidation regime (both references accepted).

Regarding restriction and comparability: Towards the same outcome but from a different perspective, in the X Holding case the CJEU ruled that the situation of a resident parent company wishing to form a single tax entity with a resident subsidiary and the situation of a resident parent company wishing to form a single tax entity with a non-resident subsidiary are objectively comparable with regard to the objective of a tax scheme such as that at issue in the main proceedings in so far as each seeks to benefit from the advantages of that scheme, which, in particular, allows the profits and losses of the companies constituting the single tax entity to be consolidated at the level of the parent company and the transactions carried out within the group to remain neutral for tax purposes.

Considering the aforementioned restriction, the next step would be to identify whether Homeland can successfully invoke any justifications for this restrictive measure. A similar analysis to the Marks & Spencer (or subsequent line of case law) would be expected here, notably that indeed if Homeland were to consider WOW's losses, then its balanced allocation of taxing powers could be disrupted (with reference to the concept of the balanced allocation of taxing rights, i.e. the need to safeguard the symmetry between the right to tax profits and the right to deduct losses, in particular in order to prevent taxpayers from choosing freely the Member State in which profits are to be taxed or losses are to be deducted.) The danger of losses being used twice and the risk of tax avoidance should be mentioned, although the need for the 3 of them to be taken together (as in Marks & Spencer) has since then, been relaxed in the CJEU case law. The cohesion of the tax system as a potential justification would fail here in lack of a direct link (different taxes, different taxpayers).

Upon identifying the successful justifications, the analysis should move to the proportionality principle. The question here is silent as to whether WOW's losses are final or can be carried forward or back (note par. 55 of the Marks & Spencer judgment). Here, the candidates should hypothesise whether the losses are final or not and continue their analysis accordingly. If they assume that the losses are final (explain that, according to the M&S judgment those are the losses that cannot be taken into account in the current period, carried back, forward or transferred to a third party), then on the basis of the proportionality analysis and the 'always somewhere principle', these losses should be consolidated with ABC's profits.

Part 2

The fact that the DTC between the two states exempts profits and losses (provides for base exemption) means that the foreign PE results are not included in the tax base of ABC. Accordingly, and consistently with the territoriality principle, both non-domestic profits and losses are ignored at the level of the parent in Homeland.

Thus, if one applies the CJEU line of reasoning (see for instance, Lidl Belgium (C-414/06) Timac Agro (C-388/14)), then while indeed a restriction exists as ABC may be deterred from carrying out its business through a PE in Blueland, this restriction may be justified by an overriding reason in the public interest. Such a ground may be found in the lack of comparability between the two situations (domestic PE vs. 'foreign' PE) as Homeland does not exercise any tax powers over the profits the foreign PE as opposed to the domestic PE. Alternatively, one could successfully argue, that Homeland's balanced allocation of taxing rights would be jeopardised if it extended the tax consolidation regime in the case at issue.

Reference to final losses, under proportionality.

Part 3

This question must be addressed from both the 'fundamental freedoms' and the ATAD angles. Starting from the latter, one would have to identify whether the imposition of the CFC rules in the present case is mandated by the ATAD, Article 7. Accordingly, one would have to go through the Article 7 requirements for the application of CFC rules. There is no doubt that most of them are easily met (taxpayer, CFC, control requirement and passive income). It is more difficult to establish whether the low taxation requirement can be assumed as Article 7(2)(b) refers to the actual corporate tax paid. As the directive does not compare the nominal tax rates but the effective tax liability, the provided information in the question do not allow for a clear answer as to whether the 'low taxation' requirement is met. However, even if the applicable rule here implemented Article 7 of the ATAD, the relevant case law of the CJEU starting with the Cadbury Schweppes judgment (C-196/04), consistently provides that only rules that address 'wholly artificial arrangements' are acceptable as a restriction of the fundamental freedoms. According to this judgment, for an arrangement to qualify as wholly artificial there must be, in addition to a subjective element consisting of the intention to obtain a tax advantage, objective circumstances showing that, despite the formal observance of the conditions laid down by EU law, the objective pursued by the freedom of establishment has not been achieved.

In addition to this requirement, CJEU case law has consistently held that a legislation that introduces a general presumption of fraud and abuse cannot be accepted (see for instance, Cadbury Schweppes, Eqiom and Enka (C-6/16)). Instead, as the Court has held, for example in Euro Park Service (C-14/16), the competent national authorities may not confine themselves to applying predetermined general criteria but must subject each particular case to a general examination of that operation, since the imposition of a general rule automatically excluding certain categories of operations from the tax advantage, without account being taken of whether or not there is actually tax evasion or avoidance, would go further than is necessary for preventing such tax evasion or avoidance.

Question 2

The facts of the question are similar to the facts of the case C-484/19, Lexel AB v. Skatteverket.

According to the facts, this is a case where domestic legislation provides different conditions for the deduction of interest expenses, depending on the place where the loan is drawn. There is a difference in the tax treatment at the home state, as when the debt is owed to an associated enterprise resident in the same state, the interest is deductible without conditions or limitations, whereas when the debt is owed to an associated enterprise established in another member state, interest expenses are not deductible. Company A is treated in a more burdensome way as it is not allowed to deduct the interest made payments made to the F bank. In the present case there is a difference in treatment which has an adverse impact on the exercise by companies of the freedom of establishment. Since the rule applies to associated enterprises, the principal freedom under which the rule must be examined is the freedom of establishment. Such a difference in treatment is only compatible with the freedom of establishment if it relates to situations that are not objectively comparable or if it is justified by an overriding reason in the public interest and is proportionate to that objective. In this case the cross-border situation is comparable to a purely domestic situation. Comparability has to be examined having regard to the purpose and content of the national provisions in question (judgment of 22 February 2018, X and X, C 398/16 and C 399/16, paragraph 33 and the case-law cited).

A situation in which a company established in one Member State makes interest payments on a loan taken out from a company established in another Member State and belonging to the same group is no different, so far as the payment of interest is concerned, from a situation in which the recipient of the interest payments is a company belonging to the group and established in the same Member State (C-484/19 Lexel, para 44). Therefore, it is necessary to examine whether the difference in treatment may be justified by overriding reasons in the public interest.

It is the established case law of the Court of Justice that a restriction on the freedom of establishment is only permissible if it is justified by overriding reasons in the public interest, if it is appropriate to ensure the attainment of objectives and if it does not go beyond what is necessary to attain those objectives (for example: Marks & Spencer, C 446/03, para 35; Cadbury Schweppes and Cadbury Schweppes Overseas, C 196/04, para47; and Test Claimants in the Thin Cap Group Litigation, C 524/04, para 64). In that regard it must be examined whether the different treatment can be justified first by the need to fight against tax evasion and secondly by the need to maintain a balanced allocation of the power to impose taxes between the member states.

In order for a restriction on the freedom of establishment provided for under Article 49 TFEU to be justified by those grounds, 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 (Cadbury Schweppes and Cadbury Schweppes Overseas, C 196/04; X and X, C 398/16 and C 399/16).

In order to determine whether a transaction represents a purely artificial arrangement entered into for tax reasons alone, the taxpayer must be given an opportunity, without being subject to undue administrative constraints, to provide evidence of any commercial justification that there may have been for that arrangement (Test Claimants in the Thin Cap Group Litigation, C 524/04, para 82). Moreover, the principle of proportionality requires that the refusal of the right to a deduction should be limited to the proportion of that interest which exceeds what would have been agreed had the relationship between the parties been one at arm's length (Test Claimants in the Thin Cap Group Litigation, C 524/04, para 83). The provisions of the domestic law in Country A do not seem to be targeted only to purely artificial arrangements. Indeed, the specific objective of the exception is not to counter purely artificial arrangements and the application of that exception is not limited to such arrangements. The fictitious nature of the loan is not decisive for refusing the right to a deduction because the intention of the company concerned to take on a debt, mainly for tax reasons, is sufficient to justify refusal of the right to a deduction. However, the fact alone that a company wishes to make a deduction of interest payments in a cross-border situation, in the absence of any artificial transfer, cannot justify a measure which undermines the freedom of establishment provided under Article 49 TFEU. Consequently, the justification based on the fight against tax evasion and tax avoidance cannot be accepted (C-484/19, Lexel, para. 55).

Another justification that can be put forward is whether the difference in treatment may be justified by the need to safeguard the allocation of the power to impose taxes between the member states. According to the established case law of the Court the justification based on the need to maintain the balanced allocation of the power to impose taxes between the member states can be accepted where the system in question is designed to prevent conduct which is liable to jeopardise the right of a member state to exercise its power to tax in relation to activities carried out in its territory (Marks & Spencer, C 446/03, para 46, and Hornbach-Baumarkt, C 382/16, para 43). In its judgment of 22 February 2018, X and X (C 398/16 and C 399/16, paragraphs 40 and 41), the Netherlands rules on the deduction of interest could not be justified by the need to preserve a balanced allocation of the power to impose taxes. That was the case in particular because, unlike the situation of the general offsetting of costs and gains specific to a single tax entity, the case which gave rise to that judgment involved an advantage without any specific link to the tax scheme applicable to such entities.

Furthermore, a distinction must be made according to which provisions that seek to prevent the erosion of the tax base which could result from tax planning linked to the deduction of interest expenses in a cross-border situation cannot be confused with the need to preserve the balanced allocation of the power to impose taxes between the Member States (C-484/19, Lexel, para. 67). The reduction in tax revenue cannot be regarded as an overriding reason in the public interest which may be relied on to justify a measure which is in principle contrary to a fundamental freedom (Marks & Spencer, C 446/03, para 44). A finding to the contrary would amount to allowing the Member States to restrict, on the basis of that ground, the freedom of establishment. Accordingly, the justification based on the preservation of a balanced allocation of the power to impose taxes between the Member States cannot be accepted.

The Court has already ruled that national legislation which is not specifically designed to exclude from the tax advantage which it confers purely artificial arrangements, devoid of economic reality and created with the purpose of escaping the tax normally due on the profits generated by activities carried out on national territory, may nevertheless be regarded as justified by the objective of preventing tax avoidance, taken in conjunction with the objective of preserving the balanced allocation of the power to impose taxes between the Member States (SGI, C 311/08, para 66). However, it must be pointed out that the taking into consideration of those grounds of justification together has been accepted by the Court in very specific situations, namely where the fight against tax avoidance constitutes a particular aspect of the public interest linked to the need to preserve a balanced allocation of the power to impose taxes between the Member States (Oy AA, C 231/05, paras 58 and 59, and SGI, C 311/08, para 67).

As the Court has noted, the objectives of safeguarding the balanced allocation of the power to impose taxes between Member States and the prevention of tax avoidance are linked. 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, is such as to undermine the right of the Member States to exercise their tax jurisdiction in relation to those activities and to jeopardise a balanced allocation between Member States of the power to impose taxes (Oy AA, C 231/05, para 62). However, where, the Member State cannot validly assert the justification based on the need to preserve a balanced allocation of the power to impose taxes between the Member States, a measure, such as that at issue in the main proceedings, cannot be justified on the basis of taking account together of the need to preserve a balanced allocation of the power to impose taxes between the Member States and of that of the fight against tax avoidance. In other words, if none of the justifications is applicable in the first place, a combination of them (i.e. of the non-accepted justifications) does not succeed either.

Accordingly, the legislation in Country A is contrary to Article 49 TFEU (freedom of establishment).

PART B

Question 3

Part 1

First, one has to identify whether the case falls within the scope of fundamental freedoms. The cross-border element is present and the case would fall either within the ambit of freedom of establishment or free movement of capital (depending on the holding and the definite influence test). The question is effectively a two-prong question: a) whether indeed the exemption and the credit methods are different from an EU law perspective and b) whether the Most Favoured Nation principle applies in this context.

Specifically, as there is no specific reference to Mrs Jones' holding, one can either refer to the free movement of capital or freedom of establishment. The law at issue seems to apply regardless of the holding. The next step is to identify whether Mrs Jones' freedom (of establishment or capital) is infringed in the present case. For it not to be infringed, the treatment must be the same as the one that applies to domestic investments. The question, thus, boils down to whether the exemption and the credit methods can be considered as equivalent. As the CJEU ruled in the Haribo case (C-436/08 and C-437/08), when the taxation at source is lower than the taxation at residence, as is the case at present, the residence State must grant an overall tax credit corresponding to the tax paid by the company making the distribution in the State in which it is resident. In this case, Mrs Jones should get full relief for the tax paid at source (the case would be different if the tax rates were reversed). As long as the treatment can be considered equivalent, then the question of compatibility with EU law moves to the question of the burden of having to provide a declaration of the actual tax paid. This is a question of proportionality. The Court ruled in the Haribo case that additional administrative burdens which are imposed on the taxpayer, in particular the fact that the national tax authority demands information relating to the tax that has actually been charged on the profits of the company distributing dividends in the State in which the latter is resident, are an intrinsic part of the very operation of the imputation method and cannot be regarded as excessive.

The last part of the question asks whether it makes any difference that Dreamland has other DTAs in place with other Member States that allow the exemption of incoming dividends from tax in Dreamland. For those dividends, it is implied, that no declaration of the actual tax paid is required. The question boils down to whether the Most Favoured Nation (MFN) principle applies in this context. In other words, whether the favourable treatment, granted for investments in other Member States can be extended in the case at hand. As the Court has ruled in the D. judgment (C-376/03), the MFN cannot be extended outside the context of the DTAs that have agreed reciprocally on specific rights and obligations.

Part 2

The second part of the question relates to Mrs Jones's fundamental rights. The first step in answering the question is the identification of the right legal framework for the exchange of information between Dreamland and Snoozeland. 'DAC 1' (Directive 2011/16/EU) on administrative cooperation in the field of taxation allows the exchange of foreseeably relevant information on request (Articles 3(8) and 1(1) of the directive). The next question is whether Mrs Jones can rely on EU law to cancel the fine imposed for failure to disclose the income. With regard to the procedure followed in Dreamland, reference has to be made to the principle of national procedural autonomy, that allows Member States to establish their own national procedural rules to govern the exercise of EU law, as long as they respect the principles of equivalence and effectiveness. Accordingly, it is primarily for Dreamland to decide the procedural rules that apply to Mrs Jones. The first question that arises here is whether Ms. Jones can invoke her fundamental rights arising from the Charter. To do so, Article 51(1) of the Charter provides that the provisions of the Charter are addressed to the Member States only when they are implementing Union law. The fine, in the present case, is a result of Mrs Jones' non-disclosure of the income, and thus, it is not a penalty relating to the exchange of information under DAC 1 (for example for failure to disclose the information, as in the Berlioz case). However, in line with the Sabou judgment (C-276/12), Mrs Jones could invoke her right of defence, a general principle of EU law. This case concerned the collection and exchange of information in the investigation stage and the CJEU decided that when the authorities gather information, they are not required to notify the taxpayer of this or to obtain their point of view.

The same applies, according to the Court, to the reply made by the requested tax authorities and the inquiries carried out to that end by those authorities. Furthermore, the Court ruled that the right of the defence does not require that the taxpayer should be heard at the point when inquiries, which may include the examination of witnesses, are carried out in the requested Member State or before that Member State sends the information to the requesting Member State. One could approach the case from an ECHR perspective and Articles 6, 8 and/or 13 (ECHR), specifically (right to a fair trial, to privacy and to an effective remedy, respectively). The answer would not change as the ECtHR has held in Othymia (75292/10) that the Court has accepted, in the context of "the interests of national security" and "public safety" and "the prevention of crime", that investigative methods may have to be used covertly and the same applies in matters of taxation. Accordingly, prior notice of lawful tax investigations or exchanges of tax related information does not have to be given to all persons potentially implicated.

Question 4

To the Government of Member State A
Report on the compatibility of New Tax Law with the TFEU
Prepared by: Tax Advisor

Concerning the draft legislation that was submitted to me with the question of whether it is compatible with the fundamental freedoms of the EU, please note the following:

On the introduction of turnover-based taxes

In recent years, the Court of Justice has frequently dealt with the EU law aspects of various elements of progressive turnover-based taxes, for example, in ANGED (Case C-233/16) and Hervis (Case C-385/12), in Poland v. Commission (Joined Cases T-836/16 and T-624/17), Hungary v. Commission (Case T-20/17), Vodafone (Case C-75/18) and Tesco (Case C-323/18).

Three of these cases concerned the same Hungarian "law on the special tax on certain sectors", as applied to retail trade (Hervis and Tesco) and telecommu- nications activities (Vodafone), which introduced a turn- over-based tax, with a progressive rate structure, applicable to certain sectors of the economy.

The Court's judgments in Vodafone and Tesco shed light on the assessment of indirect discrimination under the fundamental freedoms and the compatibility of sector-specific turnover taxes with article 401 of the VAT Directive (2006/112).

In general, according to the case law of the Court, if a domestic levy "does not display all the essential characteristics of VAT" it is, "consequently, not subject to the prohibition laid down in Article 401 of the VAT Directive", which states that Member States are not prevented, inter alia, from maintaining or introducing "any taxes, duties or charges which cannot be character- ised as turnover taxes".

The Court's traditional analysis is based on whether a certain national turnover tax "has the effect of jeopardising the functioning of the common system of value added tax (VAT) by being levied on the movement of goods and services and on commercial transactions in a way comparable to VAT". Potential of a turnover tax to interfere with VAT is only present if that tax meets the four essential characteristics of VAT (Vodafone (C-75/18), para. 62, referring to Banca Popolare di Cremona (C-475/03), para. 28): VAT applies generally to transactions relating to goods or ser- vices; it is proportional to the price charged by the taxable person in return for the goods and services which he has supplied; it is charged at each stage of the production and distribution process, including that of retail sale, irrespective of the number of transactions which have previously taken place; the amounts paid during the preceding stages of the process are deducted from the VAT payable by a taxable person, with the result that the tax applies, at any given stage, only to the value added at that stage and the final burden of the tax rests ultimately on the consumer.

More generally, and irrespective of economic incidence, if the tax is not designed to be passed on to the consumer, it would typically also not be prohibited by article 401 of the VAT Directive.

The EU concerns raised include the application of the the fundamental freedoms, especially the freedom of establishment under articles 49 and 54 of the TFEU, with regard to potential covert discrimination of foreign-owned taxpayers.

On the compatibility with fundamental freedoms

Regarding the first option, this does not seem to create any different treatment, as the turnover is a neutral criterion and it applies in the same way to all undertakings.

As regards the second option, it is evident that elements of the economic activity of the whole multinational group is taken into account and therefore the tax rate of two undertakings with the same turnover in Country A may be different (higher) for the undertaking that belongs to a multinational group, as the consolidated turnover of the linked undertakings is to be taken into account. Where the linked undertakings are established in other member states, the fundamental freedoms apply.

As the Court held in the Hervis case, where a similar rule was under examination, the imposition of such a tax may affect the provisions of the Treaty relating to the freedom of establishment, the freedom to provide services and the free movement of capital. Therefore it is necessary first to determine which freedom is at issue. According to the settled case-law of the Court, the purpose of the legislation concerned must be taken into consideration (Case C 35/11 Test Claimants in the FII Group Litigation, para 90). National legislation intended to apply only to those shareholdings which enable the holder to exert a definite influence on a company's decisions and to determine its activities falls within the scope of Article 49 TFEU on freedom of establishment (see Test Claimants in the FII Group Litigation, paragraph 91 and the case-law cited).

Since the draft law is aimed to apply to taxable persons who have linked undertakings and the consolidated turnover is taken into account, it appears that the freedom of establishment is applicable. In case the law applied to linked undertakings irrespective of whether those shareholdings enable the holder to exert a definite influence on a company's decisions and to determine its activities, then the free movement of capital could also be applicable. In the latter case, even companies that belong to multinational groups established outside the EU could potentially seek protection under the TFEU.

<u>On the issue of discrimination</u>

Possible discrimination issues may be raised due to the fact that the new tax has a progressive rate structure and takes into account the consolidated turnover of the linked undertakings, where an undertaking is a member of a multinational group. At the core of Vodafone was the argument that the progressive rate structure amounted to covert discrimination, as it, in fact, targeted largely foreign-owned taxpayers.

According to the established case law of the Court, covert or indirect discrimination could arise from criteria that do not constitute nationality discrimination from a purely formal perspective, but have the same effect, such as residency-based discrimination or differences in taxation based on unlimited or limited taxation of the taxpayer's parent company (see for example Case C-279/93, Schumacker, para. 26, C-383/05, Talotta, para. 17; Case C-324/00, Lankhorst- Hohorst, paras. 27-30, Hervis (C-385/12), para. 30; and ANGED (C-233/16), para. 30).

In Hervis the special tax took into account the full turnover of the worldwide group ("linked undertakings") before allocating turnover to the Hungarian company and taxing it at steeply progressive rates. In that way elements of the economic activity of the group became relevant in computing the tax liability of a Hungarian resident. The Court in Hervis, however, accepted the existence of covert discrimination in respect of such a system if "the taxable persons covered by the highest band of the special tax are 'linked', in the majority of cases, to companies which have their registered office in another Member State". In the Vodafone case, the Court adopted a narrow approach: the fact that a tax is borne in the vast majority of cases or exclusively, by non-residents or foreign-owned residents should not necessarily be seen, in itself, as indirect discrimination. Accordingly, the second alternative by which the tax is based on the consolidated of the linked undertakings can give rise to covert discrimination if it is established that the companies it by the higher tax rate are mainly members of multinational groups.

PART C

Question 5

Part 1

Suggested answer: First identify that both companies fall under the scope of the directive and thus, the PSD is applicable (holding, corporations, annex). In this context, the obligations the PSD imposes are exemption from withholding tax (WHT) for Luxembourg and exemption or credit for Spain unless the minimum holding period is ultimately not fulfilled (see art. 3(2) (b) of the Dir.) or the dividend was deductible in Luxembourg. The answer would change if STRESS was a SICAV exempt from corporate tax, because, then, it would not fall within the scope of the PSD as according to Article 2 (a) (iii) to fall within the scope of the PSD, the company must not be exempt from tax, which is what STRESS is according to the case. Additionally, the SICAV does not figure in Annex I for Luxembourg and according to the Gaz de France case (C-247/08) the list of Annex I is exhaustive as otherwise legal certainty would be jeopardised.

Part 2

Suggested answer: No Italy cannot fully tax the dividends, Article 1(1) (c) extends the application of the PSD to the PE. Italy must exempt/give credit.

Part 3

Yes, Italy as the PE state is not subject to the obligation under Art. 5 PSD, since a payment from the PE to the head office does not qualify as a distribution of profits. However, such an equivalence levy would likely amount to a violation of the fundamental freedoms (CLT-UFA, C-253/03) since Italy would not be allowed to levy a withholding tax if the PE were a subsidiary; the withholding tax on the distribution of the subsidiary on the basis that Spain exempts the received dividends is not in line with Article 5 PSD, the exemptions provided under Articles 4 and 5 PSD are necessarily cumulative in order to prevent economic double taxation.

Part 4

The solidarity levy would be covered by Article 4(3) PSD and, thus, would be in line with the directive. However, such a levy would most likely violate the free movement of capital (as per the Groupe Steria case, C-386/14) as it would only apply to distributions to foreign shareholders.

Question 6

The ATAD was inspired from the BEPS project. Until the adoption of the ATAD, each Member State had its own general or specific anti-avoidance rules, without any obligation to introduce specific anti-avoidance legislation, other than the obligations imposed by primary EU law, existing secondary EU law and the CJEU case law. Most of these obligations related to the CJEU anti-abuse doctrine in direct taxation that existed already since the Cadbury Schweppes (C-196/04) judgment.

As the directive had to be implemented across all Member States, it certainly introduced obligations to these states to either amend their existing laws or introduce new laws to comply with the anti-avoidance provisions of the ATAD. In this sense, a level playing field has been achieved in that all Member States must now comply with the interest limitation rule (Article 4 of the ATAD), the exit tax rule (Article 5 of the ATAD), the GAAR (Article 6 of the ATAD), the CFC rules (Articles 7 and 8) and the anti-hybrid rules (Article 9 and 9a of the ATAD). This level playing field has to be contrasted to the situation prior to the adoption of the ATAD, whereby Member States had no obligation to have in place such rules (exit taxes, CFC etc.) and thus, the internal market was indeed fragmented as to the anti-avoidance provisions each State had in place.

Despite the aforementioned positive impact, the ATAD remains a directive that has to be implemented in the Member States. As opposed to a Regulation (which according to Article 115 TFEU cannot be used in direct taxation), the directive by and of itself leaves some leeway to Member States in the implementation process. As the ATAD provides only for a minimum level of harmonisation, the actual form of implementing measures taken by each Member State can vary widely as Member States may opt to implement stricter anti-avoidance rules than the ones in the directive. In addition, the existing options granted in the ATAD give rise to a certain fragmentation, which is however lower than it would be in the absence of the Directive's minimum harmonisation effect. These explicit options, that may undermine the possibility of establishing a level playing field, give the possibility to Member States to foresee exceptions to the application of an anti-avoidance rule, e.g. the exclusion of financial undertakings from the interest limitation rule; the extension of the substance carve-out to third-country resident CFCs; the (temporary) exclusion from the scope of the anti-hybrid rule for certain mismatches resulting from interest payments.

Question 7

The need to maintain the balanced allocation of taxing rights has been invoked as a justification for restrictive tax laws on several occasions, sometimes by itself but more often in conjunction with the goal of preventing tax avoidance. At the core of this justification is the idea that a Member State has the right to ensure that incomes subject to the balanced allocation of taxing rights in a given country can in fact be taxed there.

The need to maintain a balanced allocation of taxing rights was first invoked as a justification in the 2005 case Marks & Spencer. The same approach was continued in Oy AA (Case C-231/05), Lidl (Case C-414/06), Glaxo Wellcome (Case C-182/08), Société de Gestion Industrielle (SGI) (Case C-311/08) and X Holding (Case C-337/08).

The need to safeguard balanced allocation of taxing rights, however, has not been evaluated separately, except in the X Holding case. In other cases the justification has been evaluated together with other reasons justifying a restrictive tax measure. In Marks & Spencer, the other reasons mentioned were the risk of double use of losses and the risk of tax avoidance; in Oy AA, in Glaxo Wellcome and in Société de Gestion Industrielle (SGI), the risk of tax avoidance and, in Lidl, the risk of double use of losses.

The need to safeguard balanced allocation of taxing rights may even alone justify tax treatment constituting a restriction on the TFEU freedoms. However, the risk of cross-border tax avoidance very often involves the risk of unbalanced allocation of taxing rights between the Member States, so it may not always be necessary to evaluate these two justification grounds separately. In Oy AA, the EU Court mentioned that the objectives of safeguarding balanced allocation of taxing rights between the Member States and the need to minimise the risk of tax-avoidance are closely related to each other. Many tax-avoidance arrangements jeopardise the right of the Member States to use their taxing rights and consequently put at risk the balanced allocation of taxing rights between Member States. This is particularly relevant for wholly artificial arrangements with no relation to economic reality.

As the Court held in the Lexel case (C-484/19), the justification based on the need to maintain the balanced allocation of the power to impose taxes between the Member States can be accepted where the system in question is designed to prevent conduct which is liable to jeopardise the right of a Member State to exercise its power to tax in relation to activities carried out in its territory (Marks & Spencer, C 446/03, para 46, and Hornbach-Baumarkt, C 382/16, para 43). The preservation of the balanced allocation of the power to impose taxes between Member States may make it necessary to apply to the economic activities of companies established in one of those States only the tax rules of that State in respect of both profits and losses (Lidl Belgium, C 414/06, para 31, and SGI, C 311/08, para 61).

The justification based on the preservation of the balanced allocation of the power to impose taxes between Member States has inter alia been allowed by the Court where a condition of residence is required in order to benefit from a particular tax scheme in order to avoid the taxable subject having the free choice of deciding in which State a profit is taxed or a loss is taken into account and the possibility of freely moving the taxable base between Member States (Oy AA, C 231/05, para 56; SGI, C 311/08, para 62 and X Holding, C 337/08, paras 29 to 33). For those reasons, the Court has held that the consolidation at the level of the parent company of the profits and losses of the companies forming a single tax entity constitutes an advantage which may justifiably be reserved to resident companies in view of the need to preserve the allocation of the power to impose taxes between the Member States (X Holding, C 337/08, paras 29 to 33).

However, as regards tax advantages other than the transfer of profits or losses within a tax-integrated group, a separate assessment must be made as to whether a Member State may reserve those advantages to companies belonging to such a group and consequently exclude them in cross-border situations (Groupe Steria, C 386/14, paras 27 and 28). In its judgment of 22 February 2018, in the case X and X (C 398/16 and C 399/16, paras 40 and 41), the Court held that the Netherlands rules on the deduction of interest could not be justified by the need to preserve a balanced allocation of the power to impose taxes. That was the case in particular because, unlike the situation of the general offsetting of costs and gains specific to a single tax entity, the case which gave rise to that judgment involved an advantage without any specific link to the tax scheme applicable to such entities. In the Lexel case the justification based on the preservation of a balanced allocation of the power to impose taxes between the Member States was not accepted (para. 70).

In the Lexel case the Court also examined whether the rules at issue in the main proceedings could be justified by taking account together of the justifications related to the fight against tax evasion and tax avoidance and the preservation of a balanced allocation of the power to impose taxes between the Member States. In the SGI case (C-311/08) the Court has already ruled that national legislation which is not specifically designed to exclude from the tax advantage which it confers purely artificial arrangements, devoid of economic reality and created with the purpose of escaping the tax normally due on the profits generated by activities carried out on national territory, may nevertheless be regarded as justified by the objective of preventing tax avoidance, taken in conjunction with the objective of preserving the balanced allocation of the power to impose taxes between the Member States. However, the taking into consideration of those grounds of justification together has been accepted by the Court in very specific situations, namely where the fight against tax avoidance constitutes a particular aspect of the public interest linked to the need to preserve a balanced allocation of the power to impose taxes between the Member States (Oy AA, C 231/05, paras 58 and 59, and SGI, C 311/08, para 67).

The Court has noted that the objectives of safeguarding the balanced allocation of the power to impose taxes between Member States and the prevention of tax avoidance are linked. 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, is such as to undermine the right of the Member States to exercise their tax jurisdiction in relation to those activities and to jeopardise a balanced allocation between Member States of the power to impose taxes.

Consequently where, as was the case in Lexel, a Member State cannot validly assert the justification based on the need to preserve a balanced allocation of the power to impose taxes between the Member States, a measure, cannot be justified on the basis of taking account together of the need to preserve a balanced allocation of the power to impose taxes between the Member States and of that of the fight against tax avoidance (para. 76).

Question 8

Anti-tax avoidance and aggressive tax planning preventive measures established by the ATAD aim to guarantee a single tax principle in cross-border taxation. The directive was considered the appropriate means to transpose the OECD BEPS measures into the national systems of EU member states in a coherent and coordinated fashion. However, some doubts are raised whether the Directive is indeed an appropriate mechanism to transpose the OECD BEPS measures into the EU legal system.

The ATAD contains five anti-tax avoidance rules: 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 ; CFC Rule reflects BEPS Action Plan 3, and Hybrid Mismatches Rule mirrors BEPS Action Plan 2. The Exit Taxation rule and the GAAR are not part of the OECD BEPS project.

Article 5 of the ATAD provides for 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 and imposes taxation based on the market value at the moment when the assets, residence or business leaves the tax jurisdiction.

According to the case law of the Court of Justice, exit taxation constitutes a discriminatory obstacle to the freedom of establishment. This follows immediately from the fact that a tax charge is levied on the mere change of location where it involves a crossing of borders within the EU, while no such charge arises upon relocation within one Member State. In a long series of cases (Case C-9/02 de Lasteyrie du Saillant; Case C-470/04 N; Case C-345/04 Commission v Portugal; Case C- 269/09 Commission v Spain) the CJEU has developed conditions under which the levy of such a tax can nevertheless be justified in light of the need to ensure that increases in asset values are taxed in the country where they arise without giving rise to double taxation or opportunities to escape taxation as a consequence of bilateral tax treaties dividing taxing rights based on physical location of assets or residence (the CJEU brings this within the justification ground of the "balanced allocation of taxing rights linked to its temporal component"). Although the ATAD seeks to replicate the requirements set out by the CJEU for EU-law compliant exit taxation rules, in particular in light of DMC (Case C-164/12) and Verder Labtec (C-657/13), questions remain.

The first issue is the compatibility of a collection in instalments over a fixed period of five years for the taxation of unrealised capital gains assessed upon a change of tax jurisdiction. While the Court had previously held that the taxpayer ought to be given at least the option for tax collection to be deferred to the point of actual realisation, it had accepted such collection by instalments – for companies – in DMC and Verder Labtec. Given the discriminatory nature of an exit tax – which is not levied upon asset or residence movements within a country – it is not clear why this should be accepted as the least restrictive measure to safeguard the balanced allocation of taxing rights between the Member States involved in all cases.

Another concern arises, second, from the option given to Member States to require both interest payment (Art. 5 para. 3 subpara. 1 ATAD) and guarantees (Art. 5 para. 3 subpara. 2 ATAD) in case a taxpayer takes advantage of taxes paid in instalments. Even if collection of the tax in installments was considered to be a necessary and appropriate measure the charge of interest in addition appears to be disproportionate.