

# Article

## *ATA Directive: Some Observations Regarding Formal Aspects*

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*In this article the authors analyse to what extent the objectives of the Council of the European Union (EU) and the EU Commission are effectively realized through the ATA Directive. Authors believe that the choice for a Directive is likely not the most effective, while for a substantial period potentially resulting in legal uncertainty regarding the scope of the Directive's terminology and provisions. The relationship with existing international (tax) treaty obligations is complex as well as with existing income tax Directives. Moreover, the choice for a Directive puts the tax authorities – who have the primary initiative in applying its provisions – in a relative weaker position since under EU law they cannot unlike taxpayers directly apply the Directive's provisions. Finally, it can be questioned where local tax authorities have the initiative, whether the EU Commission review and monitoring process will be sufficient to safeguard a consistent application of the Directive's provisions within the EU, creating a level playing field. In view of this, authors conclude that a Regulation or alternatively a peer review mechanism may result in less legal uncertainty and a more effective mechanism to realize the Council of the EU and the EU Commission's objectives.*

### 1 INTRODUCTION

In January this year, the European Union (EU) Commission published a draft Directive,<sup>1</sup> following through on the Council of the EU's policy decision to implement the Organization for Economic Cooperation and Development (OECD) recommendations of Base Erosion and Profit Shifting (BEPS) project within the EU context. This draft Directive introduces EU provisions for the areas covered by the OECD BEPS project, (1) hybrid mismatches, (2) Controlled Foreign Corporation (CFC), (3) interest deduction limitation as well as EU provisions for areas not covered by the OECD BEPS project, (4) switch-over clause, (5) exit taxation and (6) General Anti-Avoidance Rule (GAAR). The draft Directive has been approved on June 21, 2016.<sup>2</sup>

This Directive aims restoring a level playing field between enterprises solely operating within one EU Member State and enterprises operating in multiple EU Member States and other countries. The latter category is according to the EU Commission better able to reduce

their effective income tax rate through exploring differences between the income tax regimes of EU Member States.<sup>3</sup> Hence by issuing a Directive under Article 115 Treaty on the Functioning of the EU ('TFEU'), the EU Commission takes the position that the balance between fiscal autonomy on direct taxation and the functioning of the internal market should be mitigated in favour of the latter.<sup>4</sup> It should be observed that in *Euwings*,<sup>5</sup> the European Court of Justice (ECJ) allowed EU companies to benefit from tax competition within the internal market.

Out of several options,<sup>6</sup> the EU Commission has chosen for proposing a Directive to the Council of the EU. Below it is investigated whether a Directive is the best available option to realize the goals as stated in the preamble of the ATA Directive as well as other policy statements made by the Council of the EU. In paragraph 2, first some introductory observations are made, notably regarding the asymmetry in which EU law impacts corporate income taxation. Subsequently, in paragraph 3 all instruments available to the EU Commission to realize the Council of the EU's goals are analysed followed by how the decision to propose a Directive relates to the purpose of the BEPS project and EU internal market. Next in paragraph 4 it is discussed whether the Directive meets the subsidiarity and proportionality

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<sup>1</sup> 28 Jan. 2016, COM(2016) 26, to be further referred to as the ATA Directive (Anti-Tax Avoidance).

<sup>2</sup> The article incorporates developments up to 15 May 2016, except that in this article no references are made to the draft ATA Directive.

<sup>3</sup> Resulting from a lack of (1) coordination between EU Member States, (2) harmonization of the tax base within EU Member States or (3) unification of the tax base and eventually tax collection at the EU level.

<sup>4</sup> Implying that some differences between the income tax regimes are mitigated through the ATA Directive.

<sup>5</sup> ECJ 26 Oct. 1999, C-294/97 (*Euwings Luftverkehrs*).

<sup>6</sup> A Directive, a Regulation, a multilateral Treaty between EU Member States and/or an EU monitoring group with peer review.

tests under Article 115 TFEU. Subsequently, in paragraphs 5 and 6 the implementation and appeal procedures are highlighted, followed in paragraph 7 by a brief discussion of potential conflicts with other (EU) tax law and income tax treaties entered into by the Member States. Thereafter paragraph 8 contains a brief discussion on the consequences for the assessment of uncertain tax positions under US Generally Accepted Accounting Principles (GAAP) and International Financial Reporting Standards (IFRS). This article is concluded by a summary.

## 2 INTRODUCTORY OBSERVATIONS

It is important to observe that applying current EU law in the area of direct taxation may result in asymmetrical consequences when determining the domestic taxable base. Under EU law an EU Member State is obliged to treat non-residents active on its domestic market through the internal market, no worse than its domestic residents not relying on the internal market. The reverse situation is however not covered under EU law: an EU Member State may treat its own residents<sup>7</sup> not active on the internal market less beneficial compared with non-residents<sup>8</sup> which are active in this EU Member State through the internal market. A Member State may thus discriminate against its own residents and it is this asymmetric position which amongst others facilitates EU cross border tax planning and is a location factor for setting up business within the EU. This asymmetry manifests itself most clearly in the determination of the taxable base and in fact in the allocation of the taxable base between EU Member States. Non-residents which are under the same facts and circumstances are treated less advantageous than residents, will in most instances enjoy a reduction in taxable base. However, residents only operating domestically cannot enjoy a reduction in their domestic taxable base which international operating entities are able to enjoy by exploiting differences in income tax regimes, primarily by using legal entities resident in different jurisdictions between which income is allocated. The ATA Directive only partly addresses shifting or differences in determining the taxable base between EU Member States, while it does not address rate differences between EU Member States.<sup>9</sup> So rate differences, being a powerful incentive for tax planning, can still exist on a domestic level within the EU and remain unaffected by this Directive, especially where such rate has

cleared the State Aid threshold and falls outside the scope of the Harmful tax competition criteria.<sup>10</sup>

This asymmetry in determining the taxable base also benefits enterprises in jurisdictions outside the EU and European Economic Region (EER). As of 1 January 1994 such enterprises in 3rd jurisdictions can in principle<sup>11</sup> rely on the EU freedom of capital. Hence, like any EU resident, they can in principle avail themselves of the differences in taxable base allocations as well as income tax rates between different EU Member States. However, in the proposed switch-over and CFC measures it maybe that low tax regimes in 3rd jurisdictions are treated worse than similar regimes within the EU, benefitting from other protections under EU law.

One could say that this ATA Directive is to a certain extent at the internal market level mirroring what the State Aid provisions<sup>12</sup> are covering at a domestic level: only international operating companies have the opportunity to benefit from differences between EU Member States' income tax regimes.<sup>13</sup> Where the State Aid provisions are based on a specific provision in the TFEU, the ATA Directive is however based on a general concept within EU law (intervention at the EU level in case of 'mal'functioning of the internal market) and so one could ask whether relying on such general principle may be a sufficient legal basis for the ATA Directive. For example, the Directive only targets tax planning between related entities, and so unrelated business entities operating in various EU Member States enjoying the same benefits under the same circumstances can continue to benefit from exploiting differences. The latter is so far apparently not perceived as unintended consequences and hence so far no correction mechanism seems warranted under EU law, all other facts and circumstances being equal.<sup>14</sup> Since the TFEU without State Aid provisions would probably lack an effective mechanism to combat State Aid based on general EU principles and provisions, one could subsequently ask whether tax evasion as targeted by the ATA Directive

<sup>7</sup> A resident corporate payer whose shares are owned by (a) resident tax payer(s), active on its domestic market.

<sup>8</sup> A resident corporate tax payer whose shares are owned by (a) resident tax payer(s), active on both its domestic as well another EU Member State's market. Or a resident corporate tax payer whose shares are owned by (a) non-resident tax payer(s), active in its domestic market (and eventually in another EU Member State as well).

<sup>9</sup> Rate differences are a key driver for exploiting difference between income tax regimes, and so setting a minimum income tax rate could help.

<sup>10</sup> E.g. generic working innovation box regimes.

<sup>11</sup> Unless the standstill provision of Art. 64, para. 1, TFEU can be invoked by an EU Member State.

<sup>12</sup> Arts 107–109 of the TFEU, declaring selective advantages through state resources incompatible with the internal market where competition has been or may be distorted and trade between EU Member States may likely be affected.

<sup>13</sup> As opposed to selective advantages granted to domestic residents by one EU Member State.

<sup>14</sup> E.g. an airline leasing aircrafts from an unrelated lessor (e.g. a leasing companies owned by multiple airlines and leasing aircraft to these multiple airlines whose shareholders do not qualify as related) under an at arm's length lease with local substance in a low tax EU jurisdiction is not covered by the ATA Directive, while the same transaction is potentially covered when the lessor is related to the lessee airline, all other facts and circumstances being the same. Such intercompany leasing transaction is relevant for both the switch-over rule as well as the CFC rule (but only if it qualifies as a financial lease. The CFC rule only covers financial leases, while the Directive does not contain standards for qualifying cross border lease in multiple jurisdictions). Being in scope for both rules, only the CFC rule provides a safe harbor and thus targets primarily wholly artificial establishments.

would be better countered by a similar type of provision in the TFEU.<sup>15</sup>

### 3 INSTRUMENT

#### 3.1 Introduction

Both the EU Commission as well as the EU Council have stated that they will implement the proposed measures of the OECD BEPS project within the EU. In doing so there are various legally binding instruments ('hard law') they can use. Alternatively, they could follow the OECD in setting up peer review groups on the various topics covered by the BEPS project ('soft law') somewhat similar to the Global Forum Transparency and Exchange of Information for tax purposes ('GFTEI'). Even though such arrangements through peer review are in principle non-binding, the political dynamics as well as press coverage generated by these peer review groups aim to ensure that EU Member States implement domestic legislation leading to a better and more level playing field.

#### 3.2 'Soft Law' Option

Within the EU context, a 'soft law' arrangement such as peer review has a different dynamic compared with a 'hard law' arrangement such as a Directive or Regulation. A peer review process is more inclusive in its set-up compared with a Directive or Regulation. First, each EU Member State has in principle an equal say, since there are no corrections made for the number of inhabitants in any EU Member State. Even though the approval of a Directive or Regulation in the area of direct taxation is subject to unanimity, once that hurdle has been cleared, the larger EU Member States<sup>16</sup> could potentially through the EU Commission have a relative bigger impact on the subsequent monitoring of the domestic implementation or execution through for example infringement procedures. Furthermore, a peer review process is outside the scope of the ECJ and thus while on the one hand no legal proceedings are available to challenge the outcome of such peer review, on the other hand the ECJ's role, having at times issued rulings in the area of income taxation which sometimes seem contra dictionary, is not always resulting in the level playing field most EU Member States desire. A negative aspect of peer review is that the direct democratic representation at the EU level in such process is relatively weak to non-existent.<sup>17</sup>

<sup>15</sup> This would be a challenge for income taxation however, since EU law has no direct exclusive competence in the area of direct taxation.

<sup>16</sup> Larger EU Member states may assign relatively more EU civil servants than smaller EU Member States and have relatively more EU Commissioners compared with smaller EU Member States. As a consequence, they may have a relative bigger impact on the monitoring the implementation and execution of a Directive or Regulation pursuant to Art. 17, para. 1, TEU once it has been adopted.

Since no 'soft law' option has been pursued, the 'hard' law options are further discussed and qualified below.

#### 3.3 Options in EU Legal Framework

The Treaty on the functioning of the EU provides in Article 288<sup>18</sup> two hard law instruments through which direct taxation issues can be addressed, a Directive based on Article 115 TFEU or a Regulation based on Article 352 TFEU. Both instruments are prepared and drafted by the EU Commission but in principle issued by the Council of the EU, having legislative power. A proposed Directive is subject to review by the European Parliament as well as the national parliaments of the EU Member States.<sup>19</sup> In the area of direct taxation, a Directive or Regulation can only be approved in the Council of the EU by unanimous vote. Both instruments create definitions and terminology which is distinct from the meaning of similar definitions and terminology at a domestic level. Since both instruments are based on authority vested in the TFEU, they have an independent meaning within the TFEU context. Hence definitions and terminology used in a Directive or Regulation can not be equated with the domestic meaning in an EU Member State.

The legal consequences 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 covered under the Regulation. Since a Regulation is vested in the TFEU, it has a somewhat stronger footing than domestic legislation and thus is in a sense overriding domestic legislation and treaties entered into by a Member State.<sup>20</sup> A Regulation can be challenged by starting<sup>21</sup> an annulment procedure with the ECJ<sup>22</sup>

<sup>17</sup> There is no democratic elected EU institution involved in the peer review, hence one should find the democratic basis for such review in the authority vested in domestic Parliaments.

<sup>18</sup> Art. 288 TFEU reads: '(i) to exercise the Union's competences, the institutions shall adopt regulations, directives, decisions, recommendations and opinions; (ii) a regulation shall have general application. It shall be binding in its entirety and directly applicable in all Member States; (iii) a directive shall be binding, as to the result to be achieved, upon each Member State to which it is addressed, but shall leave to the national authorities the choice of form and methods; (iv) a decision shall be binding in its entirety upon those to whom it is addressed; (v) recommendations and opinions shall have no binding force.'

<sup>19</sup> The procedure is further elaborated in Protocol (No 2) to the TFEU on the application of the principles of subsidiarity and proportionality. This procedure is not discussed in further detail.

<sup>20</sup> Art. 352 TFEU reads amongst others: 'if action by the Union should prove necessary, within the framework of the policies defined in the Treaties, to attain one of the objectives set out in the Treaties, and the Treaties have not provided the necessary powers, the Council, acting unanimously on a proposal from the Commission and after obtaining the consent of the European Parliament, shall adopt the appropriate measures.'

<sup>21</sup> By the EC, the European Parliament and/or EU Member States.

<sup>22</sup> The ECJ (i) reviews the legality of the acts of the institutions of the European Union (annulment procedure), (ii) ensures that the Member States comply with obligations under the Treaties (infringement procedure), and (iii) interprets European Union law at the request of the national courts and tribunals (preliminary rulings).

should the regulation been issued in violation of primary material EU or formal EU law, such as procedural defect, lack of authority or misuse of authority.<sup>23</sup> The interpretation of a Regulation insofar applied domestically may be subject to preliminary rulings with the ECJ to be submitted by the local courts.

A Directive however is only binding upon the EU Member States which are free in choosing the form and methods for implementing the Directive. EU citizens and entities can directly apply an EU Directive in the event EU Member States have incorrectly or not timely implemented the Directive to the detriment of an EU resident. Contrary to an EU Regulation, public institutions cannot directly apply an EU Directive.<sup>24</sup> Since the provisions of a Directive can only be implemented in domestic law, they remain in principle<sup>25</sup> of a lower ranking than provisions in international treaties to which a Member State is party. So even though the authority to issue a Directive is vested in a generally higher ranking treaty, the domestic provisions resulting from its implementation rank below provisions from international treaties.

Challenges to the domestic implementation of a Directive are brought before a domestic court which can ask the ECJ for a preliminary ruling, which either challenges the domestic implementation of part or all of the Directive or in rare circumstances all or part of the Directive itself being for example in violation with EU law.<sup>26</sup> Where a domestic court let provisions in international (tax) treaties prevail over the local provision based on the ATA Directive, the EU Member States may violate EU law,<sup>27,28</sup>

Alternatively, all EU Member States can upon initiative of for example the Council of the EU or EU Member

States enter into a separate international treaty. Such treaty, even though rooted in the TFEU, would function as a separate treaty next to the TFEU, and needs to be ratified by the governments of all EU Member States before it can take effect in all EU Member States. Such ratification procedures can be lengthy and complex especially where a treaty enters into force once all Member States have ratified the treaty under their domestic procedures. Alternatively, in the event such treaty enters into force once a minimum number of Member States have ratified such treaty, a level playing field is still not yet ensured in all EU Member States. However, this can be solved by designating for instance jurisdiction to the ECJ to give judgment concerning the interpretation of the treaty.<sup>29</sup> Likewise, they could create an institution which shall oversee the application of the treaty and ensures a correct application of it.

### 3.4 Chosen Instrument

The Council of the EU and the EU Commission have chosen a Directive for implementing part of the OECD recommendations of BEPS project within the EU context. At first sight issuing a Regulation seems not possible, since an EU Regulation can only be issued for matters where the EU has exclusive competence or legislates extensively<sup>30,31</sup> which is not directly the case for direct income taxation. However, Article 352 TFEU<sup>32</sup> allows to adopt appropriate measures to attain one of the objectives set out in the Treaties even when the Treaties have not provided the necessary powers. One could argue thus that even though no explicit power has vested at the EU level this article nevertheless provides a legal basis for issuing a Regulation provided all procedural requirements are met. These procedural

<sup>23</sup> Art. 263 TFEU.

<sup>24</sup> E.g. ECJ 26 Feb. 1986, case 152/84 (Marshall).

<sup>25</sup> Depending on the law of the EU Member State, which may or may not have provisions which prioritize international treaties over domestic provisions.

<sup>26</sup> E.g. ECJ 8 Apr. 2014, joined cases C-293/12 and C-594/12 (Digital Rights Ireland and Seitlinger).

<sup>27</sup> Art. 351 reads: '(i) the rights and obligations arising from agreements concluded before 1 January 1958 or, for acceding States, before the date of their accession, between one or more Member States on the one hand, and one or more third countries on the other, shall not be affected by the provisions of the Treaties. (ii) to the extent that such agreements are not compatible with the Treaties, the Member State or States concerned shall take all appropriate steps to eliminate the incompatibilities established. Member States shall, where necessary, assist each other to this end and shall, where appropriate, adopt a common attitude. (iii) In applying the agreements referred to in the first paragraph, Member States shall take into account the fact that the advantages accorded under the Treaties by each Member State form an integral part of the establishment of the Union and are thereby inseparably linked with the creation of common institutions, the conferring of powers upon them and the granting of the same advantages by all the other Member States.'

<sup>28</sup> ECJ 10 Mar. 1998, joined cases C-364/95 and C-365/95 (T-port) sets principles for when EU law provisions can be deprived of effect due to international obligations towards 3rd countries (see para. 61).

<sup>29</sup> Art. 272 TFEU.

<sup>30</sup> See Art. 288 TFEU.

<sup>31</sup> The same applies for a Directive.

<sup>32</sup> Art. 352 reads as follows:

1. If action by the Union should prove necessary, within the framework of the policies defined in the Treaties, to attain one of the objectives set out in the Treaties, and the Treaties have not provided the necessary powers, the Council, acting unanimously on a proposal from the Commission and after obtaining the consent of the European Parliament, shall adopt the appropriate measures. Where the measures in question are adopted by the Council in accordance with a special legislative procedure, it shall also act unanimously on a proposal from the Commission and after obtaining the consent of the European Parliament.
2. Using the procedure for monitoring the subsidiarity principle referred to in Art. 5(3) of the Treaty on European Union, the Commission shall draw national Parliaments' attention to proposals based on this Article.
3. Measures based on this Article shall not entail harmonization of Member States' laws or regulations in cases where the Treaties exclude such harmonization.
4. This Article cannot serve as a basis for attaining objectives pertaining to the common foreign and security policy and any acts adopted pursuant to this Article shall respect the limits set out in Article 40, second paragraph, of the Treaty on European Union.

steps are more or less in line with the procedural steps for issuing a Directive, of which the unanimity and subsidiarity<sup>33</sup> requirements are the most important. The benefits of issuing a Regulation would be twofold: a directly binding obligation to all private and public actors in the EU and a reduced risk of an inconsistent implementation of Directive provisions between the domestic laws of EU Member States. There are no public sources available on why the EU Commission did not opt for a Regulation.

Article 115 TFEU authorizes the Council of the EU to issue Directives for the approximation of EU Member States laws, regulations and administrative provisions where they affect the functioning of the internal market. When proposing a Directive, the EU Commission should verify whether the draft Directive meets the subsidiarity and proportionality tests, since direct taxation is not directly governed by EU laws. It needs to be demonstrated that not further approximating laws, regulations and administrative provisions in the BEPS area, is adversely affecting the functioning of the internal market. These tests are further discussed in the next paragraph.

The ATA Directive differs in its perspective from the earlier issued Directives in the areas of direct taxation. The Directives implemented so far,<sup>34</sup> aimed to eliminate obstacles in the EU Member States' domestic local income and dividend tax laws. Hence these Directives allowed for exemptions of or roll over relief from domestic taxation for qualifying transactions between Member States, provided certain condition are met, while simultaneously providing safeguards against tax evasion and tax avoidance through an anti-abuse rule. In other words, these Directives addressed an internal market deemed not functioning well enough.

Under these Directives bona fide tax payers executing qualifying transactions are the principle actors when relying on the Directive, while tax authorities will check whether a qualifying transactions may qualify as tax evasion under the anti-abuse rule. Tax payers have a clear incentive to challenge domestic tax provisions and regulations which are not in line with these Directives or have not been implemented in accordance with EU law, because they directly benefit from the relief granted. Hence tax payers triggered a multitude of cases<sup>35</sup> which nearly all resulted in eliminating domestic obstacles when executing qualifying cross border transactions covered by these Directives and setting boundaries what is to be perceived as tax evasion under EU law.<sup>36</sup>

The ATA Directive has an inverse set-up compared with implemented Directives, first of all addressing multiple topics instead of one topic per Directive as earlier directives did. Since the ATA Directive aims to ensure within the EU that income tax is paid where profits and value are generated, it is a correction on the existing status quo. So the starting premise is that even though direct taxation is not directly governed by EU law, domestic tax provisions may unintendedly adversely affect the functioning of the internal market, because the interaction of domestic tax systems across various EU Member States may result in an overall taxation which is not in line with where economic value is generated. In other words, this Directive addresses an internal market deemed functioning too good to be in accordance with primary EU law.

This is a novel and far-reaching concept in direct taxation, likely subject to challenge and if upheld could provide the Council of the EU and/or EU Commission with more power in the area of direct taxation. However, it can be questioned whether under Article 5 Treaty of the European Union (TEU)<sup>37</sup> EU Member States have indeed conferred such competences to the EU in the area of direct income taxation. The ATA Directive, absent a distinction between the subject and object of direct income taxation in a given EU Member State and absent a mechanism for resolving conflicts in subjects and objects of taxation between multiple EU Member States, other than the EU Arbitration Convention, in essence forces a correction of the taxable base (the object) in (a) (multiple) Member States. Hence the basis under the ATA Directive seems solely based on the assessment of the functioning of the EU internal market by the Council of the EU and/or EU Commission.<sup>38</sup>

Now implemented, tax authorities are the principal actors having a clear incentive for applying the principles laid down in this Directive, while tax payers will look for safe harbors for transactions covered by the Directive. The tables have thus been turned compared with the other Directives covering direct income taxation. The tax authorities are at a relative disadvantage compared with tax payers, because where domestic provisions have been implemented to the detriment of tax authorities they cannot directly rely on the ATA Directive's provisions, while taxpayers in the reverse

<sup>33</sup> Art. 5 TEU.

<sup>34</sup> The Merger Directive, 1990/434/EEC amended by 2005/19/EC, the Parent-Subsidiary Directive, 1990/435/EEC amended by 2003/123/EC, 2014/86/EU and 2015/121/EU and the Interest and Royalty Directive, 2003/49/EC.

<sup>35</sup> See e.g. joined cases C-283/94, C-291/94 and C-292/94 (Denkavit International BV, VITIC Amsterdam BV and Voormeer BV) and C-250/95 (Futura participations SA).

<sup>36</sup> Anti-abuse concepts under EU law will in principle differ from domestic anti-abuse concepts.

<sup>37</sup> Art. 5, para. 2, TEU reads: 'under the principle of conferral, the Union shall act only within the limits of the competences conferred upon it by the Member States in the Treaties to attain the objectives set out therein. Competences not conferred upon the Union in the Treaties remain with the Member States.'

<sup>38</sup> Pursuant to Art. 263 TFEU, should an EU Member State be of the view that Art. 5 TEU has been violated, they should within two months of publication of the ATA Directive file an annulment procedure with the ECJ. In a later stage the same arguments can be put forward in the other appeal procedures.

situation can. Legal challenges will further clarify this mechanic.

An important question is whether a Directive covering simultaneously multiple topics related by the OECD's BEPS project as well as independent EU topics, is in its current form the optimal legal instrument under EU law to achieve the Council of the EU and EU Commission's stated objectives. The ATA Directive 'unites' and contains six different measures of which some seem better suited for implementing through a Directive than others. Where measures are relatively targeted, such as those relating to hybrid mismatches, exit taxation and interest limitation deduction, the choice for a Directive seems right especially where the concepts laid down in the Directive do not much deviate from domestic similar concepts. However, where provisions do have a more general character and nature, such as the CFC, switch-over clause and the GAAR, domestic concepts of EU Member States in the same general areas covered by the ATA Directive differ from the EU concepts. As a result, when implementing the Directive, it is far from clear whether and how these EU and domestic concepts will align and so increasing the risk of litigation at a domestic level. A Regulation or a peer review mechanism for implementing general anti-abuse concepts, may be a better and more effective measure for all actors, tax payers as well as tax authorities, because a consistent application in all EU Member States is more likely and thus may ensure a more level playing field.

#### 4 SUBSIDIARITY AND PROPORTIONALITY

Since the EU has no exclusive competence in the area of direct taxation, a proposed directive should meet the standards of Articles 5 and 115 TFEU, the subsidiarity and proportionality tests.<sup>39</sup> Regarding the ATA Directive, the tax evasion this Directive aims to combat, is in practice almost always a result of differences between the EU Member States' direct income tax systems, where tax payers look for differences in determining the taxable subject and object as well as differences in qualifying legal instruments.<sup>40</sup> As discussed in the preceding paragraph, the Council of the EU and the EU Commission are of the view that competence to regulate in this area has been conferred to them by EU Member States. These grounds are likely to be tested by taxpayers given the relative narrow playing field in which the Council of the EU and EU Commission operate. Even though the ECJ has been relatively reluctant in accepting challenges to provisions in an EU Directive based on the subsidiarity principle, in the

area of direct taxation there have yet been no challenges to a Directive based on the violation of the subsidiarity principle litigated and this thus remains uncharted territory.

The EU Commission believes that implementing the recommendations of the OECD BEPS project and tackling cross-border tax avoidance can not be left to the EU Member States on their own; where the objective is to adopt solutions that function for the internal market as a whole and improve the internal market's resilience against (internal and external) aggressive tax planning, the appropriate response is coordinated initiatives at the EU level. In the EU Commission's view the subsidiarity test is thus met<sup>41</sup> since a domestic implementation of the OECD's BEPS recommendations – which all EU Member States have committed to implement – and the additional topics tackling cross-border tax avoidance have by definition a cross border dimension, hence a balancing of divergent interests within the internal market through a Directive is warranted. Moreover, according to the EU Commission in the event the OECD's BEPS recommendations are implemented through the acquis, tax payers can have legal certainty that they comply with EU law.<sup>42</sup> In our view, an alternative argument could be that even though EU Member States have not transferred any authority regarding the set-up (who is subject to direct income taxation and what is the object of taxation) of their income tax systems to the EU, the way income is allocated among EU Member States, may fall within the scope of Article 115 TFEU because this may affect the functioning of the internal market. The EU Commission does however not explain why the measures not covered in the OECD BEPS initiative but included in the ATA Directive also meet the subsidiarity test, but probably their view is that this test is met as well because these measures are covering more or less the same areas as the OECD BEPS recommendations, especially where the taxable base as opposed to being reduced may be broadened as a result.

Where the prior tax Directives were aimed at eliminating domestic obstacles potentially violating the EU fundamental freedoms,<sup>43</sup> the ATA Directive imposes measures based on a consensus reached by the Council of the EU in adopting the OECD BEPS project's recommendations as well as promoting its own EU initiatives. The ATA Directive mostly targets the outcome of specific or multiple transactions, for example the total effective taxation of the income relating to a dividend or a lease, instead of a specific transaction<sup>44</sup> or event<sup>45</sup> within the internal market between actors in two or more Member States, for example a dividend

<sup>39</sup> A Regulation should meet these criteria too, but this is not further discussed given the choice for a Directive.

<sup>40</sup> See for instance Arnaud de Graaf, Paul de Haan & Maarten de Wilde, *Fundamental Change in Countries' Corporate Tax Framework Needed to Properly Address BEPS*, 42 *Intertax* 306 (2014).

<sup>41</sup> 28 Jan. 2016, COM (2016) 26, 2016/0011 (CNS), page 4.

<sup>42</sup> See page 4 bottom, of the Explanatory memorandum to the draft ATA Directive.

<sup>43</sup> Free movement of capital and freedom of establishment.

<sup>44</sup> E.g. dividend, royalty or interest payments.

<sup>45</sup> E.g. (de)merger.

distribution or a lease between related companies. This is reflected in the proposed measures included in the ATA Directive which vary in focus between a specific transaction or event, the outcome of various transactions within a group, a specific state within a group of companies to a general anti-abuse provision. The proposed measures intervene in the working of the internal market and reverse the outcome for specific transactions or for actors on the internal market which primarily take advantage of the differences in income tax rates. In our view this approach sets a high bar for whether measures included in the ATA Directive meet the subsidiarity and proportionality tests.<sup>46</sup> A measure combatting tax evasion with potential adverse effects on the functioning of the internal market,<sup>47</sup> is in our view only acceptable under EU law if accompanied by relief for bona fide actors on this market.<sup>48</sup> The ATA Directive seems short on such safe harbor mechanisms.

The ATA Directive is a variety of related topics united in one Directive. First, this raises the question on how the subsidiarity and proportionality tests should be applied. Is the Directive itself or each of the different measures the object of these tests, given the variety of the provisions? In our view each measure should be tested on its own, because if the Directive as a whole should be tested measures clearly not meeting the subsidiarity test can piggy back on those meeting the test. One can further argue whether the subsidiarity and proportionality tests can be met when a measure deliberately creates distortions for the functioning of the internal market, especially when there is insufficient relief for bona fide actors and transactions suffering from these distortions.<sup>49</sup> An example is the proposed interest limitation rule, which resembles rules some EU Member States already have included in their domestic income tax laws. An interest limitation rule implemented in domestic law – thus excluded from the competence of the EU – should satisfy the basic principles of EU law, primarily the fundamental freedoms provisions and the proportionality test; the subsidiarity test is not part of the analysis. Since a domestic interest limitation rule is generally set-up as a generic measure not discriminating against resident and non-resident tax payers, there is in principle no conflict with any of the fundamental freedoms. However, where the interest limitation rule is introduced based on Article 115 TFEU the measure should now be tested under the subsidiarity principle where the functioning of the internal market is affected, a slightly different test than the one under the fundamental freedoms. In the former the relevant test is whether a domestic provision is equally applicable and

has a similar effect for resident and non-resident actors alike. In the latter the resident tax payer as benchmark falls out of the equation, the primary benchmark has now become the functioning of the internal market. And under this test the proposed interest limitation could probably adversely affect the functioning of the internal market, for example when non-deductible interest in the debtor's EU Member State remains fully taxed in the creditor's EU Member State and adversely impacts the credit rating of the debtor.<sup>50</sup> Where the interest is taxed against a sufficiently high effective income tax rate, relief could be granted avoiding distortions.

Another concern is where an EU Member State can change its direct income taxation rules and regulations while also directly impacting the taxation in another EU Member State under the provisions based on this Directive. It raises the question whether the subsidiarity and proportionality principles have been met which can be illustrated by how the switch-over and CFC rules can work out. When an EU Member State lowers its statutory income tax rate, this may impact a parent resident in another EU Member State when it has a subsidiary based in the first mentioned Member State. Where this parent is subject to a substantial higher statutory income tax rates compared with the rate applicable in the subsidiary's Member State, the switch-over and CFC rules can kick in when the effective income tax rate drops below 40% of the statutory or effective rate of the parent company. So by implementing the ATA Directive, executing general tax policy in one Member State<sup>51</sup> could affect the application of income taxation in another Member State. Such a move by one EU Member State will in our view affect the functioning of the internal market because the parent in the other jurisdiction will be either confronted with higher income tax on assets and/or activities performed in another jurisdiction or alternatively will reorganize these assets and/or activities as well as distribute income out of this Member State prior to the rate change. Absent any clarity on how the accumulated earnings prior to such rate change will be treated it is also unclear whether the proportionality test has been met as well.

Finally, there is a risk that in the process leading up to the Directive, a formality has been omitted: so far there has been no impact assessment made public while this a requirement under chapter III of the Better

<sup>46</sup> See C-294/97 (Eurowings Luftverkehrs).

<sup>47</sup> And potentially enlarging the combined taxable bases of the Member States involved.

<sup>48</sup> See e.g. C-43/00 (Andersen og Jensen Aps).

<sup>49</sup> See e.g. C-254/04 (Test Claimants Thin Gap GLO).

<sup>50</sup> A lower credit rating could increase the debtor's borrowing cost and force creditors keeping higher capital reserves, making lending to such companies slightly less attractive.

<sup>51</sup> Prior to the ATA Directive this effect occurred as well, but without the ATA Directive EU Member States have the liberty to amend their income tax laws where deemed appropriate provided general EU law is not violated. Under the ATA Directive this triggers an automatic and direct effect, only to be resolved through lowering its own statutory income tax rate. An example illustrating such effects are the recent changes in statutory income tax rates of various jurisdictions accommodating the Japanese CFC rules and the ensuing negotiations.

Regulation Guidelines.<sup>52,53</sup> Absent such impact assessment, national Parliaments will be limited in their ability to judge whether the subsidiarity and proportionality tests have been met.

## 5 IMPLEMENTATION

After the approval by the Council of the EU, the ATA Directive needs to be implemented in the domestic legislation by the Member States before 1 January 2019.<sup>54</sup> Generally, a Directive introduces or refers to terminology which is rooted in EU law, and thus cannot be explained by the terminology's context and meaning under the EU Member State's domestic law. Moreover, the procedure under which the Directive is 'enacted', is not akin to regular legislative procedures by Member States. The Directive has not been reviewed by an independent body providing comments to prior drafts while there is also no formal legislative history similar to EU Member States' Parliamentary proceedings. Documents published while preparing a Directive,<sup>55</sup> have limited formal status under EU law, while most of them are not made public. The legislative procedures are somewhat opaque.

The domestic legislator will follow the local procedures for enacting a law proposal incorporating the provisions of the ATA Directive. Each Member State is bound by the minimum level of protection this Directive proscribes for safeguarding the domestic tax base but is free to implement higher standards of protection. This discretionary authority can lead to differences in taxation not covered by the ATA Directive falling outside the scope of the ATA Directive. This raises various practical concerns. First, these higher level of protections need to be tested against the fundamental freedoms and other general EU law provisions, like any regular (income tax) provision. Next, if the terminology is based on the ATA Directive, but the level of protections goes further than what the ATA Directive requires, the question arises which court renders the final verdict on the scope of the terminology. This should likely be the ECJ based on case law rendered in the Netherlands,<sup>56</sup> but in other countries the outcome may be different.

<sup>52</sup> Better Regulation Guidelines dated 19 May 2015 and issued in Strassbourg, COM(2015) 215 final.

<sup>53</sup> Such deficiency can make a Directive in its entirety subject to challenge by EU Member States and their parliaments under an annulment procedure.

<sup>54</sup> Dutch State Secretary of Finance stated in a letter of 13 May 2016 to the Lower house of the Dutch Parliament that 1 Jan. 2018 is proposed as the date of application.

<sup>55</sup> ECJ 14 Dec. 2005, C-170/05 (Denkavit).

<sup>56</sup> C-28/95 (Leur Bloem).

## 6 INTERPRETATION

The basis for implementation in domestic law will be the terminology and its meaning under EU law. However, some of the terminology used is ambiguous, for example is Earnings Before Interest, Tax, Depreciation and Amortization (EBITDA) in all Member States determined in the same manner,<sup>57</sup> especially where the accounting under income taxation differs from the accounting for book purposes. And even though the ATA Directive contains definitions of the most important terms used therein, it remains uncertain whether this captures all the possible varieties arising in the Member States upon implementation. Moreover many terms are not defined, creating the risk that such terms are not applied consistently across the EU because domestic courts may in first instances follow the domestic scope and interpretation.<sup>58</sup> The ATA Directive lacks a mechanism to ensure a consistent application of its terminology in all Member States.<sup>59,60</sup>

An uncertainty is also the legal basis of the Directive. It can be questioned whether this directive, based on Article 115 TFEU, complies with the principle of conferral as set out in Article 5, paragraphs 1 and 2, TEU. Taxpayers may request the ECJ to issue a preliminary ruling on whether, in the absence of a valid legal basis, the ATA Directive is valid. Although any declaration invalidating a directive will, in principle, be backdated to the date on which the directive came into force, several years are likely to elapse before such a request can be considered and a ruling issued. Hence not just the legal basis might be questioned but it may also infringe on the EU fundamental freedoms or other provisions of primary EU law. For example, when the subsidiarity test is not judged to be met when under part or all of the Directive itself or its implementation in one Member State violates the fundamental freedoms. Clarity will only arise once the ECJ has rendered verdict.

The domestic rules resulting from the implementation of the ATA Directive will first be applied by the

<sup>57</sup> Even though the accounting rules are fairly standardized through EU Directives 78/660/EEG, 83/349/EEG and 2006/43/EG abolished and amended by 2013/34/EU as well as Regulation (EC) No 1601/2000, there is no certainty or mechanism to ensure that the methodology is applied consistently across the EU, especially since the required detail in the accounting rules differ depending on the size of the reporting entity (the categories are small, medium, large) and thus not all companies are required to report EBITDA.

<sup>58</sup> Based on case law, rules need to be clear, precise and predictive, C-282/12 (Italcara).

<sup>59</sup> An illustrative quirk is that the ATA Directive applies to taxpayers that are subject to corporate income tax in one or more Member States. Hybrid entities seem not covered in the state where such entities are transparent under their domestic tax law.

<sup>60</sup> E.g. the determination of taxable income of a permanent establishment may differ between the state where the legal entity is a tax resident and where the permanent establishment operates, which can for example impact the interest limitation or hybrid mismatch rules.



local tax authorities and subsequently challenged by the taxpayer. The initiative to effect these rules lies with the competent income tax inspector for the tax payer and so the ATA Directive relies for its effectiveness on the judgment and competence of the local income tax inspector. This is a different setting compared with the other income tax directives, where tax payers under EU law<sup>61</sup> can directly rely on the Directive when filing a request for relief at source or refund by challenging domestic provisions, which would then be subsequently handled by the tax authorities. This difference is important since an income tax inspector can not directly rely on the ATA Directive, while it has a discretionary authority when challenging a certain income tax position. Challenges to provisions following from the ATA Directive will start at the domestic level and move up to the ECJ insofar domestic tax courts refer the matter to the ECJ for a preliminary ruling. Where a local court deems the provisions clear (*acte claire*), there will be no preliminary ruling filed with the ECJ. Although the EU Commission will initiate a review process three years after its implementation, it can be questioned whether this is sufficient for ensuring that local income tax inspectors as well as local courts apply the domestic provisions based on the ATA Directive consistently, especially given the relative long time it takes to get final clarity.

Legal challenges to provisions following from the ATA Directive may take many years before clarity will be shed on the scope of the new provisions. First, income tax returns need to be filed after the close of a financial year and may generally upon request be extended with six to twelve months on their regular deadline. Next income tax inspectors need to review the return and challenge a position taken by a tax payer, which will subsequently start the appeal procedure under the domestic law of a Member State, eventually to be extended with a reference to a preliminary ruling to the ECJ followed by a final verdict.<sup>62</sup> The entire appeal procedure may easily take four to six years after the date of submission of an income tax return, which is typically six to twenty months after the close of a taxpayers' financial year.

All in all, it can easily take five to eight years after the implementation of the ATA Directive in domestic law before clarity on the scope of a domestic provision based on the Directive will be shed. This is more or less consistent with the implementation of the other income tax Directives, albeit that where the relief is available through an administrative request, procedures challenging the rejection of such requests typically start prior to filing an income tax return. Since the ATA Directive is driven by combatting tax evasion, the likely longer lead

time for challenges is more cumbersome compared with the other income tax Directives.

A potential side effect of a lack of coordination and monitoring is that like provisions from any Directive, the ATA Directive provisions may not be consistently applied<sup>63</sup> throughout the EU. Where a Directive eliminates distortions in domestic law this is burden, but the benefits taxpayers reap from a correct application of the provisions is a sufficient countervailing power ensuring consistent application throughout the EU. However, where an abuse of law or tax evasion concept defined at the EU level – like in the ATA Directive – may be inconsistently applied through the EU, the lack of a sufficient strong countervailing power seems a material deficiency. There is a serious risk that concepts defined at the EU level are not equally applied by domestic tax authorities and thus are not consistently applied throughout the EU.

## 7 CONFLICTS

The ATA Directive may conflict with other EU (tax) laws and (income tax) treaties entered into by EU Member States. However, the impact of international treaties in relation to Directives has not yet fully crystallized. First of all Article 351 TFEU<sup>64</sup> grandfathers treaties existing before 1 January 1958 or the date of accession of new EU members states, but at the same time imposes the obligation to bring the provisions in these treaties in accordance with EU law. All new treaties after 1 January 1958 (the founders) or the accession date (all other Member States) are in principle overruled by EU law because they must be compatible with EU law.<sup>65</sup> Next, it is unclear whether treaties which are compatible with EU law before a Directive has been issued, but subsequently become incompatible with the Directive should be grandfathered as well. The EC Commission seems of the view that this is the case, but the ECJ seems to have a different view.<sup>66</sup>

<sup>63</sup> This is relevant for all EU Directives.

<sup>64</sup> See Art. 351 TFEU.

<sup>65</sup> This applies for example to both Investment Protection Agreements as well as Income Tax treaties. Now the UK opted for a Brexit, all new agreements to be entered with the UK as a third country must be in accordance with EU law, while it is unclear what would happen to the existing agreements (those existing prior to the founding of the EC with the founding members, those with EU Member States prior to the UK joining the EU as well as those entered into while the UK was member of the EU). The manoeuvring room for the UK for entering into international treaties with the EU Member States remains indirectly driven by EU law.

<sup>66</sup> ECJ 10 Mar. 1998, joined cases C-364/95 and C-365/95 (T-port), limiting grandfathering only to international treaties concluded before the EC Treaty and subsequent amendments, provided the third country derives benefit from such treaty. The same seems to apply to international treaties existing prior to joining the EU.

<sup>61</sup> See e.g. C-375/98 (Epson Europe BV).

<sup>62</sup> The average duration of references for a preliminary ruling in 2015 was 15.3 months, see ECJ Press Release 34/16, dated 18 Mar. 2016.

## 7.1 Other EU Directives

A key open item is how to deal with conflicts between the ATA Directive and the existing EU income tax Directives.<sup>67</sup> Areas of potential conflict are the application of the Parent Subsidiary Directive and Merger Directive in relation to the switch-over, CFC rule and the GAAR rules. First, the relationship between the anti-abuse provisions in the Parent Subsidiary Directive and Merger Directive with the GAAR rule in the ATA Directive is not clear. Is the GAAR the general rule overriding the anti-abuse provision based on the other Directives? Or should the GAAR be seen as complimentary to the anti-abuse provisions based on these Directives, in the sense that if a taxpayer meets any of the anti-abuse provisions based on the other Directives, the underlying transaction or series of transactions relating there to can not be captured under the GAAR? Another uncertainty is that where a taxpayer relies on the Parent Subsidiary Directive or Merger Directive and is entitled to relief, whether such relief can be rolled back based on the switch-over or CFC rules in the ATA Directive. Here again, it is unclear in the event multiple Directives may apply to a given fact pattern whether the ATA Directive is complimentary or subsidiary to the existing Directives.

## 7.2 EU Arbitration Convention<sup>68</sup>

The EU Arbitration Convention establishes a procedure under which double taxation between associated enterprises – resulting from an upward adjustment made by tax authorities in one EU Member States while not followed by a corresponding downward adjustment in the other EU Member State – is resolved through a binding obligation of both Member States to eliminate double taxation from such adjustment. The convention first stipulates that tax authorities have the authority to apply the at arm's length standard to commercial and financial transactions between related parties in different Member States and may adjust such transactions when they do not meet this standard. Next, in the event the related parties and their tax authorities cannot reach an agreement regarding these adjustments, the convention provides a mechanism to resolve such conflict, eventually through an advisory commission. The convention set its own terms within the terms of the domestic appeal framework of the country where the tax payer is challenging the adjustments. Depending on the circumstances first the domestic appeal procedures may need to have been completed before any arbitration procedure under

this Convention can be finalized, so that a binding arbitration may take between five and ten years to complete, which outcome needs to be implemented irrespective time limits prescribed by domestic laws. In practice this Convention so far has been applied in a few cases.

This Convention has no immediate relevance for the ATA Directive, since the Convention's application is tied to transfer pricing corrections, which are not the object of the latter Directive. However, where as a result of the application of provisions based on the ATA Directive, conditions are imposed upon related parties which differ from those which would have been made between unrelated parties, one could perhaps argue that the Convention should provide relief. Moreover, this Convention showcases legal mechanisms, albeit slow, that avoid double taxation while respecting each EU member independent's authority regarding income taxation.

## 8 AUDIT ASSESSMENTS

The newly introduced open norms in the ATA Directive may complicate the audit assessment of uncertain tax positions. Enterprises, especially those applying US GAAP and IFRS, need to address uncertain income tax positions under their applicable audit rules. Generally speaking within the parameters<sup>69</sup> set for an audit, a tax benefit resulting from an uncertain position may be recognized if it is 'more likely than not' that such tax position will be sustained upon audit ('recognition threshold'). If so the next step is under most audit concepts determining for what amount the tax benefit should be recognized.

Depending on the legal status under the applicable tax laws, a tax ruling<sup>70</sup> entered into with a tax administration can in principle take the uncertainty out of an income tax position and thus ensure that a tax benefit can be fully accounted for.<sup>71</sup> Alternatively, third-parties can issue an opinion on whether the more likely than not threshold is met in a particular fact pattern, on which the auditor may rely during the audit process.

When implementing the ATA Directive, the consequences for the authority and the ability of tax administrations to issue an Advance Tax Ruling (ATR) or Advance Pricing Agreement (APA) on the topics affected by this Directive are unclear. The ATA Directive introduces various concepts rooted in EU law directly affecting the application of provisions in domestic income

<sup>67</sup> Below we will only address the existing income tax directives.

<sup>68</sup> Convention 90/436/EEC

<sup>69</sup> The various materiality threshold under the audit rules.

<sup>70</sup> Through an ATR or APA, the tax authorities and a tax payer reach a mutual agreement or get a binding confirmation from the tax authorities on the application of domestic income tax provisions to a given fact pattern and circumstances disclosed by the tax payer.

<sup>71</sup> Tax ruling may be issued under specific assumptions and conditions which should be validated by a tax payer during the audit process.

tax. Hence an income tax inspector, when applying such domestic income tax provision, needs to address and interpret these new concepts. Local guidance in either the legislative history relating to the implementation of the ATA Directive or jurisprudence is likely of limited help. Moreover, absent a legislative history at the EU level on which one can rely,<sup>72</sup> uncertainty and unclarity regarding the meaning and scope of concepts introduced in the ATA Directive, can only be finally clarified by the ECJ. So tax authorities may become limited in their ability to issue ATRs and APAs on topics affected by the ATA Directive. This equally applies to third parties when requested to issue opinions. The above issue is particularly cumbersome under the agreed switch-over and CFC rules as well as the GAAR rule.

## 9 SUMMARY

This article explains how Member States can choose from a variety of instruments when seeking to adopt anti-avoidance measures within the European Union. While the EU Commission and Council have opted for a directive for this purpose, the OECD/G20 have shown a preference for soft-law arrangements in the non-treaty-related BEPS measures. As the explanatory notes demonstrate, and as is also implicit in the preamble of the ATA Directive, the EU Commission's choice was driven by considerations relating to a level playing field and legal certainty. In this article we argue, however, that a directive is not the most suitable instrument for seeking to achieve these European ambitions. Firstly, the legal basis of the ATA Directive can be questioned, and specifically whether this directive, based on Article 115 TFEU, complies with the principle of conferral as set out in Article 5, paragraphs 1 and 2, TEU. Taxpayers may request the ECJ to issue a preliminary ruling on whether the ATA Directive has a valid legal basis. Although any declaration invalidating a directive will, in principle, be backdated to the date on which the directive came into force, several years are likely to elapse before such a request will be considered and a ruling issued.

It can also be queried whether the ATA Directive complies with the principles of subsidiarity and proportionality. The Commission makes it very clear in the notes, however, that it regards the directive as complying with both these principles. And given that the ECJ has so far never honoured a request from a Member State, the European Parliament, the Council or the EU Commission to rule an EU legislative act to be invalid on

the grounds of these particular principles, we therefore also see no prospect of this happening on this occasion.

In addition, we argue that, in view of the subject matter on the one hand and the effect of the directive (no reverse vertical effect) on the other hand, the ATA Directive may limit domestic tax authorities in effectively applying the anti-avoidance measures. This problem, which is characteristic of a directive, would be avoided if tax authorities were able to rely on a regulation, which has reverse vertical effect. This is important, since the initiative to enforce and apply provisions based on the directive lies primarily with the national tax authorities and not, in contrast to earlier directives on direct taxation, with taxpayers.

Another issue remaining open is the question of how it is planned to ensure that all tax authorities implement the provisions and also do so uniformly. A further disadvantage of a directive or regulation based on Article 115 or Article 352 TFEU respectively is the absence of public discussion on how the proposal should be interpreted and the lack of any possibility to amend the proposal in response to such discussion. Now the proposal has been adopted by the Council, it will be difficult to change the new anti-avoidance measures at a later stage, given that the Commission has the exclusive right to initiate amendments, while any amendment proposed also requires the unanimity of the Member States. As a legal instrument, therefore, European legislation is relatively inflexible in this respect.

Questions can similarly be raised regarding the relationship between the ATA Directive and the Member States' existing tax treaties, the EU freedoms and the directives on direct taxation. With regard to the terms used in the ATA Directive, we note that although some of them have been defined, many others have not. The brevity of the notes provides little assurance in this respect, while the ECJ will also not attach any importance to these notes when interpreting the Directive. This will not help ensure consistent and uniform implementation in all Member States.

Furthermore, and depending on national courts' willingness to request preliminary rulings, the ECJ will have an important role to play in interpreting these provisions. Experience to date with regard to direct taxes has shown this process sometimes to be littered with obstacles and possible misunderstandings, including problems relating to correctly explaining the functioning of a Member State's domestic tax laws to this court. This in turn has resulted in some seemingly contradictory judgments. The question, therefore, is whether, in the event of intervention driven by a wish to improve the functioning of the internal market, much more should have and will have to be done to safeguard the legal certainty of taxpayers, specifically given that competences have not been transferred to the EU in this area.

<sup>72</sup> The EU legislative process bears no resemblance with most domestic legislative process. Reports, Considerations and other supporting material has limited binding legal status under EU Law. See Bruno Peeters, *Europees belastingrecht*, De Boeck & Larcier, 2005, pp. 353–354.

Now the Directive has been adopted, it will be the Commission's responsibility to ensure the provisions are correctly implemented and enforced. Past experience of infringement and state aid procedures instigated by the Commission in areas such as direct taxes show that larger Member States are relatively less likely to face such procedures. The authors consequently doubt whether a directive will prove to be a sufficiently effective instrument for implementing anti-avoidance measures while also ensuring legal certainty and a level

playing field in Europe. The authors believe that the same objectives can be achieved through arrangements based on the example of the monitoring model of the GFTEI. Despite the soft-law nature of such arrangements, this model would seem to create a stronger basis for ensuring anti-avoidance measures are implemented and complied with. Such an approach would also seem to align more closely with the sense of EU overreach that many Member States currently feel.