EDITORIAL

Time for Rethinking: The ATAD Experiment and the Conceptional Flaws of Its Hybrid Mismatch Rules

For a decade, one EU tax legislation initiative has followed another. Eight years ago, Anti Tax Avoidance Directive I (ATAD I)[1] was adopted, two years later ATAD II[2] concretized the terms of the linking rules aimed at combating hybrid mismatches and, following the adoption of the GloBE Directive[3] in 2022, the commission presented Business in Europe: Framework for Taxation (BEFIT)[4] as a capstone[5] in the harmonization of corporation tax in the EU.

1 Legislative experiments

Much of the EU tax legislation of the last decade is of an experimental nature as it was intended to be drafted for new challenges of the digitalized global economy that may have necessitated inventing novel instruments. However, legislative experiments require a precise definition of the objectives pursued, careful monitoring of the impact of the new instruments, and corrections if it is realized that an instrument does not meet expectations. In the highly intrusive mass procedures of tax law, it is particularly important that compliance costs are equally proportioned between taxpayers and the tax administration and improve the quality of the international tax system. It is also important not to overlook the actual purpose of a tax law. It is not about compliance burdens for the sake of compliance but about generating state revenue. At a higher level, this also raises the question of whether EU tax legislation, with the burden of the unanimity principle for subsequent adjustments, provides the appropriate framework for such experiments.

Individual elements of the ATAD such as the general anti-avoidance rule (GAAR) or controlled foreign corporation (CFC) rules have been long established and have models in many Member States while others are highly innovative. This applies particularly to the attempt to alleviate the deficiencies between the Member States' non-harmonized tax systems through the most comprehensive anti-hybrid rules possible.

2 Comprehensive hybrid mismatch legislation: Linking instead of harmonizing?

The idea of harmonized corporate tax law has been circulating in the EU ever since the Neumark Report.[6] However, the Member States have thus far resisted all attempts to harmonize the tax base. Following the failure of the Common Consolidated Corporate Tax Base (CCCTB) I[7] and CCTB II,[8] the commission is making – though on the misconception that the GloBE tax base provides an acceptable starting point – another attempt to harmonize the tax base across Europe withBEFIT. However, it is doubtful whether the Member States will bring themselves to relinquish tax sovereignty this time in order to adopt it regardless of whether greater uniformity brings advantages – for taxpayers as well as for national tax authorities and budgets. Up to now, the reality of cross-border business in the EU has consisted of twenty-seven different corporate tax systems with the resulting gaps and overlaps.

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1 *Council Directive 2016/1164 of 12 July 2016 Laying Down Rules Against Tax Avoidance Practices That Directly Affect the Functioning of the Internal Market,* OJ L 193/1, 1–14 (19 Jul. 2016).

2 *Council Directive 2017/1952 of 29 May 2017 Amending Directive (EU) 2016/1164 Regarding Hybrid Mismatches With Third Countries*, OJ L 144/1, 1–11 (7 Jun. 2017).

3 *Council Directive 2022/2523 of 14 December 2022 on Ensuring a Global Minimum Level of Taxation for Multinational Enterprise Groups and Large-scale Domestic Groups in the Union*, OJ L 328/1, 1–58 (22 Dec. 2022).

4 *Proposal for a Council Directive on Business in Europe: Framework for Income Taxation (BEFIT)*, COM(2023) 532 final (hereinafter: BEFIT).

5 BEFIT, Explanatory Memorandum, s. 1.

6 European Economic Community, The EEC Reports on Tax Harmonization: The Report of the Fiscal and Financial Committee and The Reports of The Sub-groups A, B and C (International Bureau of Fiscal Documentation 1963) (so called *Neumark-report); see* H. van Arendonk, *Citizens and Taxation in the EU: Fifty Years After the Neumark Report*, 21 EC Tax Rev. 144 (2012), doi: 10.54648/ECTA2012015.

7 *Proposal for a Council Directive on a Common Consolidated Corporate Tax Base (CCCTB)*, COM(2016) 883 final.

8 *Proposal for a Council Directive on a Common Corporate Tax Base*, COM(2016) 685 final.

In this context, how appealing do linking rules appear for overcoming the discrepancies between the national tax systems without having to harmonize them? After all, uniformity of tax systems is not an advantage in itself given the cumbersome nature of European tax legislation, especially as harmonization would eliminate any competition for better systems. Would it not perhaps be sufficient to simply close the gaps between the national systems? That is one of the policy aims of anti-hybrid rules. The starting point of Base Erosian and Proft Shifting (BEPS) Action 2 as an impulse for the ATAD anti-hybrid rules may have been a targeted use of the gaps by 'aggressive' tax planning. In the resulting set of rules, however, it no longer matters whether the taxpayer deliberately exploits the loopholes. Even though the ATAD focuses on hybrid financial instruments and entities, the EU tax legislature is concerned 'to establish rules that neutralise hybrid mismatches in as comprehensive a manner as possible'.[9] The experiment grew larger, however, as tempting as it may initially seem to eliminate the distortions between the national tax systems through linking rules without forcing the Member States to harmonize their tax systems, there were objections from the outset in both concrete terms and terms of conception. The fact that the current anti-hybrid rules that are limited to entities and financial instruments still do not cover all mismatches despite the complexity already caused must not lead to further transaction-related linking rules before the concept – with its pros and cons – is not fully understood. In the surge of research on anti-hybrid rules[10] that the ATAD instigated, critical voices predominate.

3 Questionable innovation

Links between domestic and foreign tax law are common practice in international tax law regarding offsetting foreign taxes against the domestic tax owed on the corresponding income. However, they do not affect individual elements of the tax base like single deductions. Linking specific elements is logical and can be necessary when, as in the case of the parent-subsidiary directive,[11] conceptually corresponding rules are involved (Article 4, paragraph 1 Parent-Subsidiary Directive). The exemption of dividends at the parent company level reflects the taxation at the subsidiary level and can therefore only be granted if the dividend has not led to deductible expenses. In the case of Article 9-9b ATAD, on the other hand, there is no such conceptual link since the aim here is precisely to eliminate distortions resulting from uncoordinated tax systems.

The first mistake, already often lamented, is that the ATAD anti-hybrid legislation is biased and only intends to eliminate the gaps resulting in double non-taxation but not also to overlaps and discrepancies that effectuate international double taxation. It was not the concern about international double taxation but the exploitation of gaps between national tax jurisdictions through aggressive tax planning that first prompted the OECD with BEPS Action 2[12] and later the European legislator with ATAD II. The requirements for Member States' anti-hybrid legislation contained in ATAD II no longer recognize this genesis. Even though the hybrid mismatch rules of the ATAD are only directed against under-taxation, they are not designed as abuse rules[13] as they also cover accidental mismatches and non-tax-related arrangements. The (latent) accusation of abuse cannot be refuted. At best, it can be expressed in the context of the burden of proof that it is the task of the tax authorities to explain the mismatch. Only then must the taxpayer who wishes to claim deductions prove that the income has been recognized by the recipient or that no double deductions have been made.

The main objection, however, is the immense complexity of the rules that primarily results from the fact that each individual payment must be analysed to determine whether the corresponding income is taxed which is particularly difficult if the effects occur in different periods. This complexity impacts companies regardless of their size and without a de minimis threshold. All of this is done at the cost of shifts in the taxing jurisdiction[14] which, in any case, cannot be justified by the value creation principle. Furthermore, it is in violation of the objective net principle and that of taxing individual ability to pay. Of course, all of this is not a phenomenon limited to the anti-hybrid rules but a consequence of the materially empty objective – often nevertheless erroneously referred to as a 'principle'[15] – of single

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9 Recital 5 ATAD II.

10 See for example the PhD thesis on BEPS Action 2 and Art. 9-9b ATAD L. Mechtler, *Hybrid Mismatches im Ertragsteuerrecht* (Lexis Nexis 2017); L. Parada, *Double Non-taxation and the Use of Hybrid Entities. An Alternative Approach in the New Era of BEPS* (Kluwer Law International 2018); F. D. Martínez Laguna, *Hybrid Financial Instruments, Double Non-taxation and Linking Rules* (Kluwer Law International 2019); and the PhD thesis on the transformation into German tax law M. Surmann, *Hybride Gestaltungen nach der ATAD II* (Otto Schmidt 2022s); M. V. Kockrow, *Die Anti-hybrid Mismatch-Rules in § 4k EStG anhand von ausgewählten Strukturen und Praxisfällen zur unions- und verfassungsrechtlichen Konformität* (Duncker & Humblot 2024).

11 *Council Directive 2011/96/EU of 30 November 2011 on the Common System of Taxation Applicable in the Case of Parent Companies and Subsidiaries of Different Member States (recast)*, OJ L 345/8, 8–16 (29 Dec. 2011).

12 OECD, *Neutralising the Effects of Hybrid Mismatch Arrangements – Action 2: 2015 Final report*, OECD/G20 Base Erosion and Profit Shifting Project (OECD Publishing 2015), at 23.

13 Martínez Laguna, *supra* n. 10, at 291; H. M. Helminen-Kossila, *EU Law Compatibility of BEPS Action 2: Neutralising the Effects of Hybrid Mismatch Arrangements*, 3 Brit. Tax Rev. 325, 330 (2015).

14 Even if Recital 11 ATAD II claims the contrary.

15 R. S. Avi-Yonah, *International Taxation of Electronic Commerce*, 52(3) Tax L. Rev. 507, 517 (1997), doi: 10.2139/ssrn.3920270; R. S. Avi-Yonah & H. Xu, *Evaluating BEPS*, in *Tax Sovereignty in the BEPS Era* 97 at 102 (S. André Rocha & A. Christians eds, Kluwer Law International 2017); on the historical background R. S. Avi-Yonah, *Who Invented the Single Tax Principle?: An Essay on the History of U.S. Treaty Policy*, 59(2) N.Y.L. Sch. L. Rev. 309 (2015), doi: 10.4337/9781781952320.00018.

taxation that is followed by recent EU tax legislation. The GloBE rules, too, are not concerned with who is taxed nor which jurisdiction taxes and receives the revenue but only with the fact that taxation takes place at all.[16]

4 Improve or abolish?

The genuine issue, however, is beyond the fundamental criticism not at the level of the norm but at the level of enforcement. Therefore, the question of facilitating the enforcement of the existing anti-hybrid rules arises. However, how should this simplification be accomplished? Can the inherently complex anti-hybrid regulations be simplified at all, or would it be better to abolish them altogether?

The magic word is 'decluttering'. Thus far, this is discussed primarily as a matter of repealing special anti-abuse rules introduced in a first step once these have become superfluous because their purpose is achieved in the same way by rules, that are more comprehensive, specifically Pilar II and the EU GloBE directive. Avoiding duplicate requirement was already recommended in the 2023 OECD Report Tax Co-operation for the twenty-firstCentury[17] and repeated in the same report for 2024.[18] In the European Union, this first requires a revision of EU directive law as national legislators are bounded by its requirements.

Decluttering contains the hope of simplification. However, for the GloBE directive that was later adopted, this will only happen if the legislative objective of eliminating distortions between the tax systems of the Member States is abandoned for companies with turnover below the EUR 750 million threshold of Article 2 of the GloBE Directive.[19] As long as this is not the case, the commission will probably not table any initiatives to renegotiate the ATAD. The BEFIT also assumes that the ATAD will continue to apply unchanged.[20] However, the reason for decluttering should not be limited to instances of redundancy in which special anti-avoidance measures become obsolete but should be extended to situations in which the original plan proves unreasonable or not feasible.

5 The need for evaluation of legislative experiments

This requires a timely review. The experimental nature of the ATAD is reflected in the evaluation clause in Article 10 ATAD according to which the commission shall evaluate the implementation of this directive and report to the council thereon.[21] This includes not only the review of the legislative implementation by the Member States with the consequence of possible infringement proceedings[22] but also to achieving the ATAD's objectives without undesirable side effects such as creating double taxation. In particular, the anti-hybrid rules of Article 9-9b were meant to be evaluated until 1 January 2022.[23] It is unclear whether this occurred and, if it did, the result is not publicly available.[24] It is little consolation that national legislators are no better at fulfilling their evaluation promises. When the German interest barrier, which was the inspiration for Article 4 ATAD, was introduced in 2008, an evaluation was promised within a reasonable time[25] and finally delivered only twelve years later in 2020[26]; twelve years in which taxpayers already had to comply with the new rules.

Evaluation is one of the newer fashions in legislative technique. The legislator does not know exactly what he is doing, so he adds an evaluation clause to his legislation that also strengthens the willingness to compromise of those who have reservations about the rule. With Article 10 ATAD, the European legislator uses this technique as well. However, how is the effectiveness of measures to be checked if it is not clear what they are supposed to achieve[27]? Furthermore, what would be possible consequences from a negative outcome of the evaluation? It

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16 Critical R. A. Galendi Júnior, *The Single Top-Up Tax Principle: Justification, Content and Functions Upon the Design of QDMTTs*, 15(4) World Tax J. 575, 593 (2023), doi: 10.59403/1jrtj2b.

17 OECD, *2023 Progress Report on Tax Co-operation for the 21st Century: OECD Report for the G7 Finance Ministers and Central Bank Governors, May 2023, Japan* 6, 17 (OECD Publishing 2023).

18 OECD, *2024 Progress Report on Tax Co-operation for the 21st Century: OECD Report for the G7 Finance Ministers and Central Bank Governors, May 2024, Italy* 8, 14 (OECD Publishing 2023).

19 Thus far, the GloBE Directive also applies to hybrid and reverse hybrid entities thus integrating the hybrid entity concept instead of replacing it.

20 BEFIT, Explanatory Memorandum, s. 1.

21 *See Commission Staff Working Document Impact Assessment Report Accompanying the Document Proposal for a Council Directive on Laying Down Rules on a Debt-equity Bias Reduction and on Limiting the Deductibility of Interest for Corporate Income Tax Purposes*, SWD(2022) 145 final, at 61.

22 *See* the overview of pending infringement investigations as of Jul. 2024 European Commission, *Infringement Decisions,* https://ec.europa.eu/atwork/applying-eu-law/infringements-proceedings/infringement_decisions/index.cfm?version=v1&typeOfSearch=byDecision&langCode=EN&title=ATAD&activeCase=true&decisionDateTo=10%2F07%2F2024&page=0&size=10&order=desc&sortColumns=decisionDate (accessed 10 Jul. 2024).

23 Article 10, para. 1, subpara. 2 ATAD II.

24 However, *see* W. Haslehner & K. Pantazatou, *Assessment of Recent Anti-tax Avoidance and Evasion Measures (ATAD & DAC 6)*, Publication for the Subcommittee on tax matters (FISC), Policy Department for Economic, Scientific and Quality of Life Policies 14 (European Parliament 2022).

25 Bundestag document No. 16/5491, at 13; Bundestag document No. 17/10354, at 2.

26 Bundestag document No. 19/31822, at 7.

27 Regarding the mismatch between objectives and rules, *see* Martínez Laguna, *supra* n. 10, at 328.

would still need the vote of all Member States to change the directive. The unanimity principle with its tendency to petrification and experimental law making is an oxymoron. A solution could be a sunset clause[28] that would require a renewed commitment to the ATAD based on the experience gained.

6 The right time for conclusions

It can be argued that seven or eight years after adopting the relevant directives, two years after the expiry of the last transposition deadline, it is still too early to request renegotiation because relevant experience is still lacking; no tax audits have taken place not to mention the lack of any existing case law from national courts or the European Court of Justice (ECJ). Even if the Member States transposed the directive on time, they are still in the process of composing administrative regulations for applying the new standards. Taxpayers must, of course, comply with these from the very beginning which particularly implies fulfilling considerable documentation obligations.

However, the interaction between the various EU instruments is not just an empirical question but also a logical one of the systematic interplay of different rules. Understanding this would actually be the task of a legislator in the precursor to legislation but can also be examined at any time afterwards. The question of the costs and effects of eliminating loopholes on a case-by-case basis by means of anti-hybrid rules in relation to the global minimum tax now in force is also less of an empirical question than one of norm theory. A political question is whether there should be a limit to enforcing the minimum tax burden of 15% only for large corporations (EUR 750 million turnover threshold) or whether double non taxation resulting from qualification conflicts should be combated regardless of company size.

7 Harmonization of the national corporate tax systems of the Member States through individual directives: A wrong track?

The ATAD regulations on hybrid mismatches are just one, but a particularly impressive, example of the limits of piecemeal harmonization of technically complex legal systems. The ATAD initially involves the challenge of transposing detailed EU directive law into national law, on the one hand, so precisely that infringement proceedings can be avoided and, on the other hand, with the need to subsume them into established domestic tax systems. This is particularly challenging because Article 9-9b ATAD affect not only a single provision but involve the legal consequences of an undefined number of different tax law provisions. Considerable deviations and heterogeneity are very likely even though, for linking norms, a precise fit is required in order for it to work.[29]

The less effective that the ATAD rules work, the greater the fundamental concerns become both with regard to the competence of a Union legislator under Article 115 TFEU and its compatibility with the fundamental freedoms. It must not be forgotten that the ATAD restricts the freedom of movement. The consequence of the EU legislator's ambitious regulatory requirements is a significant increase in compliance costs for cross-border activities. Companies operating across Europe continue to encounter regulations that may now be similar but differ in compliance-relevant details while being all the more complex at the same time. This does not contribute to the realization and functioning of the internal market. Furthermore, the justification based on the coherence of the tax system of which the application to the linking rules is already subject to considerable doubt[30] is completely shaken if the anti-hybrid rules result in double taxation even if it is unintended. In terms of proportionality, uniformity could help and is the only relevant ground of justification for the EU tax legislator transforming the OECD actions into European law. However, true uniformity that is necessary for the nexus rules to achieve their objective is only possible to a limited extent as harmonization through directives naturally involves a certain degree of latitude in their implementation, and the national law thus created will be enforced differently in the Member States.

Failing experiments must be ended. On the one hand, the ATAD contains rules, such as the interest barrier or the CFC regime, of which some have been tried and tested for decades. In general, these rules work. The question here is rather whether the GloBE directive leads to duplicate regulations that advocate for abolition. The attempt to achieve seamless taxation through comprehensive anti-hybrid rules, on the other hand, is unprecedented and, as explained above, in addition to the problem of double regulation, raises considerable doubts as to its effectiveness while massively complicating matters at the same time. As the error here lies on the conceptual level, it also does not need more time to gain experience with the

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28 A. P. Dourado, *The Commission Proposal to Replace Unanimity With a Qualified Majority in the Case of Tax Matters*, 47(4) Intertax 341, 344 (2019), doi: 10.54648/TAXI2019033; C. Heber, *Enhanced Cooperation and European Tax Law* 28 (Oxford University Press 2021), n. 86; W. Schön, *Facilitating Entry by Facilitating Exit: New Paths in EU Tax Legislation*, 46(4) Intertax 339, 341 (2018), doi: 10.54648/TAXI2018033.

29 K. Spies, *Hybrid Entities and Anti-hybrid Rules in the EU ATAD (Article 9 and 9a ATAD)*, in *A Guide to the Anti-tax Avoidance Directive* (W. Haslehner et al. eds, Edward Elgar Publishing Limited 2020), at point 9.70; Martínez Laguna, *supra* n. 10, at 328.

30 *See* Martínez Laguna, *supra* n. 10, at 298.

new regime. It must always be remembered that it is the taxpayers who bear the costs of such field trials. In view of the fact that the GloBE also works here in a fallback position and prevents non-taxation, the Member States must urge the commission to submit a proposal for repeal. If this fails due to the unanimity requirement, the ultimate hope is the ECJ.

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