Art. 4 ATAD
How the Interest Limitation Rule of the ATAD aligns with the Freedoms of the TFEU and National Constitutions

Author: Caroline Meyer im Hagen
Supervisor: Associate Professor Katia Cejie
This thesis addresses Art. 4 ATAD and looks at it from two different angles. Firstly, Art. 4 ATAD will be examined in the light of the TFEU freedoms. Special regard will be had to the principle of proportionality. Secondly, it will be evaluated how Art. 4 ATAD, or rather its domestic implementation, aligns with the constitutions of the Member States.

For the first part, Art. 4 ATAD has to be measured against the case law the ECJ has developed regarding testing anti-avoidance rules against the TFEU freedoms. An interest limitation rule like Art. 4 ATAD falls under the scope either of the freedom of establishment or the free movement of capital. However, since Art. 4 ATAD applies to cross-border interest payments in the same way as it applies to such payments on a purely national level, it does not impose a restriction on any of the freedoms. Since Art. 4 ATAD is not a domestic rule, which is tested against the TFEU freedoms, but EU law, it still has to follow the proportionality principle according to Art. 5 (1) TEU. For this reason, the proportionality test, which usually forms part of the justification test, still has to be conducted on its own. Art. 4 ATAD has to be suitable for securing the attainment of the objective which it pursues without going beyond what is necessary to attain it. As the name of the ATAD implies, its main objective is preventing tax avoidance. Regarding this justification ground, the ECJ has developed two different lines of judicature. The first line involves the anti-avoidance purpose on its own. Then, the given measure has to target wholly artificial arrangements, which do not reflect a real economic activity. Moreover, the taxpayer needs to be given the chance to prove such an economic reality. Art. 4 ATAD does not meet these requirements, because it covers all sorts of interest payments and does not provide for an exception in case of a proven sound business reason. The second line considers the anti-avoidance purpose combined with another justification ground. Then, the provision does not
have to target only wholly artificial arrangements. Here, the balanced allocation of taxing rights is suitable for this purpose. Nevertheless, the problem still remains that Art. 4 ATAD is not limited to cross-border interest payments, but covers all kinds of interest payments and therefore overshoots its aim of securing the balanced allocation of taxing rights. This is why this justification ground is not able to render Art. 4 ATAD proportionate either, neither combined with the anti-avoidance purpose nor taken on its own. Art. 4 ATAD in not in line with the TFEU freedoms, because it violates the principle of proportionality, which is part of the justification test.

For the second part, Art. 4 ATAD has to be measured against national constitutions. As an example serves the German interest barrier rule. This is, because it served as a blueprint for Art. 4 ATAD, so it can be seen as already implementing Art. 4 ATAD. Furthermore, the German interest barrier rule is currently under review by the German Constitutional Court, because its constitutionality is being questioned. The reason for this is that by limiting the deduction of interest expenses, the German interest barrier rule interferes with the objective net principle. In German tax law, the objective net principle is deduced from the ability-to-pay principle, which again is deduced from the principle of equality. The principle of equality is laid down in Art. 3 (1) of the German Constitution. Through the connection to the principle of equality, the objective net principle itself is covered by the German Constitution. This derogation from the objective net principle is not justified, because the German interest barrier rule - like Art. 4 ATAD - is not proportionate in relation to its objectives, i.e. the control of economic policy, the state's financing needs and the need to prevent abusive structures. The same problem would occur with an actual domestic implementation of Art. 4 ATAD. In case, the objective net principle is also covered by the constitutions of other EU Member States, they will face the same difficulties. Even if the objective net principle is not covered by the
constitution of a Member State, it still is a fundamental principle of tax law. It is true, that EU law prevails over domestic laws and even national constitutions. However, according to Art. 4 (2) and (3) TEU, the EU also has to respect the national fundamentals and follow the principle of sincere cooperation. This means, that the EU should not counteract such fundamental principles of the Member States as the objective net principle and the ability-to-pay principle. By adapting Art. 4 ATAD, the EU does not meet these requirements.

It can be concluded that Art. 4 ATAD results in difficulties both with primary EU law and with national constitutional law or at least fundamental principles. Although these concerns are rather of a theoretical nature, they still lead to the legitimate question if the EU legislators have made the right choice in phrasing Art. 4 ATAD as they did.
# Table of Contents

1. Introduction.................................................................................................1
   1.1 Problem..............................................................................................1
   1.2 Objectives of the Thesis.....................................................................3
   1.3 Delimitations......................................................................................4
   1.4 Method and Material Used...............................................................4
   1.5 Outline..............................................................................................6

2. Art. 4 ATAD: The Rule on Interest Limitation.........................................7
   2.1 Introduction......................................................................................7
   2.2 Background......................................................................................7
   2.3 The Provision....................................................................................9

3. The Freedoms of the TFEU and Art. 4 ATAD........................................10
   3.1 Introduction.....................................................................................10
   3.2 The Development of the ECJ Judicature.........................................11
      3.2.1 Scope of Application.................................................................11
      3.2.2 The Restriction Test.................................................................12
      3.2.3 The Justification Test...............................................................13
         3.2.3.1 The Requirements of the Justification Test...13
         3.2.3.2 The First Line: The Anti-Avoidance Purpose
            Considered Alone.................................................................14
         3.2.3.3 The Second Line: The Anti-Avoidance
            Purpose Taken Together with the Balanced Allocation
            of Taxing Rights.................................................................16
      3.2.3.4 Interim Conclusion..............................................................18
   3.3 Application to Art. 4 ATAD..............................................................19
      3.3.1 Background..............................................................................19
      3.3.2 Scope of Application...............................................................19
      3.3.3 The Restriction Test...............................................................20
3.3.4 The Proportionality Test

3.3.4.1 The Requirements of the Proportionality Test

3.3.4.2 The First Line: The Anti-Avoidance Purpose Considered Alone

3.3.4.3 The Second Line: The Anti-Avoidance Purpose Combined with the Balanced Allocation of Taxing Rights of the ECJ's Judicature

3.4 Interim Conclusion

4. The National Constitutions and Art. 4 ATAD

4.1 Introduction

4.2 The Relation Between EU Laws and Domestic Laws

4.3 The German Interest Barrier Rule as an Example

4.4 The Potential Unconstitutionality of the German Interest Barrier Rule

4.4.1 Background

4.4.2 The German Constitution and the Objective Net Principle

4.4.3 The BFH's and Prevailing Opinion: The German Interest Barrier Rule Is Unconstitutional

4.4.4 The Opposite View: The German Interest Barrier Rule Is Constitutional

4.4.5 Interim Conclusion

4.5 Raising the Aforementioned to a General Level

4.6 Interim Conclusion

5. Conclusion

VI
List of Abbreviations

<table>
<thead>
<tr>
<th>Abbreviation</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>ATAD</td>
<td>Anti-Tax Avoidance Directive</td>
</tr>
<tr>
<td>Az.</td>
<td>Aktenzeichen; Reference number</td>
</tr>
<tr>
<td>BEPS</td>
<td>Base Erosion and Profit Shifting</td>
</tr>
<tr>
<td>BFH</td>
<td>Bundesfinanzhof; Federal Fiscal Court of Germany</td>
</tr>
<tr>
<td>BVerfG</td>
<td>Bundesverfassungsgericht; Federal Constitutional Court of Germany</td>
</tr>
<tr>
<td>BVerfGE</td>
<td>Bundesverfassungsgericht Entscheidung; Judgement of the BVerfG</td>
</tr>
<tr>
<td>CFC</td>
<td>Controlled Foreign Company</td>
</tr>
<tr>
<td>CFE</td>
<td>Confederation Fiscale Europeenne</td>
</tr>
<tr>
<td>DStR</td>
<td>Deutsches Steuerrecht (Tax Law Journal)</td>
</tr>
<tr>
<td>EBITDA</td>
<td>Earnings before interest, taxes, depreciation and amortisation</td>
</tr>
<tr>
<td>EC</td>
<td>European Commission</td>
</tr>
<tr>
<td>ECJ</td>
<td>European Court of Justice</td>
</tr>
<tr>
<td>Edn</td>
<td>Edition</td>
</tr>
<tr>
<td>EEC</td>
<td>European Economic Community</td>
</tr>
<tr>
<td>EStG</td>
<td>Einkommensteuergesetz; German Income Tax Act</td>
</tr>
<tr>
<td>EU</td>
<td>European Union</td>
</tr>
<tr>
<td>FR</td>
<td>Finanz-Rundschau (Tax Law Journal)</td>
</tr>
<tr>
<td>GG</td>
<td>Grundgesetz; German Constitution</td>
</tr>
</tbody>
</table>
**KStG**  
Körperschaftsteuergesetz; German Corporate Income Tax Act

**i.e.**  
Id est; that is

**OECD**  
Organisation for Economic Co-operation and Development

**para**  
Paragraph

**paras**  
Paragraphs

**PE**  
Permanent establishment

**TEU**  
Treaty on European Union

**TFEU**  
Treaty on the Functioning of the European Union

**VAT**  
Value Added Tax
Art. 4 ATAD
- How the Interest Limitation Rule of the ATAD aligns with the Freedoms of the TFEU and National Constitutions -

1. Introduction

1.1 Problem

In 2013, the Organisation for Economic Co-operation and Development (OECD) has released its report on Base Erosion and Profit Shifting (BEPS).\(^1\) Therewith, the OECD adopts a 15-point action plan to tackle BEPS.\(^2\) Action 4 of this plan deals with BEPS caused by interest deductions and other financial payments.\(^3\) Here, the recommended approach to address this issue is based on a fixed ratio rule which limits a company’s net deductions for interest and payments economically equivalent to interest to a percentage of its earnings before interest, taxes, depreciation and amortisation (EBITDA).\(^4\)

As a response to the BEPS action plan, the European Union (EU) released the Council Directive 2016/1164 laying down rules against tax avoidance practices that directly affect the functioning of the internal market (ATAD) in 2016.\(^5\) This directive implements the BEPS action plan EU-wide. It contains de minimis-rules to safeguard a coherent realization of the BEPS action plan by the EU member states to ensure its efficiency.\(^6\) These rules include among others provisions on controlled foreign corporation, exit taxation, anti-hybrid mismatch and - in Art. 4 ATAD - a provision on

\(^6\) ATAD, Preamble, para 2, 193/1, 1-2; EC, *Proposal for the ATAD*, 3-4; Navarro/Parada/Schwarz, EC Tax Review 2017, 117, 117.
interest deduction limitation. The latter transposes the BEPS recommendation and is largely based on the German interest barrier rule (§ 4h EStG, § 8a KStG). This leads to two major problems:

Firstly, since the substance of Art. 4 ATAD was not developed by the EU in the first place, the fundamental freedoms of the Treaty of the Functioning of the EU (TFEU) and their interpretation by the European Court of Justice (ECJ) were not decisive. As it limits the deduction of interest expenses between companies, Art. 4 ATAD could especially be an obstacle to the freedom of establishment and the free movement of capital. By covering all such payments, be it cross-border or domestic, entities which form part of a group or standalone entities, as well as payments with an underlying sound business reason, Art. 4 ATAD could further be disproportionate according to Art. 5 (1) of the Treaty on the EU (TEU).

Secondly, the German interest barrier rule, which functioned as a blueprint for Art. 4 ATAD, is currently under review by the German Federal Constitutional Court (BVerfG). The reason for this is that the German interest barrier rule is seen as violating the German Constitution, or more specific, its Art. 3 (1), which states the principle of equality. In Germany, in the field of tax law, the ability-to-pay principle is deduced from the principle of equality. The objective net principle, again, is deduced from the ability-to-pay principle. Since the German interest barrier rule limits the deduction of interest payments, it is seen as violating the objective net principle. This leads further to a violation of the ability-to-pay principle and with that the principle of equality, which eventually results in a violation of the German Constitution itself. It is true, that EU law ranks higher even than national constitutions, so a ruling by the BVerfG against the interest barrier rule would not harm an implementation of Art. 4 ATAD. At the

---

7 Lampert/Meickmann/Reinert, European Taxation 2016, 323, 323; Gutmann and others, European Taxation 2017, 2, 4.
same time, the EU has to respect the identity of the Member States and follow the principle of sincere cooperation according to Art. 4 (2) and (3) TEU. It is questionable, if the EU adheres to this by adopting a national rule on EU level, which is seen to be in breach with the constitution of that state. Moreover, considered on a more general level, this or a similar problem could occur in other Member States depending on how they value the objective principle. These two problems will be discussed in this thesis.

1.2 Objectives of the Thesis

With this thesis, two objectives are pursued: One objective is to examine the compatibility of Art. 4 ATAD with the TFEU freedoms and the proportionality principle of Art. 5 (1) TEU. In this regard, it is worth mentioning that these two tests will not be conducted separately, but combined. The reason for this is, that the ECJ usually analyzes a legislative act with respect to its proportionality as part of the justification test when measuring it against the TFEU freedoms. This further leads to the fact that most of the ECJ's case law on the proportionality test derives from cases where the TFEU freedoms are scrutinized. It even goes so far that it is sometimes impossible to clearly define where the proportionality test within the justification test starts and ends. For example, the justification ground as the first step of the justification test and the legitimate objective as one step of the proportionality test overlap as they both reflect the same issue. Thus, by referring to the compatibility of Art. 4 ATAD with the TFEU freedoms, the principle of proportionality is always considered included as forming part of the justification test. It will be illustrated how the ECJ tests provisions against the TFEU freedoms including the proportionality principle and which requirements must be met. Particularly, the development of the ECJ case law in this field concerning anti-avoidance rules will be looked at closely to draw a comparison to Art. 4 ATAD.
The other objective is to evaluate if Art. 4 ATAD, or rather its potential domestic implementation, aligns with the national constitutions of the Member States. The German interest barrier rule will serve as an example for this purpose. This has two reasons: Firstly, the German interest barrier rule served as a blueprint for Art. 4 ATAD and can therefore be seen as already implementing Art. 4 ATAD on a domestic level. Secondly, the constitutionality of the German interest barrier rule is already currently under review. The issues surrounding the German interest barrier rule will be discussed. The outcomes will then be raised to a more general level to draw conclusions on how other Member States may face problems with implementing Art. 4 ATAD.

1.3 Delimitations

The scope of this thesis is delimited to Art. 4 ATAD in the light of the TFEU freedoms and national constitutions. Hence, the BEPS project and its Action 4 as well as the remaining provisions of the ATAD will only be dealt with where necessary to provide background information in order to analyze Art. 4 ATAD. This means, that also general problems concerning the ATAD will not be discussed, but only the ones specifically related to Art. 4 ATAD. Further, it will not be examined, if Art. 4 ATAD violates other EU directives, such as the Interest-Royalty-Directive and the Parent-Subsidiary-Directive.

1.4 Method and Material Used

This thesis deals with the compatibility of Art. 4 ATAD firstly with the TFEU freedoms and secondly with national constitutions. In other words, a EU directive, i.e. EU secondary law, is measured against EU primary law and domestic constitutional law. The suitable method for this purpose is the
traditional legal dogmatic method. This method evaluates the current state of the law by considering different kinds of legal sources, such as statutes, court rulings, publications by legal academics and practitioners, other official legal documents or legal principles and concepts.\(^8\)

Here, to begin with, Art. 4 ATAD itself as well as the TFEU freedoms will be looked at. For the latter, the interpretation by the ECJ on the basis of cases is of special importance. The cases referred to were chosen, because each of them adds a new spark to the judicature of the ECJ on anti-avoidance rules. They were found both in articles discussing anti-avoidance rules and in the references of ECJ cases themselves. Although Art. 4 ATAD regards direct taxation, cases from the field of VAT law are also mentioned. The reason is, that the judicature of the ECJ on anti-abuse rules arises from VAT law and is also referred to by the ECJ when examining provisions on direct taxation. This suggests that the ECJ applies a uniform concept of abuse in the different fields of law.\(^9\)

The same applies when Art. 4 ATAD is analyzed in the light of national constitutions. The German interest barrier rule (§ 4h EStG, § 8a KStG) will be used as an example to conduct this contrasting juxtaposition. This is, because the German interest barrier rule functioned as a blueprint for Art. 4 ATAD and is currently under review by the BVerfG, because it might violate the German Constitution. The objective net principle is crucial here. By means of induction, the results will be universalized for the possible relation between Art. 4 ATAD and the national constitutions of the Member States in general. Special regard will be had to the hierarchy between EU and domestic laws. Since the ATAD is a very new directive, which does not yet have to be implemented, there is no case law on it. This is why especially essays by

\(^8\) Jan Vranken, 'Exciting Times for Legal Scholarship' (Law and Method, February 2012).
scholars discussing the ATAD will be considered. Particularly, the article by Ana Paula Dourado 'The Interest Limitation Rule in the Anti-Tax Avoidance Directive (ATAD) and the Net Taxation Principle' in EC Tax Review 2017/3, 112, served as an inspiring starting point, as it also addresses the compatibility of Art. 4 ATAD both with the TFEU freedoms and national constitutions. When examining Art. 4 ATAD in the light of the TFEU freedoms and the national constitutions, special account has to be taken of the objective of the ATAD. In order to provide such systematic and teleological information, the preparatory work will have to be taken into consideration. This is mostly contained in Action 4 of the BEPS action plan and the proposal for the ATAD.

1.5 Outline

In the first part of the thesis, the main features of Art. 4 ATAD will be described. This provides an overview of the rule at issue and allows for references in the subsequent analytical chapters.

This is followed by the part examining the compatibility of Art. 4 ATAD with the TFEU freedoms. For this purpose, in a first step, both the general approach of the ECJ to testing a measure against the TFEU freedoms and the development of the ECJ case law regarding anti-avoidance rules will be laid down. In a second step, Art. 4 ATAD is applied to this theoretical framework to analyze if they are in agreement. In an interim conclusion, the outcome will be resumed.

Subsequently, the conformity of Art. 4 ATAD with national constitutions will be shed light on. This makes it necessary to start with a description of the relation between EU law and the domestic laws of the Member States. Subsequently, since the German interest barrier rule serves as an example, this provision will be depicted to give an idea of how much Art. 4 ATAD
resembles the German interest barrier rule. Next, the potential breach of the German interest barrier rule with the German Constitution will be discussed. Further, the outcome will be raised to a general level to provide a prospect of how a domestic implementation of Art. 4 ATAD could cause a problem in other Member States. Finally, the results will be summarized in an interim conclusion.

The thesis will end with a conclusion. There, the results of the analyses will be summed up and an outlook will be given.

2. Art. 4 ATAD: The Rule on Interest Limitation

2.1 Introduction

This chapter will provide a short overview of Art. 4 ATAD. This includes on the one hand some background information on why and how Art. 4 ATAD was implemented. On the other hand, the basic features of this provision will be described to allow for references throughout the later chapters.

2.2 Background

Cross-border interest payments are a common and easy way of tax planning. Through the deduction of interest payments as business expenses, income in a high-tax jurisdiction is reduced. If the interest payments reach a low-tax jurisdiction, they are taxed at the respective lower tax rate. This is especially interesting for related entities. They can either shift their third party debt to the country with the highest tax rate or use

---

intragroup loans to shift profits from high-tax to low-tax states. The latter scenario is particularly attractive, since no money is lost as a result, but only the tax burden for the group lessened.

This practice impacts the capital ownership neutrality negatively, favours multinational groups, reduces tax revenues and hurts the integrity of the tax system. For this reason, many states limit interest deduction possibilities in different ways. The OECD has analyzed several best practices in Action 4 of the BEPS project which deals with BEPS caused by interest deductions and other financial payments.

The EU has decided to implement the BEPS Actions EU-wide through a directive, i.e. the ATAD. This is, because the EU wants to ensure that the Member States transpose the BEPS provisions in an organized, coherent and uniform manner. Otherwise, the aim of the BEPS project might be counteracted. Art. 4 ATAD reflects BEPS Action 4 and is based on the recommended approach by the OECD.

---

18 ATAD, Preamble paras 2, 3, 16; EC, *Proposal for the ATAD*, 3-4; Navarro/Parada/Schwarz, EC Tax Review 2017, 117, 117; Ginevra, Intertax 2017, 120, 120.
19 ATAD, Preamble paras 2, 3, 16.
2.3 The Provision

According to Art. 4 (1) ATAD, exceeding borrowing costs are deductible up to 30 % of the taxpayer's EBITDA in the tax period in which they incur. This does not only apply to taxpayers who are subject to corporate tax in one or more Member States including permanent establishments of entities residents in third countries, who fall under the scope of the ATAD already pursuant to Art. 1 ATAD. Rather, it also applies to entities which are permitted or required to apply the rules on behalf of a group, as defined according to national tax law and to entities in a group, as defined according to national tax law, which do not consolidate the results of its members for tax purposes. This being the case, the exceeding borrowing costs and the EBITDA may be calculated at the level of the group and include the results of all group members.

Art. 4 ATAD also provides for some voluntary exclusions from the above mentioned general rule. These include the deduction of exceeding borrowing costs up to EUR 3 000 000, a full deduction of exceeding borrowing costs if the taxpayer is a standalone entity, a grandfathering clause for loans taken before 17 June 2016, loans taken to fund long-term public infrastructure projects based in the EU or financial undertakings. Furthermore, Art. 4 ATAD contains a voluntary group ratio rule: If a taxpayer is a member of a consolidated group for financial accounting purposes, he may be given the right to deduct higher amounts of exceeding borrowing costs considering the indebtedness of the overall group at a worldwide level. There may also be an equity escape provision for a

---

21 ATAD, Art. 4 (1).
22 ATAD, Art. 4 (1).
23 ATAD, Art. 4 (3) (a).
24 ATAD, Art. 4 (3) (b).
25 ATAD, Art. 4 (4) (a).
26 ATAD, Art. 4 (4) (b).
27 ATAD, Art. 4 (7).
28 ATAD, Art. 4 (1), Preamble para. 7.
company, which can demonstrate that the ratio of its equity over its total assets is equal to or higher than the equivalent ratio of the group, not to fall under the interest limitation rule.\textsuperscript{29} In this case, a deviation of 2\% is allowed.\textsuperscript{30}

Lastly, the Member States may opt for a rule which allows entities to carry forward the unused exceeding borrowing costs without time limitation (and potentially either carry them back up to three years or carry forward unused interest capacity for a maximum of five years).\textsuperscript{31}

According to Art. 3 ATAD, these provisions are de minimis-provisions.\textsuperscript{32} The Member States may implement rules which safeguard an even higher level of protection for domestic corporate tax bases.\textsuperscript{33} Thus, the Member States may introduce harsher rules, but not more lenient ones.

3. The Freedoms of the TFEU and Art. 4 ATAD

3.1 Introduction

This chapter focuses on how Art. 4 ATAD aligns with the TFEU freedoms including the proportionality test. For this purpose, it will be described how the ECJ tests measures against the TFEU freedoms, especially if they have an anti-avoidance purpose. In a next step, Art. 4 ATAD will be applied to this theoretical framework to examine if it meets the requirements. The results will be concluded in an interim conclusion.

\textsuperscript{29} ATAD, Art. 4 (5) (a), Preamble para. 7.
\textsuperscript{30} ATAD, Art. 4 (5) (a).
\textsuperscript{31} ATAD, Art. 4 (6).
\textsuperscript{32} de la Feria, EC Tax Review 2017, 110, 110.
\textsuperscript{33} ATAD, Art. 3; Cordewener, EC Tax Review 2017, 60, 66.
3.2 The Development of the ECJ Judicature

The ECJ has developed a three-step test when assessing rules in the light of the TFEU freedoms. This test consists of discovering the scope of application, and conducting both the restriction test and the justification test. The proportionality test forms part of the justification test.

3.2.1 Scope of Application

The first step is to find out whether the rule in question falls under the scope of one of the TFEU freedoms. For an interest limitation rule either Art. 49 TFEU, i.e. the freedom of establishment, or Art. 63 TFEU, i.e. the free movement of capital, is of relevance. The ECJ usually examines a case in the light of only one TFEU freedom. It primarily applies the freedom of establishment to situations where also the free movement of capital could be of relevance. This holds especially true if the restriction on the free movement of capital is just an unavoidable consequence of the obstacle to the freedom of establishment or if a violation of the freedom of establishment has already been determined.

To distinguish if a rule is covered rather by Art. 49 TFEU or by Art. 63 TFEU, the ECJ uses two different criteria: Firstly, the ECJ looks at the primary objective and purpose of the provision. For example, if a provision aims at preventing a company from creating branches, the freedom of establishment is concerned. Secondly, if holding companies

---

34 OECD, BEPS Action 4 Final Report, 85; van Os, EC Tax Review 2016, 184, 185; Ginevra, Intertax 2017, 120, 122-23.
35 Helminen, EU Tax Law - Direct Taxation, 132.
36 Case C-231/05 Oy AA, para 24; Case C-452/04 Fidium Finanz, paras 48-49; Helminen, EU Tax Law - Direct Taxation, 132.
37 Case C-251/98 Baars, para 42; Case C-282/07 Truck Center, para 51; Helminen, EU Tax Law - Direct Taxation, 133.
38 Case C-196/04 Cadbury Schweppes, paras 31-33; Case C-452/04 Fidium Finanz, paras 34 and 44-49; Helminen, EU Tax Law - Direct Taxation, 132.
39 Case C-102/05 A and B, para 26; Helminen, EU Tax Law - Direct Taxation, 132-33.
are involved, the ECJ regards the influence of the parent over the subsidiary.\textsuperscript{40} If the holder has definite influence over the subsidiary's decisions, so he can determine its activities, this falls under the scope of the freedom of establishment.\textsuperscript{41} The free movement of capital rather applies to portfolio holdings.\textsuperscript{42} If these two criteria do not lead to a certain conclusion of which freedom is applicable, the ECJ considers the facts of the case to decide which freedom is more suitable for that specific case.\textsuperscript{43} Furthermore, the respective freedom needs to be touched by a cross-border element.\textsuperscript{44}

3.2.2 The Restriction Test

The next step lies in making out, if the rule imposes a restriction on the given freedom. In order to do so, an objectively comparable situation has to be identified.\textsuperscript{45} This is usually done by comparing a cross-border situation to an exactly identical wholly internal situation.\textsuperscript{46} Additionally, there has to be a less favourable treatment, i.e. that the cross-border situation is taxed more heavily than the comparable domestic situation.\textsuperscript{47}

\begin{flushright}
\footnotesize
\textsuperscript{40} Helminen, \textit{EU Tax Law - Direct Taxation}, 133.
\textsuperscript{41} Case C-347/04 \textit{Rewe Zentralfinanz}, para 22; Case C-231/05 \textit{Oy AA}, para 20; Helminen, \textit{EU Tax Law - Direct Taxation}, 133; OECD, \textit{BEPS Action 4 Final Report}, 85.
\textsuperscript{42} Case C-35/11 \textit{Test Claimants in the FII Group Litigation II}, para 92; Case C-282/12 Ítelecar, para 22; Helminen, \textit{EU Tax Law - Direct Taxation}, 133; OECD, \textit{BEPS Action 4 Final Report}, 85.
\textsuperscript{43} Case C-35/11 \textit{Test Claimants in the FII Group Litigation II}, para 94; Case C-375/12 \textit{Bouanich} para 30; Case C-686/13 \textit{X AB}, para 23; Helminen, \textit{EU Tax Law - Direct Taxation}, 133-34.
\textsuperscript{44} Case C-107/94 \textit{Asscher}, para 32; Case C-403/03 \textit{Schempp}, paras 21-26; Berglund/Cejie, \textit{Basics of International Taxation}, 93; Helminen, \textit{EU Tax Law - Direct Taxation}, 57.
\textsuperscript{45} Case C-282/07, \textit{Truck Center}, para. 36; Case C-279/93, \textit{Schumacker}, para 30; Berglund/Cejie, \textit{Basics of International Taxation}, 99.
\textsuperscript{46} Berglund/Cejie, \textit{Basics of International Taxation}, 99.
\textsuperscript{47} Case C-440/08 Gielen, para 44; Case C-527/06 Renneberg, para 60; Berglund and Cejie, \textit{Basics of International Taxation}, 104.
\end{flushright}
3.2.3 The Justification Test

3.2.3.1 The Requirements of the Justification Test

If a rule has been found to restrict a TFEU freedom, it must be examined if this restriction can be justified. This justification test consists of finding a justification ground and conducting the proportionality test. For this purpose, the ECJ has developed the rule of reason test. This test states, that in order to be justified, a measure has to be applied in a non-discriminatory manner, be justified by imperative requirements in the general interest, be suitable for securing the attainment of the objective which they pursue and not go beyond what is necessary in order to attain it. In other words, the imperative requirement in the general interest is the justification ground, while being suitable for securing the attainment of the objective which is pursued without going beyond what is necessary to attain it means being proportionate.

In the area of tax law, the ECJ has accepted the following justification grounds: Effectiveness of fiscal supervision, anti-avoidance purposes, prevention of double use of losses, balanced allocation of taxing rights between Member States, coherence of national tax systems and fiscal territory. For interest limitation rules, the anti-avoidance purpose is of...

---

48 Helminen, EU Tax Law - Direct Taxation, 139.
49 Berglund/Cejie, Basics of International Taxation, 123.
50 Case C-55/94 Gebhard, para 37; Case C-324/00 Lankhorst-Hohorst, para 33; Berglund/Cejie, Basics of International Taxation, 107; Karimeri, Intertax 2011, 296, 306.
51 Helminen, EU Tax Law - Direct Taxation, 139-40; Bizioli, EC Tax Review 2017, 167, 169.
52 Case C-324/00 Lankhorst-Hohorst, para 44.
53 Case C-196/04 Cadbury Schweppes, para 55.
54 Case C-446/03 Marks & Spencer, para 47.
55 Case C-446/03 Marks & Spencer, para 51.
56 Case C-204/90 Bachmann, paras 21-28.
57 Case C-250/95 Futura, para 22.
58 Berglund/Cejie, Basics of International Taxation, 109; Helminen, EU Tax Law - Direct Taxation, 140.
special importance, but also the balanced allocation of taxing rights can be called upon.\textsuperscript{59}

3.2.3.2 The First Line: The Anti-Avoidance Purpose Considered Alone

The development of the anti-avoidance purpose began more than 20 years ago. The concept of abuse appeared in an ECJ ruling already in 1997, in the \textit{Leur Bloem}\textsuperscript{60} case in the field of VAT law. In this case, the ECJ constituted that a general rule automatically excluding certain arrangements from a tax advantage, even if there is no tax avoidance, would be disproportionate.\textsuperscript{61} Furthermore, if 'valid commercial reasons' are used as an indicator for avoidance, this term must be interpreted as involving more than obtaining a purely fiscal advantage.\textsuperscript{62} In another VAT case, \textit{Emsland-Stärke}\textsuperscript{63}, the ECJ defined the concept of abuse more detailed. An abusive arrangement has to contain two elements: On the one hand, it must consist of a combination of objective circumstances, in which the purpose of those rules is not achieved, although the conditions of the given rule are formally observed.\textsuperscript{64} On the other hand, a subjective element is necessary which aims at obtaining the advantage from the rule by creating the conditions required for achieving it artificially.\textsuperscript{65} In the case \textit{Halifax}\textsuperscript{66}, also regarding VAT law, the ECJ rephrased these conditions slightly.\textsuperscript{67} Now, the first requirement is that the transaction results in the granting of a tax advantage contrary to the purpose of the provision, although all the conditions formally apply.\textsuperscript{68} Secondly, it has to be apparent from several objective factors that the

\begin{footnotesize}
\begin{itemize}
  \item \textsuperscript{59} OECD, \textit{BEPS Action 4 Final Report}, 85.
  \item \textsuperscript{60} Case C-28/95 \textit{Leur Bloem}.
  \item \textsuperscript{61} Case C-28/95 \textit{Leur Bloem}, para 48.
  \item \textsuperscript{62} Case C-28/95 \textit{Leur Bloem}, para 47.
  \item \textsuperscript{63} Case C-110/99 \textit{Emsland-Stärke}.
  \item \textsuperscript{64} Case C-110/99 \textit{Emsland-Stärke}, para 52.
  \item \textsuperscript{65} Case C-110/99 \textit{Emsland-Stärke}, para 53.
  \item \textsuperscript{66} Case C-255/02 \textit{Halifax}.
  \item \textsuperscript{67} De Broe/Beckers, EC Tax Review 2017, 133, 134.
  \item \textsuperscript{68} Case C-255/02 \textit{Halifax}, para 74.
\end{itemize}
\end{footnotesize}
essential aim of the transaction is to obtain a tax advantage. Moreover, when subsuming under the second element, the purely artificial nature of the transaction may be taken into account.

The application of the anti-abuse purpose as a justification ground in the field of direct taxation commenced in 1998, when the ECJ gave its ruling in the *ICI* case. Here, the ECJ accepted the anti-avoidance purpose as a justification ground for the first time, although it was not fulfilled. The ECJ stated, that in order to be justified as an anti-avoidance provision, a legislation needs to have the specific purpose of preventing wholly artificial arrangements, which have been created to circumvent tax legislation, from attracting tax benefits, and must not apply generally to all situations. In the case *X and Y*, after confirming the aforementioned, the ECJ further explained that tax avoidance cannot be presumed solely based on the fact that the parent company is established in another Member State. In the case *Lankhorst-Hohorst*, the ECJ transferred exactly these requirements to interest deduction limitation rules. In the case *Cadbury Schweppes*, the ECJ confirmed the necessity of a wholly artificial arrangement to justify a restriction based on anti-avoidance purposes. In addition, the ECJ referred to its two-step test from *Emsland-Stärke* and *Halifax* to find that there is such an arrangement. The ECJ continued to define a wholly artificial arrangement as not reflecting economic reality, i.e. not being an actual establishment intended to exercise genuine economic activities. Objective factors for this are, if the establishment exists physically in terms

---

69 Case C-255/02 *Halifax*, para 75.  
70 Case C-255/02 *Halifax*, para 81.  
71 Case C-264/96 *ICI*.  
72 Case C-264/96 *ICI*, para 26.  
73 Case C-436/00 *X and Y*.  
74 Case C-436/00 *X and Y*, para 62.  
75 Case C-324/00 *Lankhorst-Hohorst*.  
76 Case C-324/00 *Lankhorst-Hohorst*, para 37.  
77 Case C-196/04 *Cadbury Schweppes*.  
78 Case C-196/04 *Cadbury Schweppes*, para 55.  
79 Case C-196/04 *Cadbury Schweppes*, para 64.  
80 Case C-196/04 *Cadbury Schweppes*, paras 65-66.
of premises, staff and equipment.\textsuperscript{81} In order to comply with EU law, a provision has to exclude arrangements which mirror economic reality.\textsuperscript{82} In the case \textit{Test Claimants in the Thin Cap Group Litigation}\textsuperscript{83}, the ECJ approved the aforementioned, but also introduced the arm's length principle as a possible indicator for a wholly artificial arrangement. If a non-resident company grants a resident company a loan on terms which are not in accordance with the arm's length principle, this can be used as an objective element to determine an artificial arrangement.\textsuperscript{84} A rule, implementing this will not be disproportionate, if it, at the same time, gives the taxpayer the opportunity, without undue administrative constraints, to provide evidence for economic reality.\textsuperscript{85} Besides, if there is a wholly artificial arrangement, the tax advantage may only be denied as far as it exceeds the arm's length price.\textsuperscript{86}

From this it follows, that a rule aiming at the prevention of tax avoidance can only be justified for this reason, if it fulfils two criteria: Firstly, it must target only wholly artificial arrangements, which do not reflect real economic activity. Secondly, the taxpayer needs to have the opportunity to prove a sound business reason.

\textbf{3.2.3.3 The Second Line: The Anti-Avoidance Purpose Combined with the Balanced Allocation of Taxing Rights}

Nevertheless, the ECJ has developed another line of reasoning, which can be called upon instead of the first line displayed above. In the case \textit{Marks & Spencer}\textsuperscript{87}, the ECJ accepted the anti-avoidance purpose as a justification ground, although the provision did not aim at wholly artificial

\begin{itemize}
\item \textsuperscript{81} Case C-196/04 \textit{Cadbury Schweppes}, para 67.
\item \textsuperscript{82} Case C-196/04 \textit{Cadbury Schweppes}, para 65.
\item \textsuperscript{83} Case C-524/04 \textit{Test Claimants in the Thin Cap Group Litigation}.
\item \textsuperscript{84} Case C-524/04 \textit{Test Claimants in the Thin Cap Group Litigation}, para 81.
\item \textsuperscript{85} Case C-524/04 \textit{Test Claimants in the Thin Cap Group Litigation}, para 82.
\item \textsuperscript{86} Case C-524/04 \textit{Test Claimants in the Thin Cap Group Litigation}, para 83.
\item \textsuperscript{87} Case C-446/03 \textit{Marks & Spencer}.
\end{itemize}
arrangements.\textsuperscript{88} This was, because the ECJ took the three justification grounds balanced allocation of taxing rights, prevention of double use of losses and risk of tax avoidance together.\textsuperscript{89} Yet, the measure was held to be disproportionate.\textsuperscript{90} In this regard, the ECJ mentioned again that Member States may use rules aiming at wholly artificial arrangements to render a provision proportionate.\textsuperscript{91} The ECJ followed the line of combining several justification grounds and then not demanding the provision to aim at wholly artificial arrangements in the case \textit{Oy AA}\textsuperscript{92}, where the two justification grounds balanced allocation of taxing rights and risk of tax avoidance were considered together.\textsuperscript{93} Here, the ECJ explicitly states that the provision can still be regarded as proportionate, although it does not target only purely artificial arrangements, if it is taken as a whole.\textsuperscript{94}

The justification ground, which is most related to the anti-avoidance purpose, is the balanced allocation of taxing rights. Hence, these two grounds are often considered together, as shown in the cases \textit{Marks & Spencer} and \textit{Oy AA}. In \textit{Marks & Spencer}, the balanced allocation of taxing rights has been accepted as a justification ground for the first time. In the case \textit{X Holding}\textsuperscript{95}, it has been accepted as the sole justification ground for the first time.\textsuperscript{96} As the current judicature of the ECJ stands, the balanced allocation of taxing rights allows the Member States two things:\textsuperscript{97} Firstly, since direct taxation is not unified or harmonized within the EU, the Member States themselves have the power to define the criteria for allocating their taxing rights unilaterally or by treaties.\textsuperscript{98} They may implement rules to prevent activities capable of jeopardizing the Member

\textsuperscript{88} Case C-446/03 \textit{Marks & Spencer}, para 51.
\textsuperscript{89} Case C-446/03 \textit{Marks & Spencer}, paras 51, 43.
\textsuperscript{90} Case C-446/03 \textit{Marks & Spencer}, para 55.
\textsuperscript{91} Case C-446/03 \textit{Marks & Spencer}, para 57.
\textsuperscript{92} Case C-231/05 \textit{Oy AA}.
\textsuperscript{93} Case C-231/05 \textit{Oy AA}, para 60.
\textsuperscript{94} Case C-231/05 \textit{Oy AA}, para 63.
\textsuperscript{95} Case C-337/08 \textit{X Holding}.
\textsuperscript{96} Case C-337/08 \textit{X Holding}, para 33.
\textsuperscript{97} Berglund/Cejie, \textit{Basics of International Taxation}, 116.
\textsuperscript{98} Berglund/Cejie, \textit{Basics of International Taxation}, 116.
States' right to exercise their taxing powers within their territory. This includes for example rules which prevent taxpayers from deciding themselves where they want to have their losses taken into account.

Secondly, Member States are allowed to take guidance from the OECD Model Tax Convention or other publications by the OECD to find inspiration, how a balanced allocation of taxing rights might look. It follows, that the balanced allocation of taxing rights can be invoked by the Member States, if they restrict a cross-border activity with a measure to safeguard their taxing rights on income essentially derived in their territory.

### 3.2.3.4 Interim Conclusion

Consequently, in the area of direct taxation, two lines of judicature regarding the anti-avoidance purpose as a justification ground can be detected. These are inspired by the judicature in the field of VAT law: On the one hand, if the anti-avoidance purpose is considered alone, it has to specifically aim at wholly artificial arrangements to be accepted. Moreover, to be held proportionate, it needs to leave the taxpayer a way to prove that such an arrangement does not exist. A wholly artificial arrangement is one which does not reflect a genuine economic reality and has to be identified by a subjective and an objective component. On the other hand, if the anti-avoidance purpose is taken together with other justification grounds, such as the balanced allocation of taxing rights, the measure is not required to aim only at wholly artificial arrangements.

---

3.3 Application to Art. 4 ATAD

3.3.1 Background

As a directive, the ATAD forms part of the secondary EU law. In the hierarchy of EU laws, the primary EU law prevails over the secondary EU law. The freedoms of the TFEU belong to the primary EU law. Hence, the ATAD has to comply with the higher ranking TFEU freedoms. To see if this is the case, Art. 4 ATAD will be measured against the theoretical framework described above.

3.3.2 Scope of Application

Art. 4 ATAD touches the scope of application both of the freedom of establishment and of the free movement of capital. The aim of Art. 4 ATAD is to prevent especially groups of companies from BEPS through excessive interest payments. If groups are involved, these will most probably make use of the place of establishment of their group members when considering where to shift debts and where to shift profits. In this case, the purpose of Art. 4 ATAD considered together with the influence of one company over the other lead to the conclusion that the freedom of establishment is the one at issue.

However, Art. 4 ATAD is not limited to the application to groups of entities (the exclusion of standalone companies is voluntary). It rather includes all kinds of interest payments. If the companies engaged in interest payments are not related, the plain transfer of capital will be decisive. Then, the free movement of capital will be the freedom to be considered.

102 Helminen, EU Tax Law - Direct Taxation, 20.
103 Helminen, EU Tax Law - Direct Taxation, 9.
104 ATAD, Art. 4 (5) (a), Preamble para. 6.
Art. 4 ATAD contains a cross-border element, because it also covers payments between companies residents in different countries.

### 3.3.3 The Restriction Test

The first step of the restriction test, i.e. the comparability test, does not pose a problem. Companies, which pay or receive cross-border interest payments, are in an objectively comparable situation to companies which pay or receive interest payments within one and the same Member State. Classifying their situation as incomparable only because in one incident one of the participants has the tax residence in another Member State, would deprive the TFEU freedoms of all meaning.105 Yet, the cross-border situation has to be treated less favourably for a restriction to be at hand. In the case of Art. 4 ATAD, this provision applies to all payments equally, regardless of their being cross-border or wholly internal. Thus, the cross-border situation is not treated less favourably than the purely internal one, but equally.

Consequently, the analysis of Art. 4 ATAD could stop right here with the result that Art. 4 ATAD does not violate the TFEU freedoms as it does not impose a restriction.106 However, this would not be correct. Art. 4 ATAD is not a domestic provision, but EU law itself. When the EU takes an action, the action always has to be proportionate. This principle of proportionality is a principle of primary EU law, which is written down in Art. 5 (1) TEU. When examining an EU measure, the ECJ always takes account of the principle of proportionality, regardless of the existence of a restriction.107

---

105 Case C-231/05 Oy AA, para 30; Case C-446/03 Marks & Spencer, para 37.
107 Case C-210/03 Swedish Match, para 46-58; van Os, EC Tax Review 2016, 184, 195.
Hence, the proportionality test, which forms one part of the justification test, still has to be conducted.

3.3.4 The Proportionality Test

3.3.4.1 The Requirements of the Proportionality Test

To pass the proportionality test, Art. 4 ATAD must be proportionate in relation to its legitimate objective. As stated above, this means, that it has to be suitable for securing the attainment of the objective which it pursues and not go beyond what is necessary in order to attain it. This means, that, to begin with, it has to be examined, if Art. 4 ATAD pursues a legitimate objective to then measure the provision itself against this objective. The justification grounds in the field of tax law mentioned above all represent legitimate objectives.

As the name Anti-Tax Avoidance Directive itself implies, the predominant objective of the ATAD and its Art. 4 is to prevent tax avoidance. In itself, this is a legitimate objective, as the ECJ case law described above has illustrated. However, Art. 4 ATAD has to pursue the anti-avoidance purpose in the right manner. Therefore, it has to comply with the judicature laid down in regard of the anti-avoidance purpose. It has to be in accordance with one of the two lines of judicature set out by the ECJ.

3.3.4.2 The First Line: The Anti-Avoidance Purpose Considered Alone

For the first line, the anti-avoidance purpose has to be considered alone. Then, Art. 4 ATAD would have to specifically target wholly artificial arrangements. This is not the case. Art. 4 ATAD rather covers all kinds

---

110 CFE, Opinion Statement on the ATAD, 5; Ginevra, Intertax 2017, 120, 124.
of interest payments.\textsuperscript{111} It even covers stand-alone entities (the exclusion is voluntary)\textsuperscript{112}, where tax avoidance through interest deduction does not regularly occur.\textsuperscript{113} It also covers wholly domestic interest payments\textsuperscript{114}, where there is no risk of tax avoidance through BEPS, because the interest payments which are deducted by one company in the Member State will be taxed when they reach the receiving company established in the same Member State by the same Member State.

In addition, to be proportionate, Art. 4 ATAD would have to be suitable to attain the anti-avoidance purpose. This can already be doubted\textsuperscript{115}, because due to some of the voluntary exclusions, the risk of tax avoidance is still present.\textsuperscript{116} For example, with the exemption limit of EUR 3 000 000, tax avoidance cannot be ruled out reliably. What is certain is, that Art. 4 ATAD goes beyond what is necessary to accomplish the anti-avoidance purpose\textsuperscript{117}, because it would have to provide for an opportunity for the taxpayer to escape the interest deduction limitation by proving a sound business reason. This is not the case.\textsuperscript{118} Such a rule is not even included in one of the voluntary exclusions from the main rule. Entities may be in need of a loan\textsuperscript{119}, either because they engage in activities which usually demand the taking up of loans, for example companies working in construction or real estate, or because they are start-ups or approach a new project.\textsuperscript{120} As a result, Art. 4 ATAD is not in accordance with the first line of the ECJ’s judicature.

\textsuperscript{111} CFE, \textit{Opinion Statement on the ATAD}, 5.
\textsuperscript{112} Dourado, EC Tax Review 2017, 112, 120.
\textsuperscript{113} Navarro/Parada/Schwarz, EC Tax Review 2017, 117, 119.
\textsuperscript{114} CFE, \textit{Opinion Statement on the ATAD}, 5; Dourado, EC Tax Review 2017, 112, 120.
\textsuperscript{115} van Os, EC Tax Review 2016, 184, 197.
\textsuperscript{116} This argument has been transferred from BFH Beschluss I R 20/15, para 53; Lampert/Meickmann/Reinert, European Taxation 2016, 323, 327 to the ATAD.
\textsuperscript{117} CFE, \textit{Opinion Statement on the ATAD}, 5; Dourado, EC Tax Review 2017, 112, 119; van Os, EC Tax Review 2016, 184, 197.
\textsuperscript{118} Ginevra, Intertax 2017, 120, 124.
\textsuperscript{119} Dourado, EC Tax Review 2017, 112, 120.
\textsuperscript{120} CFE, \textit{Opinion Statement on the ATAD}, 5-6; Navarro/Parada/Schwarz, EC Tax Review 2017, 117, 118.
3.3.4.3 The Second Line: The Anti-Avoidance Purpose Combined with the Balanced Allocation of Taxing Rights

For the second line, the anti-avoidance purpose must be taken together with another legitimate objective. The balanced allocation of taxing rights is qualified for this purpose.\textsuperscript{121} This is, because the ATAD is a transposition of the BEPS project. As the name implies, base erosion and profit shifting shall be prevented, which is basically securing the balanced allocation of taxing rights.\textsuperscript{122} More specifically, Art. 4 ATAD aims at safeguarding the taxing rights of the Member States on profits derived in their territory\textsuperscript{123}, so that the balanced allocation of taxing rights forms a justification ground or legitimate objective for this provision, especially if considered together with the anti-avoidance purpose.

Nonetheless, Art. 4 ATAD must also be proportionate. Again, with the voluntary exclusions, it can be doubted if Art. 4 ATAD is suitable for supporting a balanced allocation of taxing rights. Beyond that, Art. 4 ATAD must not go beyond what is necessary to obtain this goal. Problematic is, that the purpose of the balanced allocation of taxing rights as a justification ground lies in securing that Member States can tax the profits generated in their territory. Thus, if Art. 4 ATAD only limited the interest deductions paid across the border, this would protect the tax base in the state of residence of the payer. However, Art. 4 ATAD does not only aim at cross-border interest payments, but covers all interest payments, even wholly internal ones. Regarding the latter, there is no risk of losing any taxing rights, because the interest payments remain in one and the same jurisdiction. Moreover, Art. 4 ATAD treats groups of companies, standalone companies, companies which need funding and companies

\textsuperscript{122} Bizioli, EC Tax Review 2017, 167, 171.
\textsuperscript{123} Bizioli, EC Tax Review 2017, 167, 167.
which could select other alternatives equally\textsuperscript{124}, although they are all in very different situations. For this reason, Art. 4 ATAD also goes beyond what is necessary with respect to the balanced allocation of taxing rights.\textsuperscript{125} Hence, Art. 4 ATAD does not pursue this legitimate objective proportionately, neither considered together with the anti-avoidance purpose nor taken alone.

3.4 Interim Conclusion

As has been illustrated, Art. 4 ATAD is not in compliance with the TFEU freedoms, and especially, the principle of proportionality.\textsuperscript{126} It is true that Art. 4 ATAD does not impose a restriction on the freedom of establishment or the free movement of capital, because it does not differentiate between residents and non-residents. Nevertheless, EU law has to meet the proportionality principle no matter what. The proportionality test forms part of the justification test developed by the ECJ. A measure needs to pursue a legitimate objective in a proportionate manner, i.e. it has to be suitable for securing the attainment of the objective and not go beyond what is necessary to attain it. Since Art. 4 ATAD aims at preventing tax avoidance conducted through interest payments, the objective of anti-avoidance is invoked.

For the anti-avoidance purpose as a justification ground, the ECJ has developed two lines of judicature: The first one states, if this objective is considered alone, it has to specifically aim at wholly artificial arrangements and additionally give the taxpayer the opportunity to prove a sound business reason. Art. 4 ATAD does not fulfill this, because it covers all kind of interest payments, be it between stand-alone or groups of companies

\textsuperscript{124} Dourado, EC Tax Review 2017, 112, 120.
\textsuperscript{125} Dourado, EC Tax Review 2017, 112, 119; van Os, EC Tax Review 2016, 184, 197.
or wholly domestic or cross-border payments. The second line involves the combination of the anti-avoidance purpose with another justification ground. Then, the provision does not have to aim solely at wholly artificial arrangements. Here, the balanced allocation of taxing rights is qualified. However, considering this objective, the problem still remains that Art. 4 ATAD covers all sorts of interest payments, regardless of if the taxing rights of the residence state of the payer are at risk. Moreover, leaving the taxpayer no possibility of having the full amount of the interest payments deducted, in whatever the circumstances might be, cannot be proportionate. This applies both to the combination of the objectives of anti-avoidance and balanced allocation of taxing rights and to the latter taken alone.

It is true, that the EU itself considers the ATAD as a whole in line with the proportionality principle.\textsuperscript{127} This is, because the ATAD only ensures a minimum level of protection instead of prescribing full harmonization.\textsuperscript{128} Yet, this very general remark is not able to eliminate the above mentioned concerns.

Also an interpretation of Art. 4 ATAD in accordance with the TFEU freedoms is not possible, since this would change its normative content fundamentally.\textsuperscript{129} In addition, the ATAD lays down de minimis-rules. Therefore, it is also not possible for the Member States to implement more lenient rules, but only harsher ones. Hence, not even the Member States could modify Art. 4 ATAD when implementing it, so that it would meet the requirements of the ECJ judicature.

However, this might be a rather technical concern. The question opens up, who would refer this matter to the ECJ and would the ECJ then end up

---

\textsuperscript{127} EC, Proposal for the ATAD, 5; ATAD, Preamble para 16.
\textsuperscript{128} EC, Proposal for the ATAD, 5; ATAD, Preamble para 16.
\textsuperscript{129} This argument has been transferred from BFH Beschluss I R 20/15, para 66 to the ATAD.
declaring Art. 4 ATAD incompatible with primary EU law? Cases are usually brought to the ECJ either by the European Commission (EC), which observes the compliance with the Treaties of the EU, or by a national court, which has to decide a case of a taxpayer in one of the Member States. The EC was involved in developing the ATAD itself as it put forward the Proposal for the ATAD. This makes it rather unlikely that the EC will have Art. 4 ATAD examined by the ECJ. If a national court refers the case of a taxpayer concerning the interest deduction limitation to the ECJ, Art. 4 ATAD itself will most probably not be the legislation at issue.\(^{130}\) This is, because the Member States do not adopt the ATAD directly, but have to transpose it through an own measure for which the ATAD supplies the framework.\(^{131}\) This leads to two problems: Firstly, if a domestic provision implements an EU directive, the ECJ will usually not measure this domestic provision against the TFEU freedoms, but against the directive.\(^{132}\) In that case, the compatibility with the TFEU freedoms would not be discussed. Secondly, even if the ECJ measured the domestic legislation against the TFEU freedoms, a violation would not be found. The reason for that is that the domestic provision would treat cross-border and wholly internal situations equally in accordance with Art. 4 ATAD, so no restriction of a TFEU freedom would be at hand.\(^{133}\) However, there are rare cases where a national court has asked the ECJ to evaluate an EU directive along with its domestic implementation in the light of other EU laws.\(^{134}\) Then, it has to be born in mind that the ECJ has established very high standards for ruling against EU law. The ECJ has determined that Community legislature must be allowed a broad discretion and the lawfulness of such a measure can only be affected if the measure is manifestly inappropriate in relation to the objective pursued.\(^{135}\) In fact, the

\(^{130}\) De Graaf/Visser, EC Tax Review 2016, 199, 202; Ginevra, Intertax 2017, 120, 123.
\(^{131}\) As Art. 288 TFEU stipulates.
\(^{132}\) Case C-210/03 Swedish Match, para 81; Ginevra, Intertax 2017, 120, 123.
\(^{134}\) Case C-210/03 Swedish Match, para 21; De Graaf/Visser, EC Tax Review 2016, 199, 202; Ginevra, Intertax 2017, 120, 123.
\(^{135}\) Case C-210/03 Swedish Match, para 48; van Os, EC Tax Review 2016, 184, 195.
ECJ has very seldom ruled an EU secondary act invalid for violating the TFEU freedoms and never because of a breach with the principle of proportionality. So, even if the ECJ ended up analyzing Art. 4 ATAD with regard to its compatibility with the TFEU freedoms and especially the proportionality principle, it is not certain that the ECJ would really rule against it.

4. The National Constitutions and Art. 4 ATAD

4.1 Introduction

In the next part of the thesis, it will be evaluated how Art. 4 ATAD gets in line with national constitutions. This makes it necessary to begin with some general remarks about the relation between EU and domestic laws. Subsequently, the German interest barrier rule and its accordance with the German Constitution will be discussed to serve as an example for how a domestic implementation of Art. 4 ATAD might comport with a national constitution. This is, because the German interest barrier rule has set the example for Art. 4 ATAD and can therefore be considered as already implementing this article of the EU directive. Afterwards, the results will be raised to a more general level to draw inferences about the relation between Art. 4 ATAD, or rather its respective domestic implementation, and the national constitutions of the Member States. Finally, the chapter will be closed by an interim conclusion.

4.2 The Relation between EU Laws and Domestic Laws

Art. 4 ATAD might not comply with national constitutions. Admittedly, this will not affect the validity of this provision. It is generally accepted that

\[136\] Ginevra, Intertax 2017, 120, 123.
\[137\] De Graaf/Visser, EC Tax Review 2016, 199, 209.
EU law, regardless of its rank, takes precedence over national laws, also regardless of their status.\textsuperscript{138} This is called the principle of primacy of EU law.\textsuperscript{139} The ECJ started its jurisdiction in this direction with the case \textit{Costa ENEL}.\textsuperscript{140} There, the ECJ stated that the EEC Treaty (the predecessor of the TFEU) has created its own legal system, which became an integral part of the legal systems of the Member States.\textsuperscript{141} They transferred part of their power to the community.\textsuperscript{142} Hence, the treaty as an independent source of law with a special and original nature cannot be overridden by domestic legal provisions.\textsuperscript{143} In the case \textit{Internationale Handelsgesellschaft},\textsuperscript{144} the ECJ transferred this judicature to secondary EU law and stated that even this prevails over national constitutions.\textsuperscript{145} Thus, the ATAD as secondary EU law still overrides a national constitution as long as it is in force. This does not change under the fact that a directive has to be implemented first and then becomes a domestic provision itself, which usually ranks lower than the constitution.\textsuperscript{146} The domestic law implementing a directive is still designed according to the legal framework supplied by the EU directive. Thus, at least as far as the domestic provision transposes what the directive sets apart and does not deviate from it, the national law cannot be disregarded with the argument that constitutional law is superior.\textsuperscript{147} In this case, the domestic provision represents the directive and with that EU law, so it has to prevail over the national constitution. It is rather that domestic laws must be applied and interpreted so that they are in line with EU law.\textsuperscript{148} The Member States have generally accepted the principle of primacy of EU

\begin{itemize}
\item \textsuperscript{138} Helminen, \textit{EU Tax Law - Direct Taxation}, 5-6.
\item \textsuperscript{139} Helminen, \textit{EU Tax Law - Direct Taxation}, 5.
\item \textsuperscript{140} Case C-6/64 \textit{Costa v. ENEL}.
\item \textsuperscript{141} Case C-6/64 \textit{Costa v. ENEL}, para 3.
\item \textsuperscript{142} Case C-6/64 \textit{Costa v. ENEL}, para 3.
\item \textsuperscript{143} Case C-6/64 \textit{Costa v. ENEL}, para 3.
\item \textsuperscript{144} Case C-11/70 \textit{Internationale Handelsgesellschaft}.
\item \textsuperscript{145} Case C-11/70 \textit{Internationale Handelsgesellschaft}, para 3; Gutmann and others, European Taxation 2017, 2, 5.
\item \textsuperscript{146} As implied by De Graaf/Visser, EC Tax Review 2016, 199, 202.
\item \textsuperscript{147} Dourado, EC Tax Review 2017, 112, 121.
\item \textsuperscript{148} Helminen, \textit{EU Tax Law - Direct Taxation}, 6.
\end{itemize}
law, although different states have made different reservations as to when they might not follow it.\textsuperscript{149}

At the same time, the EU has to respect the identity of the Member States and follow the principle of sincere cooperation. These fundamentals can be found in Art. 4 TEU. Art. 4 (2) TEU demands that the EU respects the national identities of the Member States, which are inherent in their fundamental structures, political and constitutional. Moreover, Art. 4 (3) TEU imposes the principle of sincere cooperation. According to this principle, the EU and the Member States shall assist each other in carrying out tasks which flow from the Treaties in mutual respect.\textsuperscript{150} From this follows that also the EU has to be mindful of the national fundamentals, which exist in the Member States when taking actions. These actions have to be shaped in such a way that they impose as little of a burden on the Member States as possible, so they can pursue the goals set out by the action as effectively as possible. Hence, the EU should not take actions which counteract the national fundamentals of the Member States and disrespect their identity and thus make it complicated for them to comply with such actions.

\section*{4.3 The German Interest Barrier Rule as an Example}

The German interest barrier rule qualifies perfectly as an example for how Art. 4 ATAD might be at odds with national constitutions. This is firstly, because the German interest barrier rule served as a blueprint for Art. 4 ATAD. For this reason, the German interest barrier rule can be seen as a domestic provision already implementing Art. 4 ATAD. Secondly, the

\textsuperscript{149} For example the \textit{Solange II}-decision by the BVerfG in Germany: EU law will not be measured against the German Constitution as long as the EU secures an effective protection of the substance of the constitutional rights.

\textsuperscript{150} TEU, Art. 4 (3).
German interest barrier rule is currently under review by the BVerfG, because it is considered as violating the German Constitution.

The German interest barrier rule was implemented into the German tax code in 2007 as a response to the ECJ decision in the case *Lankhorst-Hohorst*\(^{151}\)\(^{152}\). In this case, the former German rule on the limitation of interest expense deduction was reviewed. It was ruled as violating the freedom of establishment, because it only covered cross-border interest payments without specifically targeting wholly artificial arrangements.\(^{153}\) Instead of amending the former provision to meet the artificiality requirement, the German legislator opted for a whole new rule. This new provision, again, does not aim at wholly artificial arrangements. It avoids, however, a violation of the TFEU freedoms by covering cross-border and purely domestic interest payments equally and hence not imposing a restriction.\(^{154}\)

To understand the criticism regarding the German interest barrier rule, it is important to know how it is structured, especially in comparison to Art. 4 ATAD. The basic interest barrier rule is laid down in § 4h EStG, which applies to all forms of companies, including transparent partnerships. For the field of corporate taxation, § 8a KStG contains some deviations from § 4h EStG. Like Art. 4 (1) ATAD, § 4h (1) EStG limits the interest deduction to 30% of the EBITDA. § 4h (1) EStG allows for the carry forward of the exceeding borrowing costs without time limitation and of the unused EBITDA for a maximum of five years, like Art. 4 (6) (c) ATAD does as well. § 4h (2) EStG provides for some exceptions to the basic rule. These include, as Art. 4 ATAD, an exemption limitation of

---

\(^{151}\) Case C-324/00 *Lankhorst-Hohorst*.


\(^{154}\) Knöller, Intertax 2011, 317, 328.
EUR 3 000 000\textsuperscript{155}, a standalone clause\textsuperscript{156} and a group ratio rule\textsuperscript{157}. Unlike Art. 4 (3) (b) ATAD, § 4h EStG does not only apply the standalone clause to entities, which do not form part of a group at all, but also to companies which are only partly related to a group of companies.\textsuperscript{158} § 8a (2) KStG specifies this by stating that this will only be the case for corporations if not more than 10 % of the exceeding borrowing costs are paid to a shareholder holding more than 25 % of the corporation's nominal or stock capital directly or indirectly.\textsuperscript{159} The group ratio rule in § 4h (2) (c) EStG is applicable like in Art. 4 (5) ATAD, if the company can demonstrate that the ratio of its equity over its total assets is equal to or higher than the equivalent ratio of the group, where a deviation of 2 % is accepted. Again, § 8a (3) KStG establishes that borrowing costs which are paid to shareholders who hold more than 25 % of the interest in the corporate group directly or indirectly may not exceed 10 %.\textsuperscript{160} § 4h (5) EStG provides for the unused EBITDA and exceeding borrowing costs to be lost in case of termination of the business or transfer of undertakings, whereas Art. 4 ATAD does not contain such a rule.

These are the main features of the German interest barrier rule. The details can be left disregarded for the purpose of the following examination. It is shown, that Art. 4 ATAD has taken its inspiration from the German interest barrier rule to a large extent. The deviations are mainly owed to the fact that the ATAD is a directive, whereas the German interest barrier rule is directly applicable law.\textsuperscript{161} Earlier drafts of the ATAD differed from the German interest barrier rule more. For example, the exemption limitation was only effective up to EUR 1 000 000 and there was no voluntary exception for

\textsuperscript{155} EStG, § 4h (2) (a).
\textsuperscript{156} EStG, § 4h (2) (b).
\textsuperscript{157} EStG, § 4h (2) (c).
\textsuperscript{158} EStG, § 4h (2) (b).
\textsuperscript{159} Lampert/Meickmann/Reinert, European Taxation 2016, 323, 324.
\textsuperscript{160} Lampert/Meickmann/Reinert, European Taxation 2016, 323, 324.
\textsuperscript{161} Lampert/Meickmann/Reinert, European Taxation 2016, 323, 324.
standalone entities. However, the final version of Art. 4 ATAD has adapted most of the prerequisites from the German interest barrier rule.

4.4 The Potential Unconstitutionality of the German Interest Barrier Rule

4.4.1 Background

The BFH referred the German interest barrier rule to the BVerfG for a constitutional review in 2015 after receiving a case from a corporate entity as part of a group, which lost its exceeding borrowing costs carry forward due to a corporate restructuring. § 4h EStG and § 8a KStG are viewed as violating Art. 3 (1) GG, which constitutes the principle of equality in Germany, in its form of the objective net principle.

4.4.2 The German Constitution and the Objective Net Principle

According to the principle of equality laid down in Art. 3 (1) GG, things that are substantially alike have to be treated similarly and things that are substantially not alike have to be treated differently. The examination of a possible violation of an article of the German Constitution by a legal act looks quite similar to the analysis of a possible violation of a TFEU freedom and includes the steps scope of application, restriction test and justification test. Yet, the testing of Art. 3 (1) GG deviates from this scheme. Here, the first step lies in finding that two groups of people or

---

162 As still described in: Lampert/Meickmann/Reinert, European Taxation 2016, 323, 324.
163 § 4h EStG and § 8a KStG are viewed as violating Art. 3 (1) GG, which constitutes the principle of equality in Germany, in its form of the objective net principle.
164 BFH Beschluss I R 20/15, para 9, 13.
165 BFH Beschluss I R 20/15, para 13; Lampert/Meickmann/Reinert, European Taxation 2016, 323, 325; Birk/Desens/Tappe, Steuerrecht, 57; Tipke/Lang, Steuerrecht, 96.
166 BVerfGE 80, 137; BVerfGE 7, 198.
situations are comparable and still treated unequally. In a second step, it is scrutinized if this unequal treatment is justified.

In Germany, for the field of tax law, it has been developed that Art. 3 (1) GG can be made more concrete to the principle of ability-to-pay and the requirement of consistency. The former means, that taxpayers, who have the same ability-to-pay, must also be taxed equally heavily. This is, because the principle of equality dictates to treat substantially alike things similarly. Thus, if two taxpayers have the same ability-to-pay, and are therefore substantially alike from a taxation point of view, they have to be treated similarly. The latter principle means, that when the German legislator structures the tax law regime, and makes the decision to impose a tax burden, this must be implemented consistently. The reason for this is, if once established legisatory measures were not followed consistently, it would end up in treating situations, which fall under the scope of the measure and are therefore comparable, unequally.

One of the criteria to assess the ability-to-pay of the taxpayer is the objective net principle. The objective net principle is deduced from the ability-to-pay principle. According to the objective net principle, business expenses, which are made in order to obtain an income, have to be deducted from the tax base. This is, because business expenses reduce the ability-to-pay. Evaluating the tax base, from which those expenses are

---

167 BVerfGE 55, 72, 88; BVerfGE 121, 317, 369; Tipke/Lang, Steuerrecht, 99.
168 BVerfGE 55, 72, 88; BVerfGE 121, 317, 369; Tipke/Lang, Steuerrecht, 99.
169 BFH Beschluss I R 20/15, para 14; Tipke/Lang, Steuerrecht, 91.
170 BFH Beschluss I R 20/15, para 14; Lampert/Meickmann/Reinert, European Taxation 2016, 323, 325; Birk/Desens/Tappe, Steuerrecht, 58.
171 Birk/Desens/Tappe, Steuerrecht, 58.
172 BFH Beschluss I R 20/15, para 14; Lampert/Meickmann/Reinert, European Taxation 2016, 323, 325; Tipke/Lang, Steuerrecht, 96.
173 BFH Beschluss I R 20/15, para 15; Lampert/Meickmann/Reinert, European Taxation 2016, 323, 325.
174 Birk/Desens/Tappe, Steuerrecht, 57.
175 BFH Beschluss I R 20/15, para 15; Lampert/Meickmann/Reinert, European Taxation 2016, 323, 325; Birk/Desens/Tappe, Steuerrecht, 57; Tipke/Lang, Steuerrecht, 297.
176 Tipke/Lang, Steuerrecht, 297.
not deducted, would oppose the ability-to-pay principle. If a taxpayer earns EUR 100,000, but has had expenses of EUR 50,000 to obtain this income, the taxpayer is factually left with EUR 50,000. Then, the taxes should be determined based on the EUR 50,000, because that is the amount of money the taxpayer eventually has made during the tax period and hence defines the ability to pay.

As a result, the objective net principle is one branch of the ability-to-pay principle, which again is one concretization of the principle of equality. In other words, the objective net principle can be traced down to Art. 3 (1) GG via the ability-to-pay principle. The legislator has made the decision to use the ability-to-pay principle and the objective net principle as guiding principles in the field of tax law to define the principle of equality. According to the principle of consistency, another ascertainment of the principle of equality, the legislator is not allowed not deviate from these guiding principles, at least not without a justification ground which is pursued proportionately.\textsuperscript{177} These seamless connections between the objective net principle and Art. 3 (1) GG lead to the fact, that in Germany, the objective net principle itself is covered by the constitution.

4.4.3 The BFH's and Prevailing Opinion: The German Interest Barrier Rule Is Unconstitutional

For the BFH and the prevailing opinion in tax law literature, the German interest barrier rule is unconstitutional.\textsuperscript{178} The BFH states that, because the interest barrier rule limits the tax deduction of business expenses for borrowing costs at the level of the borrower entity, it violates the objective net principle.\textsuperscript{179} Or according to the scheme mentioned above, taxpayers,

\textsuperscript{177} München/Mückl, DStR 2014, 1469, 1471.
\textsuperscript{178} BFH Beschluss I R 20/15, para 28; Tipke/Lang, Steuerrecht, 698; München/Mückl, DStR 2014, 1469, 1473-74; Birk/Desens/Tappe, Steuerrecht, 288; Knöller, Intertax 2011, 317, 329.
\textsuperscript{179} BFH Beschluss I R 20/15, para 16; Lampert/Meickmann/Reinert, European Taxation 2016, 323, 325.
who have business expenses in form of interest payments, and taxpayers who have business expenses in any other form, are in a comparable situation, but treated unequally when only the former face a limitation on their deduction of expenses. The fact that the exceeding interest costs can be carried forward cannot change this, because it is not certain that these carried forward expenses can ever be used.\textsuperscript{180} For example, as it is the issue in the case before the BFH, the carry forward will be lost if the company is restructured.\textsuperscript{181} Furthermore, the carry forward of interest expenses to later tax periods can even be the reason for the interest barrier to trigger again.\textsuperscript{182}

This means, that there has to be a justification for the interest barrier rule.\textsuperscript{183} The justification grounds, the BFH examined, are the control of economic policy, the state's financing needs and the need to prevent abusive structures.\textsuperscript{184}

The first justification ground was accepted, in principle, as the legislator is allowed to pursue non-fiscal goals using tax legislation.\textsuperscript{185} The goal here was to strengthen the equity base of German companies\textsuperscript{186}, to create investment incentives for direct investment and to secure the tax base in Germany.\textsuperscript{187} However, the first goal cannot be achieved with all the exceptions the interest barrier provides for.\textsuperscript{188} De facto, small and medium-

\textsuperscript{180} Lampert/Meickmann/Reinert, European Taxation 2016, 323, 325.
\textsuperscript{181} BFH Beschluss I R 20/15, para 20; Lampert/Meickmann/Reinert, European Taxation 2016, 323, 325.
\textsuperscript{182} BFH Beschluss I R 20/15, para 19; Lampert/Meickmann/Reinert, European Taxation 2016, 323, 325.
\textsuperscript{183} BFH Beschluss I R 20/15, para 21; Lampert/Meickmann/Reinert, European Taxation 2016, 323, 325.
\textsuperscript{184} BFH Beschluss (I R 20/15, paras 29-30; Lampert/Meickmann/Reinert, European Taxation 2016, 323, 325-26.
\textsuperscript{185} BFH Beschluss I R 20/15, para 31; Lampert/Meickmann/Reinert, European Taxation 2016, 323, 326.
\textsuperscript{186} BFH Beschluss I R 20/15, para 30.
\textsuperscript{187} BFH Beschluss I R 20/15, para 32; Lampert/Meickmann/Reinert, European Taxation 2016, 323, 326.
\textsuperscript{188} BFH Beschluss I R 20/15, para 34; Lampert/Meickmann/Reinert, European Taxation 2016, 323, 326.
sized enterprises are excluded. Additionally, standalone companies are not covered. The second goal is not able to justify the interest barrier rule, since investment incentives do cover an interest carry forward, but not the main feature of the interest barrier rule, i.e. the limitation of interest deductions. The third goal cannot serve as a justification, because even purely domestic payments fall under the interest barrier rule, which has nothing to do with securing the German tax base.

As regards the second justification ground, the BFH generally accepts it, nonetheless, not in this case, because the interest barrier rule applies in too few cases to reach this goal.

The BFH's reasoning when dealing with the last justification ground is quite similar to the argumentation in this thesis regarding the anti-avoidance purpose as the objective of Art. 4 ATAD. Firstly, the BFH criticizes that tax legislation has to be determined by typical cases and not by atypical abuse cases. Moreover, by also covering wholly domestic payments, where it is impossible to exploit international tax differences in an abusive manner, the rule goes too far. It further applies to models with a common market practice, but not to abusive structures, which fall below the exemption limit. The BFH even refers to the EU judicature in the area of anti-abuse provisions (which has been laid down above) and concludes from this, that

\[\text{References:}\]

189 BFH Beschluss I R 20/15, para 34; Lampert/Meickmann/Reinert, European Taxation 2016, 323, 326.
190 BFH Beschluss I R 20/15, para 34; Lampert/Meickmann/Reinert, European Taxation 2016, 323, 326.
191 BFH Beschluss I R 20/15, para 36; Lampert/Meickmann/Reinert, European Taxation 2016, 323, 326.
192 BFH Beschluss I R 20/15, para 38; Lampert/Meickmann/Reinert, European Taxation 2016, 323, 326.
193 BFH Beschluss I R 20/15, para 44; Lampert/Meickmann/Reinert, European Taxation 2016, 323, 326.
194 BFH Beschluss I R 20/15, para 48; Lampert/Meickmann/Reinert, European Taxation 2016, 323, 326.
195 BFH Beschluss I R 20/15, para 50; Lampert/Meickmann/Reinert, European Taxation 2016, 323, 326.
196 BFH Beschluss I R 20/15, para 53; Lampert/Meickmann/Reinert, European Taxation 2016, 323, 327.
there is no EU law obligation to extend the scope of the interest barrier rule to domestic payments in order to ascertain its TFEU conformity, but that it is sufficient to only cover cross-border situations, if it is ensured that only abusive structures are targeted and that there is the possibility of proving a sound business reason. By aiming at both domestic and cross-border situations without providing for an opportunity to prove a real economic reason, the German interest barrier rule just overshoots this aim. Consequently, also the third justification cannot be accepted.

All in all, the German interest barrier rule is not justified and hence violates Art. 3 (1) GG, or more specific, the objective net principle. It is further not possible to interpret the German interest barrier rule in a way that it becomes conform with the German Constitution, because that would change its normative content fundamentally. Consequently, the German interest barrier rule is not in accordance with the German Constitution.

4.4.4 The Opposite View: The German Interest Barrier Rule Is Constitutional

Of course, the opinion that the German interest barrier rule violates the German Constitution, is not unanimous. Few and far between, arguments can be found in favour of the constitutionality of the German interest barrier rule. For example, it is invoked that the German interest barrier rule does not interfere with the objective net principle at all, because the exceeding borrowing costs as well as the unused EBITDA will not be lost, but only

197 BFH Beschluss I R 20/15, para 51; Lampert/Meickmann/Reinert, European Taxation 2016, 323, 326.
198 BFH Beschluss I R 20/15, para 49; Lampert/Meickmann/Reinert, European Taxation 2016, 323, 326; Tipke/Lang, Steuerrecht, 698.
199 BFH Beschluss I R 20/15, para 28; Tipke/Lang, Steuerrecht, 698; München/Mückl, DStR 2014, 1469, 1473-74.
200 BFH Beschluss I R 20/15, para 66.
201 Birk/Desens/Tappe, Steuerrecht, 288; Tipke/Lang, Steuerrecht, 698.
carried forward to another tax period.\(^{202}\) Furthermore, taxpayers who operate across the border and those who only perform within one jurisdiction are not in a comparable situation and can therefore be treated unequally.\(^{203}\) In any case, even if there was a derogation from the objective net principle, this would be justified, as the German interest barrier rule aims at securing the German tax base.\(^{204}\) Similarly, the justification ground put forward by the ECJ in tax matters, the balanced allocation of taxing rights, is mentioned.\(^{205}\) Another aim is to encourage companies to raise their equity\(^{206}\) to make them more resistant to insolvency.\(^{207}\) This leads to the conclusion, that the German interest barrier rule is not an anti-avoidance rule, but a steering rule.\(^{208}\)

However, these arguments are not persuasive. Whilst the exceeding borrowing costs and the unused EBITDA can be carried forward to another tax period, they cannot be used in the same tax period in which they occur. Since taxes are assessed each tax period anew, each of these tax periods has to be looked at separately.\(^{209}\) Then, the argument that the exceeding borrowing costs and unused EBITDA can be carried forward, does not work.\(^{210}\) Additionally, as the case before the BFH has shown, the unused interest costs and exceeding EBITDA can very well be lost definitely, for example in the case of a company restructuring. Another reason could be that the situation of the company does not change significantly, so the exceeding borrowing costs and unused EBITDA will be carried forward again and again, until they are lost definitely.\(^{211}\) Furthermore, it is not

\(^{202}\) Heuermann, DStR 2013, 1, 2.  
\(^{203}\) Heuermann, DStR 2013, 1, 2.  
\(^{204}\) Heuermann, DStR 2013, 1, 2; Ismer, FR 2014, 777, 781.  
\(^{205}\) Heuermann, DStR 2013, 1, 3; Ismer, FR 2014, 777, 781.  
\(^{206}\) Heuermann, DStR 2013, 1, 3; Ismer, FR 2014, 777, 779.  
\(^{207}\) Ismer, FR 2014, 777, 781.  
\(^{208}\) Heuermann, DStR 2013, 1, 2; Ismer, FR 2014, 777, 778-80.  
comprehensible, why companies operating across the border and entities only acting in one Member State are in a different situation. No reasons have been alleged for this hypothesis. Rather, the opposite should be the assumed, because considering companies in different situations only because of the place of their establishment, would certainly violate EU law, i.e. the freedom of establishment. Consequently, this argument cannot be legitimately submitted in Germany as a Member State of the EU. Besides, the justification grounds put forward for the German interest barrier rule do not succeed to convince. Even if these justification grounds are considered as legitimate objectives, still no arguments for their proportionality have been brought up. The German interest barrier rule goes beyond what is necessary to attain either of the objectives. Regarding the first two justification grounds, securing the German tax base and the balanced allocation of taxing rights, it is not open to scrutiny why then also purely domestic payments have to be covered. Concerning the third justification ground, the incentive to raise the capital equity, the measure goes too far in covering all interest payments, even those with an underlying sound business reason. It must be seen that some companies do not have own equity for justifiable reasons. Especially, start-ups or companies in certain fields of business activity, such as construction, rely on debt financing. They must not be punished for how they operate. Finally, it does not make sense to deny the German interest barrier rule its anti-avoidance purpose and then bring forward the justification grounds of securing the German tax base and the balanced allocation of taxing powers. This is nothing more than submitting the anti-avoidance purpose in disguise. If at all, the German interest barrier rule can be considered both a steering rule and an anti-avoidance rule, but is disproportionate either way.

As a result, the view that the German interest barrier rule is constitutional, must be rejected. The prevailing opinion, to which the BFH belongs, has laid down the more convincing arguments. The German interest barrier rule
violates the German Constitution by interfering with the objective net principle as one form of the principle of equality of Art. 3 (1) GG.

4.4.5 Interim Conclusion

Consequently, it is convincing to view the German interest barrier rule as violating the German Constitution. However, it is for the BVerfG to make this decision. This judgement is yet to come. If the BVerfG rules against the German interest barrier rule, it will be void. Ironically, the German legislator would then have to implement basically the same provision again to transpose Art. 4 ATAD. For the principle of primacy of EU law, the EU law would have to be given full effect. This shows, how strange it is to adopt a national rule on EU level, which might infringe the respective constitution.

4.5 Raising the Aforementioned to a General Level

Many of the arguments submitted by the BFH to explain the German interest barrier rule's unconstitutionality resemble the reasoning put forward above when examining the compatibility of Art. 4 ATAD with the TFEU freedoms. This shows, that the analysis of the TFEU freedoms and the German Constitution follow a similar scheme and concept. Furthermore, this displays that both jurisdictions have akin rationales. As a Member State of the EU, Germany is influenced by EU law and, of course, even bound to it. In matters, where the German legal organs cannot take guidance from EU law, they carve their own way. At the same time, also the EU, as a matter of fact, seeks inspiration from German laws, as the comparison between Art. 4 ATAD and the German interest barrier rule has illustrated.

213 Gutmann and others, European Taxation 2017, 2, 5.
This suggests, that the fellow Member States of the EU have similar schemes and concepts when it comes to measuring legislative acts against their national constitutions. If this is the case, it makes sense to draw conclusions from the BFH's ruling and to transpose them on a more general level to how a domestic implementation of Art. 4 ATAD might comport itself with the respective national constitutions of other Member States.

The principles of equality, ability-to-pay and objective net taxation are not German phenomena, but universally acknowledged principles in the field of tax law.\textsuperscript{214} Also, other Member States, like Spain and Italy, view the ability-to-pay principle as covered by their constitution.\textsuperscript{215} Further, the objective net principle is considered a manifestation of the ability-to-pay principle by other Member States.\textsuperscript{216} In fact, wherever other Member States handle it similarly to Germany, i.e. that the objective net principle can be linked to the constitution via the principles of ability-to-pay and equality, the statements made regarding the German interest barrier rule in relation to the German Constitution hold true also for the domestic implementation of Art. 4 ATAD in relation to these other national constitutions. Then, such an implementation would result in constitutional issues also in other Member States.\textsuperscript{217}

Even if other Member States do not connect the objective net principle via the principle of ability-to-pay to the principle of equality and therewith to the constitution, a domestic implementation of Art. 4 ATAD would still violate the objective net principle by limiting the deduction of interest expenses and at the same time not allow for a tax assessment based on the ability-to-pay. These two principles are in any case very prominent guiding principles in the field of tax law. So, even if in other Member States these

\textsuperscript{214} Dourado, EC Tax Review 2017, 112, 114; Tipke/Lang, \textit{Steuerrecht}, 73.
\textsuperscript{216} Dourado, EC Tax Review 2017, 112, 114.
principles are not covered by the constitution, it does not diminish their legal importance. They still belong to the fundamental structures of the tax legislation of the Member States. According to the principle of sincere cooperation and the national identities laid down in Art. 4 (2) and (3) TEU, the EU has to respect the national fundamentals of the Member States. By imposing the burden on the Member States to counteract these principles by implementing Art. 4 ATAD, the EU does not meet the requirements of Art. 4 (2) and (3) TEU.

Consequently, implementing Art. 4 ATAD will involve difficulties for the Member States at all events. Such a domestic implementation of Art. 4 ATAD is either at odds with the respective national constitution or at least thwarts fundamental domestic tax law principles like the objective net principle and the principle of ability-to-pay.

### 4.6 Interim Conclusion

As has been demonstrated, the German interest barrier rule violates the German Constitution. By limiting the deduction of interest payments, primarily the objective net principle is affected, but at the same time also the principles of ability-to-pay and equality. There is no justification, because - like Art. 4 ATAD - the German interest barrier rule goes beyond what is necessary to achieve its goals in some points, while it falls behind in others.

This problem is not a purely German one. The principles violated are rather universal principles, which can be found also in the other Member States. If the concerned principles are also covered by the constitutions of the other Member States, a domestic implementation of Art. 4 ATAD will violate their national constitution as well. Even if the former is not the case, the objective net principle and the principle of ability-to-pay represent
fundamental principles of tax law. According to Art. 4 (2) and (3) TEU, the EU should not impose actions on the Member States which make it hard on them to follow such actions effectively. This is the case for Art. 4 ATAD.

Keeping in mind the primacy of the EU law, this problem is rather theoretical. The ATAD is secondary EU law. Therefore, it and its domestic implementation, as far as it transposes the ATAD, precede even the national constitutions. However, a violation of fundamental tax law principles - regardless of their constitutional value - is reason enough to legitimately question if Art. 4 ATAD is really the kind of interest limitation rule, the EU should have opted for. Especially, the case of the German interest barrier rule raises this question. The EU adopts a provision of a Member State on EU level. Subsequently, this Member States might declare this rule void because of its violation of the constitution. This Member State would then be obliged to implement the same law again as a consequence of the primacy of EU law.

5. Conclusion

Interest payments can easily be used to shift profits and debts between countries to achieve the lowest tax burden possible. This is mostly attractive for groups of entities, since the group considered as a whole will not lose any money through these payments. The BEPS project is therefore right to target such arrangements in order to prevent BEPS. Furthermore, it makes sense for the EU to implement the BEPS actions coherently and uniformly on an EU level to ensure its efficiency. Nonetheless, when it comes to the interest limitation rule laid down in Art. 4 ATAD, the EU could have done better:

Firstly, Art. 4 ATAD as secondary EU law violates the TFEU freedoms, especially the principle of proportinality, as primary EU law. It is true that
Art. 4 ATAD does not impose a restriction, because it does not distinguish between residents and non-residents. Still, EU law always has to be proportionate. The anti-avoidance purpose and the balanced allocation of taxing rights can be regarded when searching for a legitimate objective. The first one cannot serve to render Art. 4 ATAD proportionate, because the interest limitation rule does not only aim at wholly artificial arrangements and further does not contain a possibility to prove a sound business reason. The second ground is not able to uphold Art. 4 ATAD either, neither alone nor taken together with the first ground, since the interest limitation rule still goes far beyond what is necessary by also covering purely domestic situations and legitimate arrangements.

Secondly, Art. 4 ATAD could be at odds with national constitutions. Although it follows from the principle of primacy of EU law, that EU law prevails over national constitutions, the EU is also bound to the principle of sincere cooperation and has to watch the national identities of the Member States. Consequently, the EU should not impose actions which are unnecessarily burdensome for the Member States to pursue.

The German interest barrier rule can be considered as already implementing Art. 4 ATAD, because it served as a blueprint for the interest limitation rule. The German interest barrier rule is currently under review by the BVerfG, because it is - convincingly - regarded as violating the German Constitution. By limiting the deduction of interest expenses, the German interest barrier rule breaches the objective net principle and simultaneously the principle of ability-to-pay and the principle of equality, which is laid down in Art. 3 (1) GG. This, again, is not justified, because the provision overshoots its goals on the one hand by covering also wholly domestic and legitimate arrangements and on the other hand falls behind by containing such exemptions that the aims cannot be reached.
As the principles of equality, ability-to-pay and objective net taxation also exist in the other Member States, it can be reasonably assumed that the other Member States face the same or at least similar difficulties when implementing Art. 4 ATAD. Such a domestic implementation will, depending on the legal status of the principles, either even violate the respective domestic constitution or at least the fundamental principles of tax law of the given Member States. Either result cannot really be intended by the EU legislator.

It is not comprehensible, why the EU legislator phrased Art. 4 ATAD as it did. Yes, it is based on the recommended OECD approach in BEPS Action 4 and supposed to transpose this measure. However, the OECD itself deems potential conflicts with EU law possible. The EU should respect its own law. The EU would have been better advised if it had stucked to the legal framework it had developed itself in the field of anti-avoidance rules. This means, that the key points of an interest limitation rule should be that it only covers cross-border interest payments, but aims at wholly artificial arrangements which do not reflect a real economic reality. Furthermore, the taxpayer should be given the opportunity to prove a sound business reason. As suggested by the ECJ in the case Test Claimants in the Thin Cap Group Litigation, the arm's length principle could be invoked for such a provision to meet this requirement. In such case, problems with the TFEU freedoms and especially the proportionality test as well as with domestic constitutions or fundamental tax law principles could have been avoided.

---

218 OECD, BEPS Action 4 Final Report, 85.
219 Douma/Kardachaki, Intertax 2016, 746, 753.
220 Lampert/Meickmann/Reinert, European Taxation 2016, 323, 327.
221 CFE, Opinion Statement on the ATAD, 7; Lampert/Meickmann/Reinert, European Taxation 2016, 323, 327.
222 Case C-524/04 Test Claimants in the Thin Cap Group Litigation, para 81; van Os, EC Tax Review 2016, 184, 184, 187; Navarro/Parada/Schwarz, EC Tax Review 2017, 117, 119; Ginevra, Intertax 2017, 120, 124.
List of References

Legislation


Grundgesetz für die Bundesrepublik Deutschland in der im Bundesgesetzblatt Teil III, Gliederungsnummer 100-1, veröffentlichten bereinigten Fassung, das zuletzt durch Artikel 1 des Gesetzes vom 13. Juli 2017 (BGBl. I S. 2347) geändert worden ist.

Official Documents


Cases

Judgement of 15 July 1964, Costa v. ENEL, C-6/64, EU:C:1964:66.


BVerG Urteil vom 15.01.1958, Az.: 1 BvR 400/51, in BVerfGE 7, 198.

BVerfG Urteil vom 07.10.1980, Az.: 1 BvL-(2) 50/79, in BVerfGE 55, 72.


BVerfG Urteil vom 06.06.1989, Az.: 1 BvR 921/85, in BVerfGE 80, 137.


**Books and Articles**


Helminen M, EU Tax Law - Direct Taxation (IBFD 2017).


Knöller C-P, 'The Efficacy of Thin Capitalization Rules and Their Barriers: An Analysis from the UK and German Perspective' [2011] Intertax 317.


Websites