
# "GAAR rules and digital transactions: Can they prevent tax avoidance in the digital economy?"

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# "GAAR rules and digital transactions: Can they prevent tax avoidance in the digital economy?"

Master's Thesis International Business Taxation/LLM

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**Preface**

My thesis stems from my pure interest in the measures that are followed in the EU legislation, regarding the detection of tax avoidance and particularly from my interest in the aim and application of GAARs (General Anti-abuse Rules). Along with tax avoidance I was also fascinated with the legal dynamics and taxation of digital economy as a new economic reality. My study aims at contributing to the prevention of tax avoidance in this new economic reality characterisized by the digital transactions, focusing on how GAARs apply on transactions in our digital era. My engagement in writing this thesis lasted from January 2024 to May 2024.

I would like to thank my supervisor Mr Cihat Oner of the Tilburg Law School of Tilburg University, for his valuable support. He was always able to provide useful feedback and give thoughtful answers to my concerns, showing me trust and confidence.

In addition, I would like to thank my family, colleagues and friends. Their support and encouragement throughout my life and especially during this time were a true blessing. I am more than grateful for the pure understanding and faith that they showed to my abilities.

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Anna Georgia Makrysopoulou

**Abstract**

Digitalization has influenced every domain of our lives. The field of international taxation is one of the domains under a consequent reform and under the need of vital changes because of the impact of digital economy. There is a strong discussion about if the existing rules of taxation can be applied in the digital transactions because of the different characteristics that are observed between traditional and digital transactions. Despite plenty of international efforts (BEPS Action 1, TFDE 2018 and most recently the Pillars) for regulating the taxation of digital economy, yet no consensus has been achieved. As an aspect of taxation, GAAR rules are also a theme that must be discussed, since the existing GAAR rules (both domestic and in European ones) were designed based on traditional transactions.

For this reason, in this thesis I will try to analyze whether the existing GAAR rules can be proven to be effective for tackling tax avoidance in digital transactions by evaluating if they can work as an effective tool for "stopping" mainly the big MNEs from hiding their profits. I start my thesis by analyzing the different GAAR rules of the EU Directives (ATAD, PSD, MD and IRD) along with their possible boundaries and also a short mention is done to domestic GAARs of Greece, Germany and the Netherlands, so as to have a more complete image of the existing rules. Subsequently, Imove to the chapter of digital transactions by presenting their characteristics in comparison with traditional onesand I also try to "examine" whether the existing GAARs can be also applied in digital transactions. Lastly, this thesis analyzes the need for regulatory challenges in taxation rules so as to deal with the challenges of the digital economy.

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**List of abbreviations**

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| **EU** | **European Union** |
| **OECD** | **Organization for Economic Cooperation and Development** |
| **BEPS** | **Base Erosion Profit Shifting** |
| **ATAD** | **Anti-tax Avoidance Directive** |
| **GAAR** | **General Anti-Avoidance Rule** |
| **SAAR** | **Specific Anti-Avoidance Rule** |
| **MD** | **Merger Directive** |
| **PSD** | **Parent-Subsidiary Directive** |
| **IRD** | **Interest and Royalties Directive** |
| **CJEU** | **Court of Justice of the European Union** |
| **TPC** | **Tax Procedure Code** |
| **CFC** | **Controlled Foreign Companies** |

## 1. Introduction

Digitalization has penetrated our lives during the last decade and has changed almost every aspect of our everyday life. One of the most serious changes has to do with the way that we handle our everyday transactions. Nowadays, digital transactions are the most common way to pay for a good or a service and have allowed us to realize transactions worldwide quickly and easily.

In EU law and domestic law, there are plenty of legal orders that regulate the concept of tax avoidance. Tax avoidance became popular and increased a lot during the years of the financial crisis. During this time, both individuals and legal entities were trying to find a way to pay less taxes by utilizing complex tax planning strategies to reduce their income tax base. International organizations such as the OECD started to gain interest in the importance of this topic and tried to combat these aggressive tax planning structures. As a result, in 2012 the OECD introduced the Base Erosion Profit Shifting (BEPS) project with the aim of tackling tax avoidance. For this reason GAAR rules (General Anti-Abuse Rules) were proposed as a measure to counteract aggressive tax planning that fell outside the scope of the specific anti-abuse rules.

Following the impact of digitalization that had already started in relation to economic transactions, in 2015, the OECD presented the BEPS Action 1 Report entitled Adressing the Tax Challenges of the Digital Economy[1]. In this report, the OECD identified a number of tax challenges created by digitalization in relation to "nexus, data and characterization" and acknowledged that those challenges were related to the question of allocation of taxing rights on income generated by cross-border transactions. In 2018, the OECD Interim Report[2] came as an update of the 2015 Action 1 Report and referred to the progress that was made regarding the Action 1 and also to the fact that countries at that time did not have the same opinion regarding the imposition of interim measures regarding digital transformation.

As a result of the BEPS Action 1 initiative, on July 12, 2016, the Council of the European Union (EU) adopted the Anti-Tax Avoidance Directive (ATAD I) Council Directive (EU) 2016/1164 EU (European Union) as part of the Anti-Tax Avoidance Package[3] in which they includedthe above mentioned GAAR rules (Art. 6 of the ATAD). However, general anti-abuse rules can also be found in other Directives such as in the Parent-Subsidiary Directive

[1]OECD, Addressing the Tax Challenges of the Digital Economy, Action 1 – 2015 Final Report (OECD Publishing 2015)
[2] OECD, Tax Challenges Arising from Digitalization: Interim Report 2018 (OECD Publishing 2018)
[3] Council Directive (EU) 2016/1164 of 12 July 2016 laying down rules against tax avoidance practices that directly affect the functioning of the internal market, OJ L 193/1 (hereinafter "ATAD')

(Art. 1 of the Directive)[4], in the Merger Directive (Art. 15 of the Directive)[5] and in the Interest and Royalties Directive (Art. 5 of the Directive).[6]

Nevertheless, we need to keep in mind that when the above initiatives were proposed they could not consider all the new economic challenges brought up due to digitalization. Digitalization is a transformative process driven by technological innovations that never stop evolving. As mentioned above, digital economy/transactions are now part of our everyday lives, on domestic and cross-border levels. For this reason, it is important to examine taxation of these transactions that are part of businesses that operate in the digital environment and also to search if the existing GAAR rules in EU legislation can effectively combat possible tax avoidance created by the digital economy.

### 1.1. Research question

Keeping in mind the constant and rapid growth of digital economy/transactions, both on domestic and cross-border level, we need to examine if the already existing measures that EU and domestic legislations have implemented for the combat of tax avoidance can be proven to be applied effectively also in digital transactions, with the aim of preventing any possible losses in tax revenue due to the new way of trading.

Therefore the following research question will be addressed:

"*To what extent can the existing GAAR rules of EU and domestic legislations prevent tax avoidance in the digital economy in an effective way*?"

In order to answer the above research question in a comprehensive way the following sub-research questions are also relevant:

*a. How is tax avoidance treated under the different EU GAAR rules?*

*b. What makes digital transactions special in comparison with conventional transactions?*

*c. Is there a possibility that the existing GAARs can effectively tackle tax avoidance in the digital economy?*

[4]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

[5] Council Directive 2009/133/EC of 19 October 2009 on the common system of taxation applicable to mergers, divisions, partial divisions, transfers of assets and exchanges of shares concerning companies of different Member States and to the transfer of the registered office of an SE or SCE between Member States

[6]Council Directive 2003/49/EC of 3 June 2003 on a common system of taxation applicable to interest and royalty payments made between associated companies of different Member States

## 1.2 Motivation of the study

The new economic reality of digital transactions has also raised questions about how taxing rights on income derived from digitalization should be allocated between the countries that participate in the digital trade. Digital transactions allow enterprises to offer and receive plenty of services in various jurisdictions and create value in these places without having a presence in these jurisdictions. Therefore, this means that the traditional rules based on 'nexus' can no longer work for this type of transaction.

Along with the above-mentioned problem of the allocation of taxing rights regarding digital income it is important to mention the rules that eliminate tax avoidance. GAAR rules do belong in this category. The fact that digital businesses have the opportunity to create income worldwide allows them to choose in which country they want to establish their headquarters. This way, they have the freedom to locate their business in low-tax countries for example. Furthermore, each GAAR rule includes specific practices that may be considered abusive and a test in order to determine if the transaction in question had actually, as a scope, the practice of tax avoidance.

However, since digital transactions differentiate from traditional ones (e.g. no need for PE and creation of value in multiple places), it is necessary to examine if the measures that have been introduced for the elimination of tax avoidance in traditional transactions can be proven to apply also in the digital ones.

The thesis aims to analyze the different GAAR rules that exist in the EU (both on cross-border and domestic levels) in light of assessing the effective application of these measures in combating tax avoidance in the new digital age. Because of the special features of digital transactions and the tax challenges that arise from digitalization it is important to evaluate these provisions in order to establish if the existing rules can also apply in the new age or if there is a need to introduce alternative provisions that match their features.

## 1.3 Relevance of the research

Taxation of the digital economy is a topic that has gained the interest of international organizations even since 2003 when the OECD published the "Implementation of Ottawa Taxation Framework Conditions: The 2003 Report 12 Box 1(i)". However, 21 years after the publication of this report, and with digital instructions and digital trade having such a big influence on our everyday lives, countries have not yet reached an agreement on how these transactions should be taxed and specifically if their taxation should be treated differently in comparison with the traditional ones or not.

On the other hand, tax avoidance is a matter from which plenty of countries around the globe suffered during the years of economic crisis. With the creation of tax heavens, this problem became even bigger and while big MNEs were taking advantage of these economic paradises to gain even more income, tax authorities and governments worldwide were suffering from loss of tax revenue.

In order to fight tax avoidance and the tax strategies that plenty of big MNEs followed so as not to pay their "fair share", countries cooperated and presented the BEPS (Base Erosion Profit Shifting) Project in 2013. A few years later, in 2016, Anti-tax Avoidance Directive was presented to restore trust in the fairness of tax systems and allow governments to exercise their tax sovereignty effectively. The concept of GAAR rules was also introduced in the BEPS project and was included in the ATAD Directive and more specifically in Article 6. Also, many national legal systems have adopted their own GAAR rules in accordance with the ATAD.

However, as already mentioned, the digital economy is a concept for which no specific treatment has yet been agreed by the countries, meaning that tax measures, such as GAARs, and traditional tax principles for the allocation of taxing rights may not be applicable under these transactions. For this reason, it is essential to analyze both the characteristics of digital transactions and GAAR rules in order to evaluate if the existing GAAR rules can be effective for the prevention of tax avoidance in the digital economy.

### 1.4 Methodology

As mentioned above, this thesis aims to examine the ability of the existing GAAR rules to confront abusive practices that may lead to tax avoidance in the digital economy. In order to examine the above topic the following methodology will be followed:

Firstly, the GAAR rules of three EU Council Directives (GAAR of ATAD, Merger Directive, Parent-Subsidiary Directive, and Interest and Royalties Directive) will be examined, as an answer to the first sub-research question, by addressing the aim and the scope of these measures, so as to make clear the conditions under which each of them may apply for combating tax avoidance. Along with these GAARs examples of domestic GAARs will be presented so as to compare the rules of national legislations with those of the EU from a tax avoidance perspective. Also, a mention will be made to the legislative boundaries that are set to the EU GAARS.

The tax and regulatory challenges that arise from digitalization will be presented along with the characteristics of digital economy/transactions, that will be analyzed comparatively with the traditional ones as an answer to the second sub-research question. The scope of this

section is to set the differences between digital and traditional transactions regarding the way that the trade, communication and transactions, in general, are made so as to examine in the first place if the traditional tax principles that are used in taxing the traditional ones can also apply to the digital ones or if there is the need to follow a completely different concept for their taxation.

For the answer to the third sub-research question information and elements from the above two chapters will be used so as to assess whether the ruling of the existing GAARs can prove to be effectively applied for combating any possible tax avoidance in the digital economy or if there must be alterations to the existing GAARs rule that will refer to tax avoidance on digital transactions.

The materials used in this research consist mainly of academic literature such as articles and research published in law and tax journals and books. Furthermore, EU legislation was used, meaning the documents of EU Council Directives, domestic legislation, and the CJEU Case law. The main analysis of the topic is based on the above material while the opinion of the author is addressed both during the above analysis and also in the conclusion.

## 1.5 Outline

In this thesis the concept of EU GAAR rules will be examined from the viewpoint of their effectiveness. In Chapter 2, the analysis will focus on the legal framework on which these rules are based by examining the aim and the scope of the three directives in relation to confronting tax avoidance in the EU. Furthermore, for a more comprehensive approach, examples of national GAARs will be presented along with the legislative framework of the boundaries of GAAR rules.

In Chapter 3, the economic reality of the digital economy will be presented along with a comparative analysis of the characteristics of digital transactions and their differences from the traditional ones and an attempt of application of the existing GAARs in digital economy.In Chapter 4 the regulatory challenges and policy responses that arise from the digitalization will be mentionedby focusing on the application of traditional links for the allocation of taxing rights in the digital economy and on the taxation of digital content.

## 2. The concept of tax avoidance in the EU directives

### 2.1 Difference of GAARs and SAARs and definition of tax avoidance

Before starting to analyze the aim of the GAAR rule of the ATAD it is important to mention at a first point the definition and the function/aim of the GAAR rules in the EU legislation and also the difference between the general anti-avoidance rules and the specific anti-avoidance rules (SAARs). A GAAR can be defined as "a GAAR is a general statement of principle which seeks to thwart a broadly defined category of transactions which reduce or defer tax liability".[7] Under this definition it is quite evident that while SAAR rules target a single tax avoidance behavior, and more specifically they attempt to contain tax avoidance through transfer pricing including excessive payments among related businesses for mutual international transactions, questionable sources of funds received as share capital or loans, transactions that strip out dividends or bonuses and artificial arrangements in transfers of movable property, GAAR rules on the other side, are designed to target a broad spectrum of tax avoidance.[8] This means that the general aim of GAAR rules is to fill the gaps in the tax systems, to prevent abuse and tackle abusive tax practices that have not yet been dealt with through specifically targeted provisions.[9] This means that GAARS supplement the scope or application of a SAAR and do not tend to restrict them in the case where both rules are meant to be applied in the same situation.[10] This supplementary function of GAARs of filling the gaps is twofold, meaning that: a) they fill the 'empty space' between SAARs to be exploited for abusive purposes and b) they strengthen the effectiveness of SAARs in the prevention of abusive practices, which actually means that abusive practices which SAAR does not cover because of their specific character can be targeted by GAARs. A GAAR is typically designed to strike down those otherwise lawful practices that are found to be carried out in a manner that undermines the intention of the tax law where a taxpayer has misused or abused that law. This is typically achieved by giving the tax authority the power to cancel a particular tax benefit or assess a different (increased) tax liability against the taxpayer in circumstances

[7]Nabil Orow, General Anti-Avoidance Rules – A Comparative International Analysis 58 (Jordans 2000)
[8] Parthasarathi Shome, Taxation History, Theory, Law and Administration, Springer Texts in Business and Economics, 2021
[9] Council Directive (EU) 2016/1164 of 12 July 2016 laying down rules against tax avoidance practices that directly affect the functioning of the internal market, OJ L 193/1, preamble par. 11
[10]Werner Haslehner, Katerina Pantazatou, Georg Kofler, Alexander Rust, A Guide to the Anti-tax Avoidance Directive, Elgar tax law and practice, 2020

where the course of action taken by a taxpayer is so artificial or contrived that it is only explicable by the desire to obtain a relevant tax benefit.[11]

It is quite evident that both rules aim to tackle tax-avoidance practices under a specific or a general scope. As an initial attempt to define tax avoidance we could mention that tax avoidance corresponds to what civil law jurisdictions would define as abuse of law, which is used in several areas of civil law to describe the correct application of law to a specific set of facts.[12] Tax avoidance entails taking steps to arrange the taxpayer's affairs before the tax liability arises.[13] It can also be defined as a way of removing, reducing, or postponing the tax liability through other means than tax evasion and tax saving. This can be translated as any arrangement or transaction made by taxpayers whose sole or main purpose is to reduce their tax burden, which may be legitimate or not depending on the economic factual circumstances and the purpose of tax laws at stake. From this definition we can conclude that tax avoidance is sometimes divided into 'acceptable' and 'unacceptable' categories to distinguish those activities using the law to best advantage to minimize tax liability from those activities which were not envisaged when the law was put in place. In the latter, activities go against the law's object and purpose.[14]

Because of the big revenue losses that plenty of jurisdictions around the world suffered from because of tax planning arrangements of the big MNEs that were aiming at the above mentioned reduction of tax liability and therefore to tax avoidance, countries decided to act against this practice and finally in 2016 the EU Council finally presented the ATAD Directive. By looking at the preamble of the Directive it is quite clear that the scope of this Directive, as it is mentioned in its first paragraph is 'to restore trust in the fairness of tax systems and allow governments to exercise their tax sovereignty' effectively and also in paragraph five it is mentioned that 'it is necessary to lay down rules against the erosion of tax bases in the internal market and the shifting of profits out of the internal market'.

## 2.2. The GAAR of the ATAD

One of the measures that the **ATAD Directive** introduced for restoring trust in the fairness of tax systems is the **GAAR rule**. This rule is described in **Art. 6 of the Directive** and states the following: "**1**. For the purposes of calculating the corporate tax liability, a Member State shall ignore an arrangement or a series of arrangements which, having been put into place for the

[11]Cihat Oner, Comparative Analysis of the General Anti-Abuse Rule of the Anti-Tax Avoidance Directive: An Effective Tool to Tackle Tax Avoidance?, EC Tax Review 2020 - 1, pg. 38-52
[12]Susi Baerentzen, The effectiveness of General Anti-Avoidance Rules, Their Limits, Challenges and Potential in EU and International Tax Law, IBFD Doctoral Series Volume 65
[13]A. Miller & L. Oats, Principles of International Taxation 16 (5th ed., Bloomsbury Pub. 2016)
[14]B. J. Arnold, The Canadian General Anti-Avoidance Rule, in Tax Avoidance and the Rule of Law 227 (G. S.Cooper ed., IBFD Pub. 1997)

main purpose or one of the main purposes of obtaining a tax advantage that defeats the object or purpose of the applicable tax law, are not genuine having regard to all relevant facts and circumstances. An arrangement may comprise more than one step or part. **2.** For the purposes of paragraph 1, an arrangement or a series thereof shall be regarded as non-genuine to the extent that they are not put into place for valid commercial reasons which reflect economic reality. **3**. Where arrangements or a series thereof are ignored in accordance with paragraph 1, the tax liability shall be calculated in accordance with national law."

### 2.2.1 The aim of GAAR provided by the ATAD.

To begin with, both the EU ATAD and the OECD BEPS Project (as the initial initiative that pave the way for the introduction of the ATAD) were introduced with two main objectives: a) to ensure that profits accrued by economic activities in the states are in fact taxed correspondingly in these states where the value is created and b) to align the rules throughout the states to eliminate differences and ensure transparency of taxpayer rules.[15] By aligning the rules throughout the MS, they aim to prevent the erosion of the taxable amount in the internal market and the transfer of profits outside the same market.[16] Paragraph 11 of the preamble of the Directive, mentions the aim of the GAAR according to which the feature of GAARs in tax systems is to tackle abusive practices that have not yet been dealt with through specifically targeted provisions. Therefore, their aim is to fill in gaps that should not affect the applicability of specific anti-abuse rules.

### 2.2.2 The scope of GAAR provided by the ATAD

Regarding their scope we have to take a look at Art. 1 and 6 of the Directive combined. So, this Directive and its rules respectively, apply to all taxpayers that are subject to corporate tax in one or more MS, including permanent establishments in one or more MS of entities resident for tax purposes in a third country. Therefore, the GAAR rule of the ATAD applies to corporate tax only and excludes other kinds of taxes, while regarding the taxpayers it applies both to resident and non-resident ones for the calculation of their corporate tax in a MS. In addition, as mentioned in the Preamble of the Directive, Art. 6 aims to cover both domestic and cross-border situations in a uniform manner. This feature of Art. 6 is very important as it can be understood that it seeks to prevent the discriminatory application of

[15]Susi Baerentzen, The effectiveness of General Anti-Avoidance Rules, Their Limits, Challenges and Potential in EU and International Tax Law, IBFD Doctoral Series Volume 65, 2022

[16]Andrea Purpura, DAC6: Some (potential) Incompatibility Profiles with Article 6 ATAD, Intertax volume 51, 2023, pg. 51-62

EUharmonized GAARs, and in practice, it may cover a much wider spectrum of corporate income tax. [17]

In order to apply the GAAR rule of Art. 6, there must be some **specific conditions** that have to be met. The first condition is that there must be an arrangement or a series of arrangements that have been put into place for specific purposes, which as a second condition, should have as one of their main purposes to obtain a tax advantage that defeats the object or purpose of the applicable tax law. Briefly saying it, the three necessary elements are: 1) an arrangement or a series of arrangements that are not genuine, 2) the main purpose of obtaining tax advantage and 3) defeat the object of the applicable tax law. In other words, this rule contains both a subjective and an objective test (as the CJEU stated in the EmslandStärke Case by establishing that the concept of abuse consists of two elements)[18][19] and also an economic substance test (or artificiality test). The first, can be found in the requirement for an arrangement, the additional requirements for a substantive purpose of tax avoidance and the floating tax advantage. As for the objective test it consists of defeating the object of the applicable tax law, which is fulfilled when an arrangement is contrary to the object and purpose of tax provisions, which would be put into place cumulatively under normal circumstances, meaning in situations where the arrangement would be absent, and lastly the economic substance test has to do with the fact that those arrangements have to be non-genuine.[20]

However, in order to be able to understand the situations in which this rule applies, it is first necessary to understand the meaning of these terms. None of these terms is defined in the ATAD, but since they are autonomous concepts of EU law, they must be interpreted autonomously. Domestic laws do not have the power to interpret them but their interpretation must be based in the context of Art. 6. In paragraph 4.3 of the European Commission's Recommendation on aggressive tax planning we can find the **definition of the term "arrangement**". Under this definition an arrangement means any transaction, scheme, action, operation, agreement, grant, understanding, promise, undertaking or event. [21] Also, it adds that an arrangement may comprise more than one step or part. From this definition, it can be understood that the term "an arrangement" may include all possible actions taken by

[17]Werner Haslehner, Katerina Pantazatou, Georg Kofler, Alexander Rust, A Guide to the Anti-tax Avoidance Directive, Elgar tax law and practice, 2020
[18]Susi Baerentzen, The effectiveness of General Anti-Avoidance Rules, Their Limits, Challenges and Potential in EU and International Tax Law, IBFD Doctoral Series Volume 65, 2022
[19] ECJ, 14 December 2000, Case C-110/99, Emsland-Stärke GmbH v. Hauptzollamt Hamburg-Jonas
[20]Werner Haslehner, Katerina Pantazatou, Georg Kofler, Alexander Rust, A Guide to the Anti-tax Avoidance Directive, Elgar tax law and practice, 2020
[21]Commission Recommendation of 6 December 2012 on aggressive tax planning (2012/772/EU) [2012] OJ L 338/41

taxpayers. The second **term** that needs interpretation is the **"tax advantage"**. In the point 4.7 of Commission Recommendation it is clarified that in order to identify a 'tax advantage' national authorities are invited to compare the amount of tax due by a taxpayer, having regard to those arrangement(s), with the amount that the same taxpayer would owe under the same circumstances in the absence of the arrangement(s). Subtracting the latter amount from the former will give the amount of tax advantage. The Recommendation continues by considering some situations as examples of tax advantages: a) an amount is not included in the tax base, b) the taxpayer benefits from a deduction, (c) a loss for tax purposes is incurred, (d) no withholding tax is due and (e) foreign tax is offset. In practice, in most cases a tax advantage will form a total avoidance of taxation, tax reduction (these two have an immediate effect) or tax deferral (here the effect of the arrangement can be extended over time).[22] In the author's opinion, besides these two terms, it is also essential to analyze the meaning of the rest of the rule as well.

As mentioned above, the GAAR of the ATAD consists of an objective and a subjective criterion, with the first being the "arrangement' or series of arrangements. However, Art. 6 does not only refer to arrangements in general but it also demands that these arrangements shall be regarded as non-genuine. In para. 2 an explanation of the term "non-genuine" is given, explaining that they are not put into place for valid commercial reasons that reflect economic reality. But what does non-genuine actually mean? In order to have a more complete image of how the term "non-genuine" is used under the EU law it is important to take a look at how this term is translated under the domestic laws of the MS that have adopted the ATAD into their national legislation. In everyday English language, the adjective '**genuine**' describes what is "real**, exactly what it appears to be arising** from these premises, the 'non-genuineness' would evoke fictitious arrangements and, therefore, not at all tax avoidance practices, in a rigorous sense. Plenty of different jurisdictions such as Italy ('Non genuine'), Portugal ('nãosejagenuína') etc follow the same interpretation, while the term used under the French law is more connected with arrangements of "fictitious character", a term that has also influenced the wording of other jurisdictions such as Greece, Hungary etc. German law also followed a more independent approach by using the term "inappropriate''(unangemessen) and so does the Dutch text. Based on this analysis it is quite clear that the term "non-genuine" that is used in the ATADs GAAR is a confused overlap of definitions that is influenced from the legal system and culture of every state.[23]However, since we have already used the definitions provided under the Commission's

[22]Werner Haslehner, Katerina Pantazatou, Georg Kofler, Alexander Rust, A Guide to the Anti-tax Avoidance Directive, Elgar tax law and practice, 2020
[23]Roberto Iaia, Article 6 ATAD and 'Non-genuineness' of Arrangements', EC Tax Review, 2021 - 5&6, pg. 242-253.

Recommendation for defining for example the term 'arrangement', we can also use these definitions as a primary effort to define the 'non-genuine'. The Recommendation in its GAAR rule for the combat against aggressive tax planning is not making use of the term 'non-genuine' but it uses the term 'artificial'. Also, these 'artificial arrangements' are proposed to be treated the same way from the MS as the 'non-genuine' ones, meaning to be ignored, a fact that triggers the hypothesis that the two terms may be related. Point 4.4 mentions that 'an arrangement or a series of arrangements is artificial where it lacks commercial substance' while 'non-genuineness' under the ATAD refers to arrangements that are not put into place for valid commercial reasons. In the author's opinion when something lacks commercial substance it is not also valid for commercial reasons. Furthermore, the correlation of these two terms can be also verified through the wording of the Proposal of the ATAD, which in page 9 states that 'the proposed GAAR is designed to reflect the artificiality tests of the CJEU where this is applied within the Union' and from the recital 9 of the same proposal which states that 'Within the Union, the application of GAARs should be limited to arrangements that are 'wholly artificial' (non-genuine)'[24]. Therefore, it can be understood that the phrases 'artificial' and 'non-genuine' are identical in the context of the application of Art. 6.[25]

Before moving to the next topic there are also some points that are worth mentioning. First, we have to look into the fact that paragraph 2 refers to an arrangement or a series of arrangements that shall be regarded as non-genuine **to the extent** that they are not put into place for valid commercial reasons which reflect economic reality. The element that needs extra clarification here is the phrase '**to the extent**'. The reason why we focus on this phrase is that in comparison with Art.7 of the ATAD, where the word that is used is the 'where', in our case the choice of this phrase, means that Art. 6 can be applied to arrangements that are partly artificial instead of wholly. Above it was mentioned that, Art. 6 needs some specific conditions to be met in order to apply, one of which is the economic substance test or artificiality test. The use of this phrase concerns this test and can lead to the conclusion that Article 6 has introduced a two-level artificiality test. The first step is to determine the artificiality of the entire arrangement (meaning the lack of any genuine economic activity in the territory of the host MS carried out by that arrangement. This applies a 'letterbox' or 'front subsidiary and corresponds to the lack of physical existence in terms of premises, staff and equipment or their existence but in a scale that is not commensurate to the size and the nature of the activity of an arrangement, and to the genuine nature of the activity provided by

[24]Proposal for a COUNCIL DIRECTIVE laying down rules against tax avoidance practices that directly affect the functioning of the internal market, (ATAD Proposal, pg.9 and recital 9 in pg.12)
[25]Werner Haslehner, Katerina Pantazatou, Georg Kofler, Alexander Rust, A Guide to the Anti-tax Avoidance Directive, Elgar tax law and practice, 2020

that arrangement (if any) and the economic value of that activity)[26], and second to determine the artificiality of the part of the arrangement, also understood as the artificiality of the transaction between entities or the part of such a transaction. Even if the first test fails and the involved entities are in reality non-artificial, yet there is the possibility that the second test may lead to the conclusion that the concerning arrangement is abusive insofar as thetransaction or the part of the transaction between non-artificial entities is artificial.[27] The existence of a valid commercial reason for one part of a transaction does not eliminate the abusive intention for the other part, which creates a link between the artificiality test and the first test, the taxpayer's intention, which must be determined through the prism of valid commercial reasons, as Recital 11 of the Preamble of the ATAD indicates. It must be clear that in conducting artificial transactions, the taxpayer obtains tax advantages, which considerably outweigh their non-tax (commercial) advantages. Those factors imply that the economic substance and business purpose of an (i) arrangement or (ii) transaction constitute features of 'relevant facts and circumstances' of significance for determining whether one of their main purposes was to obtain tax advantages.

To conclude, when the above tests are passed and the conditions for the application of Art.6 are truly met MS must act as indicated, meaning to ignore this non-genuine arrangement. Ignorance of the arrangement or a series of arrangements that resulted in a tax advantage requires tax authorities to deny such advantage insofar as the absence of the source of the advantage invalidates its existence. However, the tax authorities should be very careful in such denial because of the use of the phrase 'to the extent '. That is to say, the tax advantage can be denied only to the extent of its source in a non-genuine arrangement or a series of arrangements. After that denial of the tax advantage, the tax authorities should calculate the tax liability in accordance with their domestic law. Neither the wording of Article 6 nor the entire ATAD provides guidelines to what that really means. Because the prevention of abuse of tax law must be proportional, which the 'to the extent' approach nearly but not sufficiently confirms, the mentioned vacuum must be appropriately filled in. In that regard, the context of Article 6 can be helpful. The GAAR under the proposal of the ATAD says that after the ignorance of the arrangement or a series thereof, 'the tax liability shall be calculated by reference to economic substance in accordance with national law and byredefining the

[26]Case C-196/04 Cadbury Schweppes and Cadbury Schweppes Overseas paras 64–68
[27]Werner Haslehner, Katerina Pantazatou, Georg Kofler, Alexander Rust, A Guide to the Anti-tax Avoidance Directive, Elgar tax law and practice, 2020

abusive arrangement on the basis of the existence of economic substance and/or valid commercial reason.[28]

### 2.3 The GAAR of the Merger Directive

Besides the ATAD Directive, which is the main EU Directive, that aims to combat tax avoidance, GAAR rules can also be found in the text of other EU Directives, one of which is the Merger Directive. The GAAR of the Merger Directive is found in Article 15 of the Directive and states the following: **1**. A Member State may refuse to apply or withdraw the benefit of all or any part of the provisions of Articles 4 to 14 where it appears that one of the operations referred to in Article 1: (a) has as its principal objective or as one of its principal objectives tax evasion or tax avoidance; the fact that the operation is not carried out for valid commercial reasons such as the restructuring or rationalisation of the activities of the companies participating in the operation may constitute a presumption that the operation has tax evasion or tax avoidance as its principal objective or as one of its principal objectives; (b) results in a company, whether participating in the operation or not, no longer fulfilling the necessary conditions for the representation of employees on company organs according to the arrangements which were in force prior to that operation. **2**. Paragraph 1(b) shall apply as long as and to the extent that no Community law provisions containing equivalent rules on representation of employees on company organs are applicable to the companies covered by this Directive.[29]

#### 2.3.1 The aim of GAAR provided by the Merger Directive

To begin with, by reading the relevant Article, it can be understood that its **aim is to prevent 'tax evasion or tax avoidance' by refusing to apply or withdraw the benefits of all or any part of the relevant provisions of the MD**. In the Preamble of the Directive and more specifically inpara. 3,4 and 9 the general aim of the Directive is referred, that is to create a common tax system within the MS for eliminating the tax disadvantages that occur when the relevant tax provisions referring to mergers, acquisitions etc. are put into place because of the different treatment under the MS or in other words, it aims to eliminate fiscal barriers to cross-border restructurings.[30]

[28]Werner Haslehner, Katerina Pantazatou, Georg Kofler, Alexander Rust, A Guide to the Anti-tax Avoidance Directive, Elgar tax law and practice, 2020

[29]Council Directive 2009/133/EC of 19 October 2009 on the common system of taxation applicable to mergers, divisions, partial divisions, transfers of assets and exchanges of shares concerning companies of different Member States and to the transfer of the registered office of an SE or SCE between Member State

[30]Susi Baerentzen, The effectiveness of General Anti-Avoidance Rules, Their Limits, Challenges and Potential in EU and International Tax Law, IBFD Doctoral Series Volume 65, 2022

### 2.3.2 The scope of GAAR provided by the Merger Directive

Regarding its scope we can take a look at Articles 1 and 15 parag. 1a combined. So it is quite clear that it refers to operations performed by companies under the performance of mergers, divisions, partial divisions, transfers of assets and exchanges of shares involving companies from two or more Member States, which operations have as their principal objective or as one of their principal objectives tax evasion or tax avoidance. Furthermore, as indicated by the CJEU Case law and more specifically from the Zwijnenburg Case[31], the anti-abuse rule of the Merger Directive targets only abuse of income taxes. As in the ATAD, so in this directive a subjective test is applied, which is connected with the taxpayers intention to perform tax avoidance or tax evasion by gaining a tax advantage. However, in relation to the ATAD the wording of the Directive is different as in this Article the phrase that is used is the '**principal objective or on the principle objective**s', while as already mentioned, the phrase used in the ATAD is the 'main purpose'. The taxpayer's objective is 'hidden' behind the objective of the performing operation as the Article indicates that the operations should have tax evasion or tax avoidance as their principal objective so the subjective test here applies to those. It is worth mentioning that the term 'principal objective' is not defined in the MD Directive or the case law of the CJEU. Some theoretical claims that one needs to examine whether or not the transaction would have taken place in the absence of fiscal reasons. Regarding the double option – principal objective or one of the principal objectives – that the legislator has included in the anti-abuse clause, the CJEU has not clarified yet how this double option must be treated and if for example a MS should refuse a tax deferral if there are other principal objectives besides tax savings? In Leur-Bloem,[32] the CJEU refers only to a planned operation that has as its objective tax evasion or tax avoidance, without distinguishing between the principal purpose and one of the principal purposes. Furthermore, in tax law cases the CJEU does not follow a specific approach regarding the fact of characterization of the aim of obtaining tax advantage as for example in some cases uses the term 'essential aim' (Halifax Case)[33] based on which a taxpayer may be regarded as behaving abusively even if there are other economic objectives present, while in other uses the term 'essential and sole purpose' interchangeably (Thin Cap GLO Case)[34], or just the 'sole purpose' alone (Denkavit Case)[35]. In Part Service the CJEU distinguished between the principal aim and the sole aim, stating that abuse is present

[31]ECJ, 20 May 2010, Case C-352/08, Modehuis A. Zwijnenburg BV ('Zwijnenburg') vs the Staatssecretaris van Financiën (State Secretary for Finance)

[32] Judgment of the Court of 17 July 1997, Case C-28/95, A. Leur-Bloem vsInspecteur der Belastingdienst/Ondernemingen Amsterdam 2

[33] ECJ, 21 February 2006, Case C-255/02, Halifax plc etc vs the United Kingdom Government etc

[34]ECJ,13 March 2007, Case C-524/04, Test Claimants in the Thin Cap Group Litigation vs Commissioners of Inland Revenue

[35]ECJ, 14 December 2006, Case C-170/05, DenkavitInternationaal BV, Denkavit France SARL vs Ministre de l'Économie, des Finances et de l'Industrie

whereas the principal (as opposed to sole) purpose is tax avoidance. By checking the different approaches followed by the CJEU, one may argue that, based on the Merger Directive and the case law stemming from Halifax and Part Service, the benefits under the Merger Directive can be denied if one of the principal objectives (essential aims) of the transaction was tax avoidance or evasion. However, this interpretation could potentially put many reorganizations outside of the scope of the Merger Directive because tax deferral normally is one of the principal aims for structuring a transaction as a reorganization, as opposed to a taxable sale, transfer or liquidation. On the other hand, in favor of the sole aim test and based on the CJEU holding that, one could argue that in order to achieve a legitimate economic aim, a taxpayer should be able to choose the most favorable tax treatment out of several options without being charged with tax avoidance. Following this approach, the benefits under the Merger Directive could be denied only if the taxpayer had tax avoidance or evasion as the sole objective of the transaction.[36] This last opinion was also "verified" by the ECJ in Foggia (Case C-126/10), where the ECJ further provided that when an arrangement is motivated by "several objectives, which may also include tax considerations", no abuse is present "provided, however, that those considerations are not predominant in the context of the proposed transaction".[37]

Furthermore, Art. 15 in paragraph 1a, sentence b, provides a legal presumption on what kind of operations may aim at obtaining tax advantages by referring to operations that are not carried out for **valid commercial reasons** such as the restructuring or rationalization of the activities of the companies participating in the operation. Accordingly, if the operation is not carried out for valid commercial reasons, it will fall within the scope of the Article. It is understood that restructuring and rationalization are referred to in the Article as examples of valid commercial reasons, meaning that if the operation does not concern the restructuring or rationalization of the activities of the companies participating in the operation, it may be assumed that the operation has tax evasion or tax avoidance as its principal objective or one of its principal objectives.[38] In addition, as concluded from the case law (Zwijnenburg Case), it is understood that reorganization can be used as a tool to avoid any taxes, except for income taxes, as long as such avoidance is not otherwise prohibited by EU law or national anti-abuse measures specifically targeted at preventing such abuses.[39] Regarding the meaning of the term 'valid commercial reasons' no definition exist either in the text of the Directive or in judgments of the CJEU, however, in Leur-Bloem, the CJEU clarified that the attainment of a purely fiscal advantage does not constitute a valid commercial reason and that a

[36] Katrina Petrosovitch, Abuse under the Merger Directive, European Taxation December 2010, IBFD
[37] ECJ, 10 November 2011, Case C-126/10, Sociedade Gestora de Participações Sociais SA v. Secretário de Estado dos Assuntos Fiscais (Foggia), para. 35
[38]Cihat Oner, Comparative Analysis of the General Anti-Abuse Rule of the Anti-Tax Avoidance Directive: An Effective Tool to Tackle Tax Avoidance?, EC Tax Review 2020 - 1, pg. 38-52
[39] Katrina Petrosovitch, Abuse under the Merger Directive, European Taxation December 2010, IBFD

reorganization having only such an aim cannot constitute a valid commercial reason. The CJEU observed that the valid commercial reason may depend on various factors, and for this reason, it can be concluded that valid commercial reason depends on the facts of every case and there are no general criteria or specific rules, in which one could count, in order to examine its existence. Moreover, since the MD is concerned with the restrictions of companies, it is quite evident that valid commercial reasons should be reviewed for the purposes of business.

Before moving to the next topic, it is essential to make a final conclusion regarding the GAAR rule of the MD. First of all, it is worth mentioning that the CJEU in the Kofoed Case concluded that Art. 15(a) of the MD (at that time was Art. 11(a)) reflects a general principle of EU Law with reference to the prohibition of abuse.[40] In addition, if the conditions for the MD application do apply, MS may refuse to apply or withdraw the tax benefits that are covered under the Directive. However, this "may" clause does not make it clear whether MS has the right to deny those benefits or if they are obliged to. In the Kofoed Case, the Court stated that MS has an obligation under Art. 10 (now Art. 4 of the Treaty on European Union) and Art. 249 of the EC Treaty (now Art. 288 of the TFEU) to adopt measures necessary to ensure that the Directive is fully effective in accordance with the objectives it pursues. This means that MS can either adopt the ruling of Art. 15 in their national legislation or preserve their national anti-abuse rules in accordance with the MD. While at first it seems that MS has the competence to adopt national anti-abuse measures, in the end those measures must be constructed very strictly. This is also true because of the priority that EU Law has over domestic legislation, which can in no way regulate a situation in a way that infringes EU Law. Furthermore, the assessment for the existence of an abusive operation must be analyzed case by case, and tax authorities must examine all the relevant facts of each case under objective criteria in order to decide if there is a purpose for abuse. The principle of proportionality also indicates that MS cannot include in their legislation irrefutable presumptions of abuse so as to deny the tax benefits but should provide taxpayers with the possibility to provide evidence so as to prove that the operation was actually justified under commercial reasons without at the same time causing him heavy administrative burden for the evidence of their real purpose (this was also the opinion of the ECJ in the Thin Cap Glo Case).[41]

All in all, as in the ATAD so and in the MD the application of GAAR rules demands the existence of specific conditions. However, the wording of the two rules differentiates and the ATAD's GAAR consists of the general anti-abuse/avoidance measure of EU Law that applies

[40]ECJ, 5 July 2007, Case C-321/05, Hans Markus Kofoed v. Skatteministeriet
[41] Katrina Petrosovitch, Abuse under the Merger Directive, European Taxation December 2010, IBFD

to plenty of transactions while the GAAR of the MD only applies to operations under the restructuring of companies.

### 2.4 The GAAR of Parent - Subsidiary Directive

Another EU Directive that includes a GAAR rule is the Parent-subsidiary Directive (PSD). The GAAR rule of this directive was presented for the first time in the 2014 amendment.[42] Before this amendment, in the former Article 1(2) of the PSD, MS were just authorized to implement their domestic anti-abuse measures within the Directive. The GAAR of the PSD Directive is found in the **Article 1 parag. 2,3 and 4** and states the following: **2**. Member States shall not grant the benefits of this Directive to an arrangement or a series of arrangements which, having been put into place for the main purpose or one of the main purposes of obtaining a tax advantage that defeats the object or purpose of this Directive, are not genuine having regard to all relevant facts and circumstances. An arrangement may comprise more than one step or part. **3**. For the purposes of paragraph 2, an arrangement or a series of arrangements shall be regarded as not genuine to the extent that they are not put into place for valid commercial reasons which reflect economic reality. **4.** This Directive shall not preclude the application of domestic or agreement-based provisions required for the prevention of tax evasion, tax fraud or abuse.

#### 2.4.1 The aim of GAAR provided by the Parent Subsidiary Directive

By reading the text of Article 1(2) it is clear that the aim of this GAAR rule (as of the rest of the GAARs as well) is to prevent the abuse of the directive and to tackle non-genuine arrangements.[43] This new anti-abuse measure serves as a de minimis rule, implying that the Member States are obliged to implement and apply a domestic anti-abuse provision that is at least as strict (meaning that it offers the same level of protection against abusive practices) as the anti-abuse provision of the PSD.

#### 2.4.2 The scope of GAAR provided by the Parent-subsidiary Directive

In terms of the scope of the GAAR rule of the PSD, as in the other directives, there are some **specific conditions** that have to be met in order to apply it, which are the following: **1)** there must be an arrangement or a series of arrangements, **2)** these arrangements must have been put into place for the main purpose or one of the main purposes of obtaining a tax advantage, **3)** granting the tax advantage would defeat the object and purpose of the PSD and **4)** the arrangement(s) is (are) not genuine, i.e. not put into place for valid commercial reasons that

[42] Council Directive (EU) 2015/121 of 27 January 2015 amending Directive 2011/96/EU on the common system of taxation applicable in the case of parent companies and subsidiaries of Different Member States

[43]Cihat Oner, Comparative Analysis of the General Anti-Abuse Rule of the Anti-Tax Avoidance Directive: An Effective Tool to Tackle Tax Avoidance?, EC Tax Review 2020 - 1, pg. 38-52

reflect economic reality. In order to define abuse under the PSD it is essential that the above conditions must be fulfilled cumulatively, otherwise, if one the four conditions does not exist, then there is no abuse.[44] From the first read it is quite evident that the GAAR rule of the PSD is quite similar with the one that is included in the ATAD. Since mentioning the necessary conditions, it is also important to analyze their meaning. As in the ATAD so and here, the first condition is the existence of one or more **arrangements**. The meaning of this term is not further explained either in this directive. However, in the Article 1a par.2 of the proposal of the directive, there was a proposed definition of the term 'arrangement' under which the term included "a transaction, scheme, action, operation, agreement, understanding, promise, or undertaking".[45] Despite the fact that this explanation was not included in the final article it is fair to say that it may have the same meaning. The last sentence of article 1 states that "an arrangement may comprise more than one step or part". Recital 8 of the Amending Directive 2015/121, possibly explains the reason behind this clarification. More specifically, it mentions that "While Member States should use the anti-abuse clause to tackle arrangements which are, in their entirety, not genuine, there may also be cases where single steps or parts of an arrangement are, on a stand-alone basis, not genuine. Member States should be able to use the anti-abuse clause also to tackle those specific steps or parts, without prejudice to the remaining genuine steps or parts of the arrangement. That would maximize the effectiveness of the anti-abuse clause while guaranteeing its proportionality. The '**to the extent approach**' can be effective in cases where the entities concerned, as such, are genuine but the features of the used arrangement do not reflect economic reality". By reading the wording of recital 8 it can be understood that the aim of this GAAR is not only to tackle a 'whole' arrangement that includes elements that lead to abuse but also some 'smaller parts of the arrangements, which might be characterized as abusive. As for the second condition that refers to the main or of the main purposes of obtaining a tax advantage, it is the so-called (and analyzed also above for the other two directives) subjective test. This test is related with the intention of the taxpayer for the obtainment (or not) of the benefits of the provisions of the directive as the reason that led him to choose a specific transaction. In order to define abuse, the GAAR wants that the intention of obtaining a tax benefit was the main or one of the main purposes. However, some claim that this requirement puts a very low threshold of abuse, because under this provision it is quite possible that plenty of companies would be denied the benefits of the directive because they relied on a more favorable tax treatment in making specific business decisions. Moreover, as taxes are one of the biggest expenses of businesses, it is quite reasonable to take into account the tax effect when doing business, but that does not necessarily mean that the

[44]Filip Debelva and Joris Luts, The General Anti-Abuse Rule of the Parent-Subsidiary Directive, European Taxation, June 2015, IBFD

[45]Article 1a(2), first paragraph Proposed Directive (2013/814)

company was aiming at abuse of law. [46] For this reason, it is proposed that this term must be interpreted quite strictly by the Court and the tax authorities. The third condition, otherwise called the objective test, is related to the fact that the 'suspicious' arrangement defeats the purpose and the object of the directive. However, in order to find the object of the directive we have to look at its preamble. The objective of the directive is mentioned in the recital 3 of the newly version and states that "The objective of this Directive is to exempt dividends and other profit distributions paid by subsidiary companies to their parent companies from withholding taxes and to eliminate double taxation of such income at the level of the parent company". However, it is necessary to also check the wording of recital 4 "The grouping together of companies of different Member States may be necessary in order to create within the Union conditions analogous to those of an internal market and in order thus to ensure the effective functioning of such an internal market. Such operations should not be hampered by restrictions, disadvantages or distortions arising in particular from the tax provisions of the Member States. It is therefore necessary, with respect to such grouping together of companies of different Member States, to provide for tax rules which are neutral from the point of view of competition, in order to allow enterprises to adapt to the requirements of the internal market, to increase their productivity and to improve their competitive strength at the international level." By reading both of the recitals, it can be concluded that recital 4 better depicts the purpose of the directive, that is to eliminate any possible disadvantage that may arise from profit distribution between parent and subsidiaries of different member states in comparison with the treatment of companies of the same MS. Therefore, the directive aims to equal treatment between companies of the same or of the different member states. The last element that needs to be present is the non-genuineness of the arrangement. Paragraph 3 of Art.1 "specifies'' the term **''non-genuine''** by saying that it means that it is not put into place for valid commercial reasons, which do not reflect economic reality. The term non-genuine is seen here for the first time as the anti-abuse concept within the EU law until the 2015 amendment of the directive, used only the term artificial. In order to test the genuineness of an arrangement we have first to look at the purpose of the arrangement(s). This means that the main purpose test is used for two considerations: (1) to reveal if the main purpose or one of the main purposes of the arrangement or arrangements is a tax advantage, and (2) to test if the arrangement or series of arrangements are genuine.[47] As for the second necessary element of non-genuineness, that is the lack of valid commercial reason, its interpretation was mentioned above when analyzing the MD and has the same meaning also for this rule. Third, the

[46]Filip Debelva and Joris Luts, The General Anti-Abuse Rule of the Parent-Subsidiary Directive, European Taxation, June 2015, IBFD

[47]Cihat Oner, Comparative Analysis of the General Anti-Abuse Rule of the Anti-Tax Avoidance Directive: An Effective Tool to Tackle Tax Avoidance?, EC Tax Review 2020 - 1, pg. 38

requirement that an arrangement "reflect economic reality" obviously stems from the "wholly artificial arrangement" standard used by the CJEU in assessing whether a national anti-abuse rule that restricts the exercise of the fundamental freedoms may be justified by the need to prevent tax avoidance and evasion. This appears clearly in the ECJ decision in Itelcar (Case C-282/12)[48] wherein the Court held that, "[…] according to settled case-law, a national measure restricting the free movement of capital may be justified where it specifically targets wholly artificial arrangements which do not reflect economic reality".[49]In this respect, however, one could, at first glance, contend that a company that does not have economic substance and does not perform actual business or operational activities, is a non-genuine arrangement. However, this position should be qualified. Although a lack of activities do not require an extensive degree of economic substance, understood in terms of day-to-day activities, such as, the holding companies, because, despite the fact that they perform all essential (though minimal) activities related to the holding of shares, merely because they do not engage in day – to day operational activities and do not have substantial premises, equipment, personnel, etc, they are usually denied the benefits of the directive.

To conclude, since directives constitute secondary law they always have to be consistent with fundamental freedoms. If all the above conditions are met, the GAAR rule of the PSD will be applied. This implies that MS should not grant the benefits of the Directive to the companies that perform the abusive arrangements. More specifically, MS are obliged to deny the benefits of the GAAR and they do not have the discretion to decide whether or not they will apply it. The benefits of the PDS in respect of profit distributions fall under a double scope: a) the exemption of withholding taxes in the MS of the sub and b) elimination of double taxation in the MS of the parent. Therefore, both of these benefits will be denied if an arrangement falls within the scope of abuse of the PSD.

### 2.5 The GAAR of Interest and Royalties Directive

Another GAAR rule in the EU legislation can be found in the Interest and Royalties Directive and more specifically in the Art, 5 of the Directive. This GAAR rule states the following: 1. This Directive shall not preclude the application of domestic or agreement-based provisions required for the prevention of fraud or abuse. 2. Member States may, in the case of transactions for which the principal motive or one of the principal motives is tax evasion, tax avoidance or abuse, withdraw the benefits of this Directive or refuse to apply this Directive. Thus, the first paragraph presents the interaction between domestic law or agreement based

[48]Judgment of the Court (Fourth Chamber), 3 October 2013, Case C-282/12 Itelcar — Automóveis de AluguerLda v Fazenda Pública

[49]Filip Debelva and Joris Luts, The General Anti-Abuse Rule of the Parent-Subsidiary Directive, European Taxation, June 2015, IBFD

provisions and the anti-abuse article of the directive, while paragraph 2 presents the rule that limits the use of the benefits of the Directive only to non-abusive transactions.

### 2.5.1 The aim of GAAR provided by the Interest and Royalties Directive

Paragraph1, refers both to fraud and abuse in general, so it is evident that the Directive aims at preventing both. However, para.2 refers more specifically to tax evasion/avoidance and abuse, by making it clear that the aim of the article is to tackle transactions that have merely an abusive character. It is worth mentioning that the term of abuse as used in para. 1 is quite large. Provisions that aim at prevention of abuse can be found both in the tax law but also in other branches of law, and so for the application of this paragraph it could be claimed that all of these provisions could be relevant. So, since the article does not clarify as to which kind of anti-abuse measures it refers to, it can accepted that it covers all types of anti-abuse rules with either a general or specific scope.[50]

### 2.5.2 The scope of GAAR provided by the Interest and Royalties Directive

The conditions for the application of this GAAR rule and for the refusal or withdrawal of the benefits of the Directive are presented in para. 2 of Article 5. In reality by reading the wording of the article, it can be understood that there is only one condition that must be fulfilled to apply the IRD's GAAR, which is the existence of the motive/s of tax evasion, tax avoidance or abuse. More specifically, the motive for tax evasion/avoidance or abuse should be the principal motive or one of the principal motives of the "suspicious" transaction. This brings us back to the so-called subjective test since no reference is present in the wording of the IRD GAAR regarding the lack of commercial reasons.[51] If the principal motive of the transactions is more than one, then one of them should aim at tax evasion, tax avoidance, or abuse, in order to apply the article. Considering the complexity of the transactions carried out within the EU, this may create another difficulty for the MSs in finding out which motive is the principal or one of the principal motives of the transactions. Furthermore, the IRD does not mention the situations in which a transaction may be presumed to have tax evasion, tax avoidance, or abuse as its principal motive or one of its principal motives.[52] However, the CJEU has provided some guidelines regarding some conditions that may be an indicator of abuse. More specifically, the CJEU ruled that there is abuse, if the tax on dividends or interest is avoided because a "conduit company" is interposed in the group structure between the company paying the dividends or interest and the beneficial owner of the dividends or

[50]Cihat Oner, Comparative Analysis of the General Anti-Abuse Rule of the Anti-Tax Avoidance Directive: An Effective Tool to Tackle Tax Avoidance?, EC Tax Review 2020 - 1

[51] Ivan Lazarov, (Un)Tangling Tax Avoidance Under the Interest and Royalties Directive: the Opinion +of AG Kokott in N Luxembourg ,Intertax, Volume 46, Issue 11, 2018

[52]Cihat Oner, Comparative Analysis of the General Anti-Abuse Rule of the Anti-Tax Avoidance Directive: An Effective Tool to Tackle Tax Avoidance?, EC Tax Review 2020 - 1,

interest. In this way, the CJEU appears to be applying a beneficial owner test in the Parent-Subsidiary Directive and the Interest and Royalties Directive in the context of the anti-abuse doctrine. The use of a conduit company is an example of abuse, but the concept of abuse is not limited to such situations.[53] Furthermore, in this article in comparison with the above analyzed GAAR rules, the word "arrangement" is not used, instead is the term "transaction". This term is less broad that the term "arrangement", which may also include transactions, fact that may be helpful, but on the other hand is a term that usually appears in other kinds of directives such as the VAT Directive, while in directives that aim especially in corporate taxation the preferred used term is "arrangement".[54] In addition, as already mentioned, based on the wording of the Article, it can be understood that the scope of this GAAR does not include only practices that aim at tax avoidance but also at tax evasion or abuse. Thus, its scope is much wider than the one on the above Directives, meaning that it covers abuse in a more general way. However, since fraud is not mentioned in para. 2, but it is mentioned in para. 1 the question then arises, as to whether the conditions of the principal motive test (or subjective test) would not be applied to the transactions involving tax fraud.

To conclude, as already mentioned the wording of this GAAR is quite broad, which seems to allow Member States to deny the benefits of the Directive in a wide range of circumstances. This cannot be considered in a positive light for a number of reasons. First, the application of the Directive could be jeopardized by a divergent application of this provision by different Member States. Second, such a divergent application would lead to uncertainty on the tax treatment of transactions that are the basis of modern business, such as licensing and financing.[55]

### 2.6 Examples of domestic GAARs

After having analyzed the GAAR rules that are included in the aforementioned EU directives, it is also essential to make a reference to some specific domestic GAAR rules, in order to check their conformity or not with the general GAAR rule that is provided by the Art. 6 of the ATAD. This reference is made because Art. 11 of the ATAD mentions in para. 1 that "Member States shall, by 31 December 2018, adopt and publish the laws, regulations and administrative provisions necessary to comply with this Directive. They shall communicate to the Commission the text of those provisions without delay. They shall apply those provisions

[53]Otto Marres and Isabella de Groot, Combatting Abuse by Conduit Companies, The Doctrine of Abuse under EU Law and Its Influence on Tax Treaties, IBFD European Taxation August 2021

[54] Prof. Dr Drh.c. Michael Lang, The General Anti-Abuse Rule of Article 80 of the Draft Proposal for a Council Directive on Common Consolidated Corporate Tax Base, IBFD EUROPEAN TAXATION JUNE 2011

[55]Marcello Distaso and Raffaele Russo, The EC Interest and Royalties Directive – A Comment, IBFD European Taxation, April 2004

from 1 January 2019". The countries whose domestic GAARs will be analyzed are Greece, Germany and the Netherlands.

### 2.6.1 Greece

In the Greek legislation, a GAAR rule was presented for the first time with the Law 4174//2013[56], Tax Procedures Code, that was enacted in 2013 and entered into force as of January 1 2014. The GAAR rule was presented in the Art. 38 of TPC. However, after the adoption of the ATAD in 2016, a review of the existing rules was required in order to be in accord with the measures adopted by the ATAD. One of the rules that was amended in order to comply with the ATAD was the GAAR. Despite the fact that Art. 11 ATAD mentioned that the adoption of the rules should have been concluded by 31 December 2018 at the latest, Greece adopted the new legislation in April 2019. The law that amended the existing TPC was the Law 4607/2019 and more specifically Art. 13 of this law. It is also important to mention that the transposition law, provided that the provisions of the ATAD would apply for income acquired and expenses incurred as from 1 January 2019[57], despite the fact that the new law was not adopted at that point.

As mentioned above, the Greek GAAR rule is presented in the Article 38 of the Tax Procedure Code and states the following: **1.** During the tax assessment tax authorities shall ignore any arrangement or series of arrangements that have been put into place for the main purpose or one of the main purposes of obtaining a tax advantage that defeats the object or purpose of the applicable tax provisions, are not genuine, regarding all relevant facts and circumstances. **2**. For the purposes of paragraph 1, an 'arrangement' is defined as any transaction, scheme, action, operation, agreement, grant, understanding, promise, undertaking, or event. An arrangement may comprise more than one step or component. **3.** For the purposes of paragraph 1, an arrangement or a series of arrangements is not genuine to the extent that it is not put into place for valid commercial reasons reflecting economic reality. In order to determine whether the arrangement or series of arrangements is not genuine, the tax authorities shall take into account whether they involve one or more of the following situations: (a) the legal characterization of the individual steps of which an arrangement consists shall be inconsistent with the legal substance of the arrangement in its entirety; (b) the arrangement or series of arrangements shall be carried out in a manner that would not ordinarily be employed in what is expected to be a reasonable business conduct; (c) the arrangement or series of arrangements shall include elements that have the effect of offsetting or cancelling each other; (d) concluded transactions shall be circular in nature; (e) the

[56]Κώδικας Φορολογικής Διαδικασίας (TaxProcedureCode), Law 4174/2014
[57] Article 14 Law 4607/2019

arrangement or series of arrangements shall result in a significant tax benefit, however, this shall not be reflected in the business risks that are undertaken by the taxpayer or its cash flows; and (f) the expected pre-tax profit shall not be insignificant in comparison to the amount of the expected tax benefit. **4.** In the event that following the application of paragraph 1 an arrangement or series of arrangements are considered as non-genuine, then the tax liability and any other relevant sanctions shall be calculated based on the provision that would have been applied in the absence of the arrangement(s). **5**. A Decision of the Governor of the Independent Authority for Public Revenue to be issued that determines the implementation of the GAAR and any other relevant matters. By a first reading it is quite evident that Art. 38 has adopted in general the ruling of Art. 6 of the ATAD.

Regarding its scope, in comparison with the Article of the ATAD the following are observed: 1) Art. 6 of the ATAD refers only to corporate tax liability, while Art. 38 does not specify its reference only to specific taxes, which means that it applies to all taxes and levies included in the Art. 2 of the TPC (such as VAT, real property taxes, gift taxes etc). This approach is compatible with the EU Law since it respects the conditions established by the EU Law.[58] Art. 3 ATAD and Recital 3, conclude this opinion, that states that the purpose of the ATAD is to establish a minimum level of protection in national law and MS are afforded the possibility of enforcing regulations in protect the national tax base better. As a consequence, since Art. 38 does not apply only to companies; it is therefore concluded that it applies to all kinds of taxpayers that are referred to in the Art. 3 of the TPC (such as individuals, companies with legal personality, entities with or without the aim of obtaining revenue, which are not characterized as individuals or legal entities, etc), 2) Para. 2 contains a definition of the term "arrangement" as provided in the point 4.3 of the Commission Recommendation of 6/12/2012, while this definition cannot be found in the ATAD, 3) Para. 3 adds extra elements regarding the characterization of a non-genuine arrangement as indicated in point 4.4 of the above Recommendation.

Some extra comments on the Greek GAAR rule are related with the time scope of its application that is limited to a five year period. This can be concluded by the Art. 36(1) of the TPC that states that tax authorities must proceed with the issuance of a tax assessment during a 5 year period from the end of the fiscal year within the deadline for the submission of the last assessment expires. However, Art. 36(2) also mentions some exceptions to this rule. Furthermore, in comparison with the amending provision, the new Art. 38 does not refer to the subjective scope of the taxpayer, which means that an abuse may be present even if the subjective element is absent. Additionally, following the transposition of the ATAD, the

[58]Katerina Perrou, Critical Review of the ATAD Implementation, The Implementation of the ATAD in Greece, Intertax Volume 50, Issue 8-9, 2022

amended Greek GAAR adopted the main purpose test instead of the essential purpose test that was stipulated under the previous provision. However, the revised provision has also adopted the economic reality test so the GAAR is not applicable to genuine schemes. Moreover, the term 'artificial arrangement' used under the previous Greek GAAR has been replaced by the term 'non-genuine arrangement' and adopts the respective wording of the ATAD provision. However, as clarified under the Explanatory Report of L. 4607/2019, the term 'artificial arrangements' that was contained in the former Article 38 (which followed the wording of the Commission Recommendation 2012/772/EC) and the term 'non-genuine' arrangements contained in the revised Greek GAAR that adopted the wording of the ATAD are considered identical for interpretation purposes. In addition, more clarifications regarding the application of the revised GAAR are provided by virtue of the Ministerial Circular of the Independent Authority of Public Revenues n. 2071/2019. More specifically, according to the said Ministerial Circular, the Greek tax authorities bear the burden to prove that an arrangement is non-genuine while, for the interpretation of the provision, the relevant case-law of the European Court of Justice and the Commission Recommendation 2012/772/EC shall be supplementary taken into account. Further to this, the Ministerial Circular no. 2071/2019 that is based on the Preamble of the ATAD pertaining to the GAAR clarifies that the GAAR aims at dealing with abusive tax practices that are not handled by specific provisions and, consequently, do not affect the application of specific anti-abuse rules, such as the provisions regarding CFCs, the anti-abuse rule of the PSD, etc.[59]

### 2.6.2 Germany

The history of GAAR rules in Germany begins back in the late 20s and more specifically in the year 1919, when the first GAAR rule came into effect as section 5 of the German Reichsabgabenordnung (Reich General Tax Code). This rule came into existence because of the famous decision in Mitropa. The ruling concerned the purchase of corporate shells (mantelkauf), which were made in order to escape certain taxes. The ruling sparked the realization that a GAAR was required, but at the time, such a rule was considered highly controversial. The debate as to whether the GAAR was necessary or whether the issues could be handled by statutory interpretation continued for decades. The prevailing opinion today is that the GAAR is necessary in order to combat the abuse of tax law. In 1934, the German GAAR from section 5 of the Reichsabgabenordnung moved to section 6 of the Steueranpassungsgesetz (Tax Adjustment Act), and in 1977, the Steueranpassungsgesetz became the current AO, and its section 6 became the current section 42 of the AO. With this brief historical analysis we come to the current **German GAAR rule, which can be found in**

[59]Petros Pantzopoulos and Katerina Kalampaliki, The Impact of the Transportation of the ATAD On the Greek Tax System, Intertax Volume 48, Issue 2, 2020

**the Section 42 of the German Abgabenordnung (General Tax Code, or AO**, (the last amendment of this act was by Article 17 of the Act of 17 July 2017 (Federal Law Gazette I p. 2541)), under the title "Abuse of tax planning schemes" and states the following: (1) It shall not be possible to circumvent tax legislation by abusing legal options for tax planning schemes. Where the element of an individual tax law's provision to prevent circumventions of tax has been fulfilled, the legal consequences shall be determined pursuant to that provision. Where this is not the case, the tax claim shall in the event of an abuse within the meaning of subsection (2) below arise in the same manner as it arises through the use of legal options appropriate to the economic transactions concerned. (2) An abuse shall be deemed to exist where an inappropriate legal option is selected which, in comparison with an appropriate option, leads to tax advantages unintended by law for the taxpayer or a third party. This shall not apply where the taxpayer provides evidence of non-tax reasons for the selected option which are relevant when viewed from an overall perspective. [60] Furthermore, by reading the wording of the article it is evident that the german legislator did not adopt Article 6 of the ATAD into their domestic legislation, since a corresponding rule existed already in the domestic legislation.

In general, the meaning of this rule is that it restricts the principle that every taxpayer may arrange its affairs to minimize its tax liability by denying any legal arrangement that constitutes an abuse of right (Rechtsmissbrauch). The objective of this legal norm is that the taxpayer may not arrange its affairs to manipulate or distort the economic reality of a transaction, and, in this regard, any manipulation or distortion is deemed as tax avoidance. In order to apply section 42, two elements must be present: (i) an inappropriate legal arrangement and (ii) a benefit that was not intended. Regarding the burden of proof, it can be concluded by the last sentence of the rule that is on the tax administration to demonstrate that these two elements are present, and the taxpayer then has the possibility to rebut this verdict by demonstrating non-tax reasons. However, the rule does not specify what constitutes abuse, so the case law of the Bundesfinanzhof (Federal Fiscal Court) and the lower courts have shaped the GAAR in terms of its interpretation and scope. In order to identify what constitutes an inappropriate arrangement a comparison must be done against what it considered as appropriate. The application of abuse under the German GAAR is related with the facts and circumstances of the individual cases, since no specific ruling of abuse is available. However, the German Ministry of Finance in addition to older case law, has also issued a decree, which draws the contours of "inappropriate" as something "unusual", "not

[60]Translation in English of the German General Tax Code can be found here: https://www.gesetze-im-internet.de/englisch_ao/index.html#gl_p0014

economically justifiable", "complicated", "cumbersome", "intricate", "unnatural", "artificial", "ineffective" and "paradoxical" and provided three examples of such an arrangement: a) if a third party, on considering the economic facts and effects of the structure, would not have chosen the same legal structure without the generated tax benefit, b) the interposition or other use of relatives or related parties or companies was exclusively motivated by tax considerations or c) the shifting or other transfer of income or assets to another taxpayer was motivated exclusively on tax grounds. If it is established that an arrangement is inappropriate, a quantitative analysis follows in order to demonstrate that the arrangement did in fact result in a tax reduction. If the appropriate legal arrangement had led to a (sufficiently) higher tax than the chosen inappropriate arrangement, then there would been no justifiable reason for choosing the latter. Finally, it must be established that there are no significant non-tax reasons for the arrangement. So, in order to assess whether there is a potential abusive arrangement, the Court follows the following three approaches. The first approach is the Innentheorie approach, which does not require section 42 to be applied, as countering abuse in these situations is a matter of teleological interpretation. On the other hand, when the Court invokes section 42 to counter abuse, the cases take one of two paths. On the first path, the Court makes the finding of abuse conditional on the arrangement defeating the statutory requirements, which has some similarities with the Innentheorie. In these cases, the Court either refers directly to the provision in section 42 or leaves the application open as an objective test. On the second path, the Court applies the norm of appropriateness to determine whether an arrangement is inappropriate, meaning that any ruling of abuse is based on the thecase'sindividual circumstancesrather than the objective of the tax laws. The second approach, the Außentheorie equates the inappropriateness of an arrangement with abuse based on an assessment of the arrangement in question, implying that this test comes into play instead of a test against the scope of the tax provision. Lastly, artificiality is based on the arrangement's form and is not conditional on the arrangement defeating the statutory purpose of the provision. Regarding the second element of the rule, the not intended benefit, it was mentioned that according to a previous version of section 42, which is no longer applicable, it was a prerequisite that the taxpayer had acted with the intent to abusively avoid taxes, making this the decisive criterion for applying the provision. However, according to the current version of section 42, it is not necessary that the taxpayer intentionally acted in an abusive manner, and this criterion has lost significance over time. The same development has happened in relation to the doctrines and the courts, as these were not in accord with the requirement of purposive intent of the taxpayer. The German Federal Court has not made reference to any German version of abusive intent (missbrauchsabsicht) or purposive intent

since 2001. Today, the focus is purely objective and focuses on economic facts and the effects of the taxpayer's actions rather than on their motives.[61]

### 2.6.3 The Netherlands

Regarding the GAAR rule in the Netherlands the following observations must be mentioned. First of all, the agreement for the implementation of the ATAD in the EU level was made, while the Netherlands was under the Presidency of the Council of the European Union.The Netherlands have implemented the Directive (more specifically most of its parts) in its domestic Law. The Dutch parliamentary process regarding the implementation of the ATAD and its amending Directive ATAD2 were preceded with a public internet consultation. All stakeholders could comment on the draft of the legislative proposal before it was forwarded to Parliament. **The legislative proposal of the act implementing the ATAD was sent to the Lower Chamber of the Dutch** Parliament on 19 September 2018. The Lower House of Parliament accepted the act implementing the ATAD on 15 November 2018 after which it was sent to the Upper House of Parliament on 20 November. The Upper House of Parliament subsequently agreed on the act on 18 December 2018. It was published on 28 December 2018 and entered into force on 1 January 2019.[62] More specifically, as it concerns the Dutch GAAR rules, it is generally accepted that artificial or simulated transactions may be ignored by the tax authorities and the Courts of Appeals through a determination of the facts rather than the form (substance over form). However, as it concerns the GAAR rule of the ATAD, the Netherlands indicated that no explicit implementation in Dutch tax law was required since Dutch law already applies the principle of 'frauslegis', a doctrine that is developed in domestic case law. In addition, there are two specific provisions to combat tax avoidance or evasion (i.e. transactions the main purpose of which is avoidance or evasion of tax). The first approach is the just levying (richtigeheffing), under which the legal act in dispute may be ignored for tax purposes (article 31 et seq. of the AWR). This procedure is subject to prior approval by the Ministry of Finance and involves a lot of administrative work and therefore, this procedure is not commonly used. The second approach is the above mentioned 'frau legis', for the application of which, two elements are relevant: (1) actions of a taxpayer should have as a decisive objective to frustrate taxation and (2) this frustration should be contrary to the aim and purpose of the law. Even though frauslegis does not have a specific artificiality requirement, artificiality is involved to some extent in the first element mentioned above. A transaction is considered to be frauslegis when (i) the predominate motive of the transaction is

[61]Susi Baerentzen, The effectiveness of General Anti-Avoidance Rules, Their Limits, Challenges and Potential in EU and International Tax Law, IBFD Doctoral Series Volume 65, 2022

[62]J.J.A.M. Korving& C. Wisman, ATAD Implementation in the Netherlands, Intertax, Volume 49. I I, 2021

to avoid taxation, (ii) the legal actions are considered artificial and (iii) the objective and purpose of the tax law would be violated if the taxpayer would be followed by the application of the law required. Under this doctrine, the spirit of the law is decisive, rather than the exact wording. The transaction in dispute may be converted to the closest equivalent which does not give rise to an abuse of law. The abuse of law procedure may be used only as a last resort.

## 2.7. Boundaries of GAARs

It is important not to forget that GAAR rules are rules of law. This means that as the rest of the legal rules they have been established by the competent legislators. As already discussed the scope of GAARs is to fill the holes in tax legislation, which may lead to tax avoidance. However, despite the fact that they are named as "general anti-avoidance rules", there are also some boundaries placed regarding their application.

### 2.7.1 Legislative Framework and Purpose

To begin with, most of the time, we can find the boundaries of legal rules in their own text. This means that plenty of legal rules are designed in a way that applies to some specific situations and fits in the scope of the described rule. For example the GAAR of the ATAD and the PSD Directive refer to "arrangements" or "series of arrangements", while the GAAR of the MD Directive refers to "operations". In order to apply these GAAR the suspicious transaction must belong to one of the above categories, meaning that if it does not fall under the scope of the term "arrangement" as discussed above in the subchapters 2.2.2 and 2.4.2,[63] then, the rules can not apply. **SAARs** can also work as **boundaries** of GAARs. Both of them serve as anti tax avoidance rules, but GAARs have a more wide and general scope so as to tackle arrangements and operations that may be observed in the application of various tax rules, while SAARs come to "stop" the application of GAARs as specific anti-avoidance provisions by targeting tax planning techniques or abusive arrangements in areas such as transfer pricing or hybrid mismatches.

**Substance over formprinciple** can also work as a limitation of GAARs. This principle is usually used as an anti avoidance instrument, meaning thatitaims at preventing taxpayers from structuring transactions in a way that can be proven to provide them with tax benefits. For this reason, this principle is also used in GAARs, since their aim is to prevent tax avoidance. GAARs often focus on the substance of the transaction, as they use plenty of different tests (e.g. artificiality test, commercial purpose, main purpose test etc) in order to prove if the aim

[63] An arrangement means any transaction, scheme, action, operation, agreement, grant, understanding, promise, undertaking or event.

of the executing transaction was to obtain tax benefits by practicing tax avoidance or not. Because of that, GAAR rules are formed in such a way as to emphasize the substance of transactions, which has to reflect economic reality, and they do not pay so much attention to their legal form. As a consequence, substance over form principle limits GAARs by ensuring that transactions with genuine economic purposes and commercial substance are not recharacterized solely for tax purposes. Tax authorities have to look beyond the legal structure and consider the real business motives behind transactions. When these motives are legitimate and substantial, the application of GAARs can be restricted, protecting taxpayers from overly broad or unjustified anti-avoidance measures.

### 2.7.2 Key principles and tests

GAAR rules pose plenty of different tests so as to examine whether the "suspicious" arrangement or operation may be subject to challenge under GAARs. First, the most important test that GAARs establish is the **mainpurpose test or principal objective test**. The main purpose test is used in the ATAD and in the PSD, while the principle objective test is used in the MD. As it can be understood what is examined under this test is the subjective purpose/object of the taxpayer that has performed the arrangement/operation under investigation, and more specifically if the taxpayer by executing this arrangement had the acquisitions of tax benefitsas its main/principal purpose. This subjective purpose should be assessed through objective facts and circumstances, since finding the real intention of the taxpayer is not always easy. Therefore, this test does not generally aim at all the purposes of the transaction but only atits main/principal one. As a consequence, this test may result as a boundary for the application of GAARs, since the necessity for the main purpose restricts their application only to this specific situation. In addition, the purpose of the arrangement is to be determined on the basis of a "**reasonableness test**" ("having regard to all relevant factsand circumstances"), which is used to assess the subjective intent of a taxpayer or arrangement through an objective analysis of the facts and circumstances. [64]

In addition, another test that is posed in most of the above examined GAAR rules is the "**commerciality test**". For a transaction to fall under the scope of GAARs, it is necessary, that is not genuine or otherwise "not put into place for valid commercial reasons". However, since the directives or the Court have not yet provided a definition of this term, tax authorities have to examine in every case the commercial or not substance of the transaction, which may be related to the transactions that are usually exercised in the domain in which the company

[64] Carla Valério, European Union - Applying the OECD Principal Purpose Test in Accordance with EU Law: An Analysis of the Scope, Burden of Proof and Effects, European Taxation, 2021 (Volume 61), No. 11, 2011

carries out commercial activities. As a consequence, this test works as a boundary for GAARs because it allows their application only if the commercial reason does not exist. Nevertheless, the "obligation" of tax authorities to prove whether valid commercial reason exists or not, brings us to the next boundary of GAARs that is related to**the burden of proof**. The obligation of tax authorities to prove the absence of valid commercial reasons for a transaction is a crucial boundary of GAARs. This requirement ensures that GAARs are applied judiciously and only when there is clear evidence of tax avoidance. All these tests proposed in the different GAARs target in giving answers that, if are answered in the affirmative will be proven to be abusive for taxation. For this reason, tax authorities are charged with proving the grounds for establishing tax avoidance, since the possible abusive practices have a negative impact for them and consequently for the MS.

Last but not least, it is necessary to mention another important boundary of GAARs, which is posed under the **abuse of law doctrine** along with **fundamental freedoms**. GAARs aim at preventing practices that are actually abusive and have as their sole scope the acquisition of tax benefits. However, when tax authorities investigate the questioned transactions, they should always act according to the law and not use disproportionate measures against taxpayers that infringe on their fundamental rights without sufficient justification. In addition, fundamental freedoms such as freedom of establishment, free movement of capital must always be accepted when applying a GAAR rule, which refers mostly to domestic GAARs that each MS applies. Preventing tax avoidance or evasion is a serious issue, but the rules related to those should always have fundamental freedoms in mind and the only reason that these rules may act contrary to them is when it is necessary to prove that the suspicious transaction is actually fraudulent.

## 3. Challenges in taxation of the digital economy

The digitalization of the economy has been present in transactions for many years now. However, the last two decades because of the huge boost of technology and the continuous innovations in all domains, including economy, transactions and business models, have changed and evolved a lot in a short of time. Many countries around the world are even trying to "ban" the use of real money and are only encouraging the use of plastic money (c.c. bank cards) even for every day transactions such as the supermarket. This big influence has created a whole new field of transactions that tend to be pretty different from the traditional ones and have raised questions on how this new way of exchange should be taxed. Many theoretical studies have started a discussion about the application of traditional taxation to the digitalized economy. Digital transformation of the economy has gained for some years now the interest of international organizations, such as the OECD, who identified the need to reform the

international tax system in order to address and handle the tax challenges that arise from the digitalization of the economy. These tax challenges were one of the main areas of focus of the OECD/G20 Base Erosion and Profit Shifting (BEPS) Project, which led to the BEPS Action 1 Report. In this report, it was addressed that the whole economy had been digitalized, and therefore, it was not possible at that time to control the spread of digitalization in this domain. As a result, it was concluded that there was a need to find a global solution for this matter, so as to deal effectively with the new tax challenges.

### 3.1 Initiatives for taxation of the digitalized economy - Pillar 1

Pillar 1 evolved as part of the BEPS initiative. In 2018, the Inclusive Framework, working through its Task Force on the Digital Economy (TFDE), issued Tax Challenges Arising from Digitalisation – Interim Report 2018 (the Interim Report)[65], which recognised the need for a global solution on this topic. Since then, the 137 members of the Inclusive Framework have worked on a global solution based on a two pillar approach. In October 2019, the Secretariat of the OECD published a Proposal for a "Unified Approach" under Pillar One to address the tax challenges of digitalization and grant new taxing rights to market jurisdictions.[66] As a result, in October 2020 Pillar 1 Blueprint was introduced which included a useful background of the Pillar 1 Rules.[67] On July 2021 and October 2021, BEPS countries announced the approval of a statement providing a framework, for the reform of international tax rules to resolve the tax challenges created by digitalization. On July 11, 2022 a Progress Report on Pillar One was issued which included draft rules for the implementation of Amount A of Pillar One. On October 6, 2022, the OECD issued the Progress Report on the Administration and Tax Certainty Aspects of Amount A of Pillar One (the 'Progress Report'), which includes draft Model Rules on the administration of Amount A. On December 8, 2022, a Consultation Document on Amount B was issued. On December 20, 2022, the OECD opened a consultation on Draft Multilateral Convention Provisions on Digital ServicesTaxes and other Relevant Similar Measures. On October 11, 2023, the OECD published the Multilateral Convention to Implement Amount A of Pillar One (MLC), which included the text and the technical rules of Pillar 1.[68] The MLC is expected to be open for signature as from June 2024. In February 2024, the Report on Amount B of the Pillar 1 was published. [69]

[65] TFDE 2018 Interim Report
[66] OECD, Addressing the Tax Challenges of the Digitalisation of the Economy: Policy Note,at 1 (2019), https://www.oecd.org/tax/beps/policy-note-beps-inclusive-framework-addressing-tax-challenges-digitalisation.pdf
[67] https://www.oecd.org/tax/beps/tax-challenges-arising-from-digitalisation-report-on-pillar-one-blueprint-beba0634-en.htm
[68] https://www.oecd.org/tax/beps/multilateral-convention-to-implement-amount-a-of-pillar-one.htm
[69] https://www.oecd-ilibrary.org/taxation/pillar-one-amount-b_21ea168b-en

Pillar 1 consists of two different parts, Amount A and Amount B, each of which has a different scope. More specifically, as mentioned in the summary of the 2020 Blueprint, Pillar 1 focuses on new nexus and profit allocation rules to ensure that, in an increasingly digital age, the allocation of taxing rights with respect to business profits is no longer exclusively circumscribed by reference to physical presence. Globalisation and digitalisation have challenged fundamental features of the international income tax system, such as the traditional notions of permanent establishment and the arm's length principle (ALP), and brought the need for higher levels of enhanced tax certainty through more extensive multilateral tax co-operation. Regarding the **scope of Amount A**, according to the Blueprint,[70] is to determine new taxing rights for market jurisdictions over a share of residual profit calculated at a MNE group. This new taxing right would apply only to those MNE groups that fall within the scope of Amount A, which is based in two elements: an activity test and a threshold test. As for the activity test posed under the Amount A, it refers only to the so called ADS (Automated digital services), which under the general definition provided by Amount A are: i) the services that are on the positive list; or ii) the services that are automated (i.e. once the system is set up the provision of the service to a particular user requires minimal human involvement on the part of the service provider); and digital (i.e. provided over the Internet or an electronic network); and they are not on the negative list [71] and to the CFB (Consumer-facing businesses) activities, a definition on which is also provided in the Amount A as following: a consumer-facing business is a business that supplies goods or services, directly or indirectly, that is of a type commonly sold to consumers, and / or licenses or otherwise exploits the intangible property that is connected to the supply of such goods or services. Regarding the second element, the threshold test, the Blueprint contains two thresholds: i) a global revenue test, on the basis of the annual consolidated group revenue, as shown in its consolidated financial statements and ii) a de minimis foreign in-scope revenue test. The reason for the application of the first test is to exclude "smaller" MNEs from the scope of Amount A, due to the possible compliance and administrative burden that the imposition of the amount A rules will impose to taxpayers and tax administrations. The MLI published in October 2023[72] contains the specific rules and articles of the Amount A, that briefly mentioning includes the following: part 1 refers to the application and personal scope of amount A, part 2 includes the general definitions of the used terms, part 3 states the rules under which the allocation and taxation of profits will be realized, part 4 aims at the elimination of double taxation and part 5 is related with the

[70] https://www.oecd.org/tax/beps/tax-challenges-arising-from-digitalisation-report-on-pillar-oneblueprint-beba0634-en.htm

[71] The positive and negatives list are included in the Blueprint as indicators of activities that fall or not into the scope of Amount A accompanied by commentaries on all the listed activities.

[72] www.oecd.org/tax/beps/multilateral-convention-to-implement-amount-a-of-pillar-one.htm

administration and certainty part and consists of four different sections: Section 1 refers to administrative procedures and requirements, Section 2 provides a tax certainty framework for the above parts 2-4, that refer to certainty requests for the application of the previous rules, conditions for review, composition of panels (e.g. determination panel, review panel) and definitions related to this section. Section 3 provides tax certainty for issues related to Amount A by mentioning possible methods for the resolution of disputes or doubts and Section 4 is related with the exchange of information and international cooperation between the parties. Furthermore, part 5 of the MLI covers the treatment of specific measures enacted by the parties and more specifically, section 1 of this part refers to the removal and standstill of digital services taxes and relevant similar measures while section 2 deals with the treatment of specific measures in scope of tax treaties and l part 6 contains the rules related with the signature, entry in force, termination etc of this Convention. Lastly, the MLI includes also six total annexes, most of which comprise supplementary definitions and provisions for the above measures.

Moving to the **scope of Amount B**, the Blueprint[73] mentions that Amount B aims to establish a fixed return for certain baseline marketing and distribution activities taking place physically in a market jurisdiction, in line with the ALP. According to the published Report on Pillar One – Amount B, it responds to the mandate of the Inclusive Framework by providing an optional simplified and streamlined approach – formerly referred to as Amount B – that jurisdictions can choose to apply to in-scope distributors resident in their jurisdictions. The report consists of 8 Sections, each of each refers to a different topic (with the exemption ofSection 1 that serves as the introduction part). More specifically, Section 2 includes the different options from which the jurisdictions can choose in order to apply this simplified and streamlined approach, Section 3 describes and defines the set of qualifying transactions within scope of this simplified and streamlined approach, and consequently the characteristics of in-scope distributors while Section 4 explains the relationship of this simplified and streamlined approach to the most appropriate method principle. Section 5 sets forth a 3-step process for determining a return on sales for an in-scope distributor which provides an approximation of an arm's length result, Sections 6 and 7 deal with the documentation and transitional issues and Section 8 discusses tax certainty and the elimination of double taxation.[74]

As a result of these new initiatives, the OECD (2020) Tax Challenges Arising from Digitalization – Economic Impact Assessment states that the implication of Pillar One and

[73] https://www.oecd.org/tax/beps/tax-challenges-arising-from-digitalisation-report-on-pillar-one-blueprint-beba0634-en.htm (this Blueprint refers to Amount A but on its Section 1 – Executive summary, the scope of Amount B is also mentioned)
[74] https://www.oecd-ilibrary.org/taxation/pillar-one-amount-b_21ea168b-en

Pillar 2 would lead to an increase of global CIT revenues by about USD 50-80 billion per year.[75]As these measures have not yet started to be implemented, a "safe" assessment whether this goal will be achieved can not be made. However, the rule of Pillar 2 requirement regarding the minimum 15% tax rate on big MNEs can possible be a promising starting point against the fight of tax avoidance.[76] Nevertheless, it is also important to mention that according to Data on Taxation provided by the EU, CIT has actually increased in the majority of EU MS in comparison with the last years[77], an improvement that can be connected with the measures introduced by the BEPS Initiative, a concept of which is the GAARs, meaning that GAARs have actually contributed in the protection of the corporate base.

### 3.2 Economic reality in the digital economy

The reason why so much attention has been given to the digital economy mainly concerns the specializations that characterize this type of economy. More specifically as the word "digital" indicates, in this type of economy the main tool for executing a transaction is technology. This means that plenty of the traditional tools used to perform and tax economic transactions (such as physical nexus or tangible goods) are no longer necessary. The digital economy has created its own mechanisms and business models that differgreatly from those in the traditional economy. According to the OECD's Task Force on the Digital Economy (TFDE), the **digital economy is characterized by three common features**: **(1)** the ability to create and sell products without any or any significant physical presence, **(2)** the importance of intangible assets, especially intellectual property (IP) and **(3)** the importance of data, user participation and their synergies with IP.[78] These three characteristics will be analyzed below along with others.

To begin with, by taking the above mentioned characteristicsas a starting point, one of the most discussed and analyzed features of the digital economy is **the lackof physical nexus**. Digital businesses are able to contact customers and deliver their products all around the world without the need to be present in all these places where the clients are located. As a consequence digital businesses are able to operate remotely just by using technology innovations with limited or non-existent presence in the market jurisdictions from which they

[75]https://www.oecd-ilibrary.org/sites/0e3cc2d4-en/index.html?itemId=/content/publication/0e3cc2d4-en
[76]https://www.oecd-ilibrary.org/taxation/tax-challenges-arising-from-digitalisation-of-the-economy-global-anti-base-erosion-model-rules-pillar-two_782bac33-en
[77]https://taxation-customs.ec.europa.eu/taxation-1/economic-analysis-taxation/data-taxation trends_en#indicators
[78] TFDE 2018 InterimReport, para. 32

derive their income[79]by making at the same time their product accessible to the customer more easily. However, this basic feature of the digital economy also creates much confusion on how the basic traditional taxation principles will be applied in the digitalized economy. The lack of physical nexus is connected with another feature of digitalization, the **globalization**. Since digital businesses do not need to be present in all jurisdictions and places, they can easily expand their operations into new markets quite easily and connect with clients worldwide by gaining worldwide fame. This new way of doing business has reduced the barriers to entering into the markets of other jurisdictions and has also caused an increase in competition.

Another important feature of this type of economy is the specificity of the provided products and services. In the digital, world there is a complete lack of tangible goods. All the products that are sold and provided to the customers are **intangible goods**, meaning that they lack physical form (such as royalties, e-books, software etc). This feature is usually connected with the problem of identifying the real value of the sold products as their value cannot be determined according to the traditional valuation rules. On the other hand, there is the possibility of offering a tangible good but through a wholly digitalized process, meaning that everything except the prevention of the good (e.g. the communications, the research, the payment etc) are executed through digitalized measures.

The third characteristic of the digital economy according to the TFDE is **the role of data and user participation**. The use of data that are provided through user participation is an element of the digitalized economy,and the provision of user-generated content is commonly observed inthe business models of more highly digitalized businesses. The benefits from dataanalysis are also likely to increase with the amount of collected information linked to a specific user or customer. The important role that user participation can play is seen in the case of social networks, where without data and user-generated content, businesses would not exist as we know them today. In addition, the degree of user participation can be broadly divided into two categories: active and passive user participation. However, the degree of user participation does not necessarily correlatewith the degree of digitalisation: for example, cloud computing can be considered as a more highly digitalized business that involves only limited user participation.[80]

It is also worth mentioning that digital businesses have also caused changes in the **working sector**. These changes are mainly a result of technological evolution that has created

[79]Lucas Mas, Cristian Oliver and Raul FelixJunquera-Varela. Tax Theory Applied to the Digital Economy: A Proposal for a Digital Data Tax and a Global Internet Tax Agency, World Bank Publications, 2021

[80] TFDE 2018 InterimReport, para. 35

opportunities for new professions, which mainly have to do with the creation of digital content and intangible assets. A new trend that came up the last years as a consequence of digitalization of businesses is the creation of the so called “digital nomads”. Digital nomads can be described as digital workers, people who work only through their computer by using the Internet services and without being necessarilyliving in the country in which the business for which they work has its main headquarters (if those exist) and usually they travel around the world while they are working, meaning that they may stay at a specific place for example for a three-month period and then move to somewhere else. This new working trend has offered people the ability and freedom to work from all around the world. In relation to the above, another feature of digitalized economy can be addressed which is the **automatization**. This feature is related to the fact that most or all of the necessary processes for creating or selling a digital product are digitally automated and humanintervention is minimal. Online distribution channels allow the delivery of digital content without the need for physical infrastructure (e.g. transportation, delivery providers, logistics contractors), which renders it untraceable by traditional monitoring the delivery of digital content to online costumers in market jurisdictions.[81] What is meant by that is that for example when someone sells a tangible good there is the need to deliver the product to the final costumer, and humans make this delivery. On the other hand, in the digitalized world the product is sent to the final customer directly from the creator of the product without the need for intermediaries (in most cases) just by pushing a button

Last but not least, the **digital platforms** are a really well-known and alsomulti - used type of digital businesses. This kind of business works as a way of disintermediation of transactions since these platforms work to substitute traditional intermediaries and bring the costumer in direct contact with the product. These platforms are a different way of doing business in relation with the above mentioned completely intangible process since the final product or service that is provided to the client has a “physical” substance. These multi-sided platforms interact as intermediaries that enable different users or user groups to interact with each other. Prominent examples are Airbnb and Uber. These platforms are oftencharacterized by indirect network effects, which means that an increase in end-users on one side of the market gives rise to the utility for end-users on the other market side. Illustrated by the example of the online platform Airbnb,[82] which helps individuals to rent accommodations by linking hosts and guests, this means: Both types of end-users (the hosts and the guests) indirectly benefit if there are more end-users on the other side of the market. Guests benefit from having more

[81]Lucas Mas, Cristian Oliver and Raul FelixJunquera-Varela. Tax Theory Applied to the Digital Economy: A Proposal for a Digital Data Tax and a Global Internet Tax Agency, World Bank Publications, 2021
[82]TFDE 2018 Interim Report, para. 50

hosts to choose from and hosts benefit from having more potential guests. In this respect, platforms act as intermediaries between different user groups (customers and suppliers). In some cases, the platform operators themselves also act as providers. However, the platform operators' business model is usually based on receiving an agency fee when a transaction occurs. Some platforms are also financed through advertising by selling users' data to advertisers or giving advertisers access to users. The platform operators generate income from their users by making the platform available. A second way of generating revenue is to monetize users' data for advertising. The difficulty from a taxation point of view is therefore, that platform operators generate income without having a physical presence at the location of their users. The traditional source taxation principle thus reaches its limits. This applies in particular when platform operators monetize user data, i.e. use a resource without being subject to taxation at the source of this resource (the user's location).[83]

### 3.3 Comparative analysis between digital and conventional transactions and application of GAARs

In order to have a more complete image of the digital economy, it is worth pointing out its basic differences from traditional transactions. Some of the most important differences have already been addressed in the previous subchapter, however, in this part a more comparative approach will be provided, along with an effort to apply the existing GAARs to the characteristics of digital transactions.

The first thing that differentiates between these two types of transactions is the **lack of physical nexus** on the one part and the necessity for the existence of a physical nexus on the other. To begin with, as already mentioned, digital transactions can be effected without the need to have a physical presence in a specific jurisdiction, but what matters for them is to have a digital presence, that usually covers many different countries and jurisdictions. Conventional transactions, on the other hand, are obliged to have a physical nexus with the jurisdictions, where they do business and derive their income, which usually refers to the presence of an office, employees or inventory. For conventional transactions physical nexus is an important link for their taxation, since the principle of source for example is based in the existence of a PE in the countries where businesses are active, apart from the country of residence.[84]

[83] Thomas Fetzer & Bianka Dinger, "The Digital Platform Economy and Its Challenges toTaxation" Tsinghua China Law Review 12 (29)

[84] Lucas-Mas, Cristian Oliver and Raul Felix Junquera-Varela, Tax Theory Applied to the Digital Economy: A Proposal for a Digital Data Tax and a Global Internet Tax Agency, World Bank Publica0tions, 2021

A second element that distinguishes between them is related to the **types of products** that are produced and transferred. As for digital transactions, they are exclusively engaged with the production of intangible assets (meaning software, IP), "products" that do not have a physical form but are created based on the use of technology. This means that human intervention in the productivity process is quite limited as the whole process is executed by digital programs and the human factor is only visible in the idea behind its creation and in its design. Traditional transactions, on the other part have to do with the sale and production of tangible goods, in which human presence is necessary, since they execute the bigger part of the productivity process and the transfer of those products also requires the involvement of humans.

As a third difference, **accessibility** can be mentioned. What is meant by accessibility is how easy (or not) customers can access and execute both types of transactions. It is common knowledge that the access to the digital world may not be provided to everyone. In order to be able to execute digital transactions there is the need to have an internet connection, something that may be lacking it remote areas, and also to possess the necessary equipment such as laptop, mobile phones and credit cards, the acquisition of which is sometimes really costly for some people. Furthermore, the use of digital transactions is something really difficult mostly for the older adults as they are not used or trained in using new technologies. However, it is more easy for them to visit a nearby store, get the product they want, and pay in cash.

**Tax avoidance** is another point that must be discussed. In conventional transactions people often prefer to pay in cash, a fact that help businesses or professionals perform tax avoidance and hide their income, since there is no record for the money that they gain. On the opposite side, in digitalized economy all the payments take place online and the money paid is transferred to the back accounts of the providers, which means that they can be traced and taxed quite more easily.

By pointing out the differences between conventional and digital transactions it becomes increasingly apparent why inquiries into the applicability of GAARs in the digital economy emerge, since it is quite clear that these two types of transactions present plenty of different elements. To begin with, in order to evaluatethe potential extension of existing GAARs to encompass digital transactions, the author will present examples of transactions/arrangements that refer to the above analyzed GAARs.Subsequently, an endeavor will be made to align the requirements of the GAARs with the different examples so as to assesstheir efficacyin detecting tax avoidance within these transactions. As a starting point an example of a(n) (abusive) transaction under the PSD regime will be taken.

- A digital multinational company that has established conduit companies in certain EU Member States solely for the purpose of routing digital sales through these entities, even though they do not add value to the transactions. This enables the MNC to benefit from preferential tax treatment under the PSD without having genuine economic substance (regarding the two main requirements for the application of PSD, the 10% participation requirement and the inclusion of the conduit companies in the listed taxes, it is assumed that these conditions are satisfied). How can the GAAR of the PSD be applied in this situation?

First of all, it is mandatory to conduct an assessment to ascertain whether the GAARprerequisites are met in the context of this scenario. The first requirement pertains the existence of an "arrangement". As delineated in the analysis in subchapter 2.4.2 an arrangement can include a transaction, scheme, action, operation, agreement, understanding, promise, or undertaking. Consequently, the aforementioned structure can be considered as an arrangement fallingwithin the scope of the Directive, as it is a corporate scheme used by the multinational.Secondly, it is required that the imposed arrangement has as the main or one of the main purposes to obtain a tax advantage. In the specific example it is given that the company's objective is to secure a tax advantage, however, when tax authorities have to search for the objective of the taxpayer they will have to do a deep search regarding its intention, possibly by checking in detail the tax advantage of the company because of the specific arrangement by comparing it also with the amount of the company's possible tax liability in case where the arrangement under investigation did not exist. The third element refers to the fact that the arrangement defeats the directive's purpose and object. As concluded again from subchapter 2.4.2 the purpose of the directive is to eliminate any possible disadvantage that may arise from profit distribution between parent and subsidiaries of different member states in comparison with the treatment of companies of the same MS. In this situation the purpose of the Directive is defeated since the company aims at gaining the preferential tax treatment provided by the Directive and the same is also true for the last requirement of non-genuiness as the conduit companies do not contribute to value creation and they do not have economic substance. At first, it can be observed that the GAAR of the PSD can effectively be applied also in the digital economy, however, the problem with its application in the digital world is created due to the potential difficulty of tax authorities in investigating whether the conduit companies do actually contribute to value creation, because of the absence of tangible assets or operational infrastructure, and therefore if they are put into place for valid commercial or not. As the value of these transactions is created through elements that can hardly be found and absent requisite expertise, tax authorities may encounter difficulties in investigation into the commercial validity of these entities' operations.

As a second example, the application of the GAAR of the MD will be evaluated.

-Let's assume that there are two different digital companies, Company A engaged with software development that is established in a low tax jurisdiction and Company B, a platform that sells digital servicesand operates in a high tax jurisdiction. Both companies are based in different EU countries. These two companies merge their operations in order to exploit tax benefits from the low tax jurisdiction and minimize their tax liability rather than for genuine business synergies. For this reason, Company A, acquires the assets and liabilities of Company B and in exchange its shareholders receive shares in Company A. The merger is structured in a way that the acquired assets are artificially inflated.

Once again, it is necessary to examine whether the requirements of the GAAR are met. The first requisite for the application of this GAAR, as explained in the subchapter 2.3.2, is that the exercised merger, division etc must have as its principal objective or one of its principal objectives tax evasion or tax avoidance. In this specific situation, this is true because the main purpose of the merged companies is to benefit from the tax advantages of the low tax jurisdiction and for this reason they also proceed with the inflation of the intangible assets of the acquired company. Alsothe merger lacks genuine business synergies, since the companies do not choose to merge in order to maximize their profits. Therefore, the second requirement which consists of the fact that the operation was not carried out for valid commercial reasons is also fullfield. Nevertheless, since those subjective motives are not known to the tax authorities, they will have to assess whether or not the specific merged structure is abusive from a tax point of view. In order to do that they have to examine all the elements behind this merge including the value of the transferred assets. Digital companies,even though they do not have a physical presence in the jurisdictions where they operate, have to be registered in at least in one country so as to be legitimate. If the company decides to move its headquarters from one country to another because of a merge, tax authorities will have to search the reason behind this decision. Along with that, they have to examine the company's financial statements in order to assess the value of the transferred assets. However, once again the problem arises in the valuation of intangible assets connected with their intangible nature, as tax authorities usually do not have the necessary expertise to evaluate whether the values that were shown in the financial statements could depict reality.

Last but not least, a more general example will be presented by trying to apply the GAAR of the ATAD in a pure digital situation.

-Let's consider a multinational corporation (MNC) based in country A, that sells digital services such as software licenses or online advertising to costumers globally, which also has a subsidiary in Country B. Country A has significantly lower corporate tax rates compared to

Country B. In order to exploit the tax disparity between Country A and Country B, the company based in country A, charges its sub in country B excessive fees for the provided services. Those fees, are tax deductible in country B, as business expenses, and this way the taxable income of the MNC in country B will be reduced and so will the amount of taxes that will be paid, as there will be a shift of profits in the low tax jurisdiction, Country A,where the amount of taxes payed is anyway low. How could the GAAR of the ATAD apply in this situation?

To begin with, tax authorities in order to check whether this scheme falls under the scope of the GAAR will start by analyzing its elements. As in all the above examined rules, so in this one, the first condition that must be met while analyzing the abusiveness or not of a transaction is the existence of an "arrangement". As described in subchapter 2.2.2 the term arrangement means any transaction, scheme, action, operation, agreement, grant, understanding, promise, undertaking or event, condition that is met since the above companies have exerciseda specific scheme of(abusive) transactions that fall under the definition of arrangement. (as) the(ir) value does not represent the reality. As a second step, tax authorities will apply the purpose test to determine the arrangement's main purpose. In order to do that they will have to investigate both the subjective and the objective purpose of the arrangement. If these test results by pointing out that the main purpose or one of the main purposes of the arrangement was to obtain a tax advantage by defeating the scope and the purpose of the tax law, then the second condition of the GAAR will also befullfield.In addition, when tax authorities investigate the purpose of the arrangement, they check both the substance and the form of the arrangement, as the form of the arrangement may be seen as legitimate while the real economic substance of the arrangement is not. In this specific situation,the two companies applied this scheme of overcharging fees to gain tax benefits from the different tax rates of the jurisdictionsinvolved. However, as for the subjective part of the purpose test, from a practical point of view, it may be difficult to assess, since authorities can not actually know the taxpayer's real purpose was unless the rest of the criteria point to a specific conclusion. Assessing the (abusive) substance of the transactions becomes easier if the third element of the GAAR is also fullfied, as it is connected with the non-genuiness of the arrangement. The wording of the Directive refers to the lack of valid commercial reason in order to examine whether the arrangement is genuine or not, which according to the author's opinion the same is true in the case that transactions lack commercial substance and are only done for the acquisition of a tax advantage. In the described example, there is at first a commercial substance/reason for the exercised transactions as the company in country A actually offers services in country B. What lacks genuiness is the overcharging amount, fact that may be difficult to "understand" especially when the services are offered digitally

because as with the intangible goods so with the services, the value is more difficult to assess because of the lack of standardized metrics.

All in all, it can be observed that the wording of GAARs describes situations and abusive practices that can arise in the digital economy. However, the application of these measures by the tax authorities in the digital economy may be more complex in comparison with their application in conventional transactions because of the different characteristics between them and mostly because of the difficulty in finding the real value of the digital ones.

## 4. Regulatory Challenges and Policy Responses

As already analyzed, digital transactions differ from the traditional ones in various features. Because of these differences and the specific features that characterize digital economy plenty of tax challenges regarding digitalization arise, which from their part pose some regulatory challenges that relate with taxation of digital transactions and underline the need for policy responses. These tax challenges and policy responses can be summarized under the following two questions: a) how to establish taxing rights in jurisdictions where foreign businesses have significant commercial presence with little or no physical presence and, b) how and where to allocate the taxable profits of MNEs.

### 4.1. Application of traditional links for the allocation of taxing rights in the digital economy

Taxation is based on specific principles such as principle of source and residence. These principles/rules are also used for the allocation of taxing rights in situations where a business derives income from more than one jurisdictions so as to avoid double taxation. Digital businesses most of the times are involved in cross-border transactions and therefore most of their income is derived from jurisdictions other than the ones that they may have their headquarters. For this reason, the question of allocation of taxing rights arises also in digital economy, but since digital transactions present different characteristics from the traditional ones how the traditional links for allocation of taxing rights in the evolved jurisdictions be applied in the digital world?

Allocation of taxing rights is usually determined through tax treaties between the contracting States and through international tax conventions (such as the OECD 2017 Model Tax Convention on Income and Capital)[85]. One of the basic principles/links that is used for the allocation of taxing rights is the **principle of source**. According to the principle of source,

[85] Model Tax Convention on Income and on Capital: Condensed Version 2017, https://www.oecd.org/ctp/treaties/model-tax-convention-on-income-and-on-capital-condensed-version-20745419.htm

income tax treaties determine when a resident enterprise of one State maintains sufficient connection to another State to justify levying taxation by the latter State. Under Article 5 of the OECD Model Tax Convention, this connection exists when an enterprise resident in one State (the residence State) has a permanent establishment (PE) in another State (the source State)[86]. The source country may tax business profits of an enterprise only if the enterprise carries out a business in that country through a PE, and those profits are attributable to that PE. Art. 5 also provides with the definition of PE according to which, a PE is a "fixed place of business through which an enterprise wholly or partly carries out its business".According to para. 2, this can include a place of management, branch, office, factory, workshop, or place of extraction of natural resources. The PE threshold can also be satisfied if a dependent agent of the foreign enterprise acts on its behalf and habitually exercises authority to conclude contracts in its name (Art. 5 para 5). Therefore, the existence of a PE requires a certain level of physical presence in the source jurisdiction. If an enterprise does not have physical presence in the foreign jurisdiction, it does not have a PE and thus no income tax nexus arises.[87]

In order to apply source principle in digital transactions, it is necessary for digital businesses to have a physical presence in the jurisdictions to which they provide their intangible products. However, as already discussed, digital businesses are characterized by the lack of physical presence in the countries on the economic life of which they are involved. As a consequence, this brings us to the question of how the term "permanent establishment" will be interpreted in order to be used for the allocation of taxing rights on the profits that digital businesses make in different jurisdictions. The reason why it is important to find an answer on this question is basically related with the fact that since there is an absence of a PE in the market where the business digitally operates profits from digital services are taxed primarily in the residence country of the selling enterprise (i.e. country of incorporation).[88] For example plenty of highly digitized MNEs can also incorporate and stash profits in low-tax jurisdictions, such as Ireland, while engaging in sustained commercial activity in market countries where their profits remain untaxed. This has a negative effect on the tax basis of the countries that are net importers of digital services/products, and usually is characterized as an "abusive practice"[89] but also potentially distorts competition between digital business models

[86] Ibid
[87] Thomas Fetzer & Bianka Dinger, "The Digital Platform Economy and Its Challenges to Taxation" Tsinghua China Law Review 12 (29)
[88] Assaf Harpaz, Taxation of the Digital Economy: Adapting a Twentieth-Century Tax System to a Twenty-First-Century Economy, The Yale Journal of International Law, Vol 46: 57, 2021
[89] Werner Haslehner, Georg Kofler, Katerina Pantazatou, Alexander Rust "Tax and digital economy: challenges and proposals for reform", Wolters Kluwer, 2019

and analog business models if only analog business models are subject to taxation in the source state.

In order to solve the problem of interpretation of “permanent establishment” in relation with digital businesses, European Union in 2018 published a proposal for a directive laying down rules relating to corporate taxation of a significant digital presence rather than a permanent establishment.[90]Significant economic presence should be based on factors that evidence a purposeful and sustained interactionwith the jurisdiction via digital technology and other automated means. According to the above mentioned proposal, a 'significant digital presence' shall be constituted if a business consists wholly or partly of the supply of digital services through adigital interface. A 'digital interface' is defined as 'any software, including a website or a part thereof and applications, including mobile applications, accessible by users. Examples of transactions that can lead to significant digital presence are the supply of digitized products (e.g. software), services providing or supporting a business or personal presence on an electronic network (e.g. a website), providing storage space in the internet (cloud services from), streaming or downloading of music, films or games (Spotify, Netflix, App Stores), or the transfer of rights to put goods or services on an internet site operating as an online market (e.g. sharing economy platforms like Airbnb).[91] The above definitions can provide useful guidelines for the countries so as to define whether a business has or not “digital presence” in its territory. However, what can be more “tricky” to define under this proposal is the term “significant”. According to the EU’s 2018 proposal three different criteria could satisfy the definition of this term. The first one was related with the annual revenues that a business would gain in a country from the digital transactions that would be executed there (the threshold that was proposed was 7 million euro), second the amount of users that access the digital services in a country in a taxable year (10.000 users) and third based on the business contracts that a digital business would create with the users (3.000 contracts). The proposed criteria seem reasonable in order to be used as indicators of the “significant digital presence”, however in the author’s opinion the proposed thresholds may not satisfy the “expectations” of the different jurisdictions, since every country does not have the same number of residents or the same percentage of purchasing power, meaning that for some countries the threshold of 10.000 users may be really low while for others really high and the same is true for the amount of revenues. In the author’s opinion, the application of principle of source in digital transactions is both difficult and important to establish, since the term of “permanent establishment”as described under the existing rules for the traditional

[90] See Proposal for a Council Directive Laying Down Rules Relating to the Corporate Taxation of aSignificant Digital Presence, COM (Mar. 21, 2018)

[91] Thomas Fetzer & Bianka Dinger, "The Digital Platform Economy and Its Challenges to Taxation" Tsinghua China Law Review 12 (29)

businesses cannot be applied for the digital ones because of the difference in their characteristics. For this reason, it is essential for the lawmakers to find another indicator apart from the PE in order to apply the principle of source to the digital economy.This new solution should not be based on the elements that are traditionally used for the application of principle of source, since those characteristics are not part of the digital world.

Another traditional link that is used for the allocation of taxing rights is the principle **of residence.** According to Art.7 of the OECD 2017 Model Convention, business profits are taxed in the state of residence of the business unless the enterprise carries on business in the other state through a permanent establishment.[92]By reading this Article it can be understood that according to the principle of residenceprofits are taxed in the jurisdiction where the company has its residence, if the laws of this jurisdiction contain rules that allow taxation of company's worldwide profits. The application of residence taxation is based in two nexuses: 1) place of effective management and 2) place of incorporation (Art. 4 par. 1 OECD 2017 and 2014 Model Tax Convention).[93]When a business operates under the traditional analog way, it is quite easy to establish these two nexuses. According to paragraph 24 of the Commentary on Article 4 of the 2014 OECD Model Tax Convention, place of effective management usually refers to "the place (meaning location or jurisdiction) where the key management and commercial decisions that are necessary for the conduct of the entity's business as a whole are in substance made"[9495] and place of incorporation is the jurisdiction according to the law of which the enterprise was created.[96]

On the other hand when it comes to digital business models the application of this principle requires redefining those nexuses. To begin with, in conventional transactions, residency is established based on the residence of the enterprise that provides the goods. If we follow the same approach for digital transactions, then the principle of residence will be applied based on the residency status of the provider/seller of the digital intangible goods and services. As a consequence, taxation will be governed by the legislation of the jurisdiction where the creator

[92]https://www.oecd.org/ctp/treaties/model-tax-convention-on-income-and-on-capital-condensed-version-20745419.htm

[93] Model Tax Convention on Income and on Capital 2014,https://www.oecd-ilibrary.org/taxation/model-tax-convention-on-income-and-on-capital-2015-full-version_9789264239081-en

[94]https://read.oecd-ilibrary.org/taxation/model-tax-convention-on-income-and-on-capital-2014-full-version/commentary-on-article-4-concerning-the-definition-of-resident_9789264239081-38-en#page8

[95] Paragraph 24.1 of the Commentary on Article 4 of the 2017 OECD Model Tax Convention provide some factors that can be assessed when trying to find where the POEM is established "where the meetings of the person's board of directors or equivalent body are usually held, where the chief executive officer and other senior executives usually carry on their activities, where the senior day-to-day management of the person is carried on, where the person's headquarters are located"

[96] Paragraph 24.1 of the Commentary on Article 4 of the 2017 OECD Model Tax Convention provide some factors that can be assessed when trying to find where the place of incorporation is "which country's laws govern the legal status of the person, where its accounting records are kept"

of the digital content or the digital provider is considered as tax resident. However, the difficulty in this context arises from determining where the digital provider is actually established, given the possibility of digital businesses to operate remotely in multiple jurisdictions. Under such circumstances, it is necessary to ascertain where the actual residence is. For a digital enterprise to be legit, it must be formally established according to the laws of a specific jurisdiction, where it is also registered for tax purposes and possesses an assigned VAT identification number. In the author's opinion, the place of incorporation is the most straightforward criterion for establishing residency, since it may be reached quite easily. However, if such a business maintains a digital presence in other jurisdictions such as subsidiary entities, the situation becomes a bit more complex. In this scenario the implementation of tax treaties between the state of incorporation and the other states becomes necessary so as to avoid possible tax avoidance issues and also to alleviate conflicts regarding the taxation of profits among the related jurisdictions. Place of effective management could also apply for finding the residency of a digital business, because despite its online operation, the founders of the business would be established as residents in a jurisdiction from where they make commercial decisions. Nevertheless, because of the non-physical presence of these companies the determination of the POEM is again quite complex.

The last principle that will be examined is the principle of origin. According to the **principle of origin**, introduced by Prof. Eric Kemmeren,[97] a state can justify taxation of income of a business that is generated within its territory. For the principle of origin the relationship between production of income and the territory of a State is important, since the origin refers to where the income is actually created and not where it is transferred from. What is meant by that is that for example the income is generated from an enterprise in State A and then is transferred via a corporation to State B and then to a company resident in State C. According to the principle of origin only State A has the entitlement to tax these profits because they generated through its territory, since the activity that led to the production of income took place only there. State B only worked as an "intermediary" through the State of which the income was transferred to his owner. What matters in the application of this principle is where the intellectual element that adds value to things takes place. Under the author's opinion, when it comes to digital transactions, the application of this principle may become a bit more complex. From the author's understanding, origin is related with value creation, therefore what matters is to find where value is created in digital economy. While in conventional transactions there is the view that value is created in the place where goods and services are created by using the means of production, in digital economy the situation is

[97] Eric Kemmeren, Principle of origin in Tax Conventions: A Rethinking of Models, PhD Thesis, Tilburg University, 2001

different. There is the opinion that in digital transactions value creation takes place in the jurisdiction where the user is established, since digital economy is heavily based in the collection of data that are provided by the users of the digital products. Digital businesses collect, analyze and monetize the data that are provided by the users so as to maximize their profits as they can have a more complete image on the costumers behavior, their preferences and market behavior, elements that help them to create new products and services that are more targeted towards the possible digital users.[98] By analyzing this opinion about the new way that value is created in the digital economy along with the principle of origin, two contradictory conclusions can be extracted regarding the place where value creation takes place. Under the first one, value is created in the place where the users are located since as mentioned above they are the ones that contribute the necessary data to businesses. On the other hand, users' participation maystops in the contribution level. What is meant by that is that users do contribute data but just the contribution of data can not lead to profit making. This is the case of passive data collection where the user's role is limited to their prior consent and it is argued that in this case it is the business and not the user that really produces the raw input data.[99]By collecting the data businesses proceed to all the necessary steps that should be followed so as to be able to generate more income. Base on this thought, the place of origin should be the place where the data are collected and analyzed. However, this second conclusion can only be true in cases where the businesses that gather the data are actually at a later stage taking advantage of them, since there are businesses that do collect the data but they are only selling them to other digital companies that will use them for their profit.[100] As a consequence, it is evident that principle of origin is difficult and also complex to apply in digital transactions and for this reason, if a tax treaty or a domestic legislation chooses to apply this principle for the allocation of taxing rights, the relevant criteria should be examined very carefully in order to ensure a fair distribution of taxing rights.

All in all, it can be concluded that the above three analyzed traditional principles for the allocation of taxing rights between the relevant jurisdictions can hardly be applied in the digital economy under the existing criteria because of its different characteristics. In order to apply them in the digital world, new rules should be established for the identification of residency or source in the digital economy by re-establishing the relevant criteria.

[98] Aqib Aslam and Alpa Shah, Tec(h)tonic Shifts Taxing the Digital Economy, International monetary Fund, May 2020, Working Paper No. 2020/076
[99] Ibid
[100] Ibid

## 4.2 Taxation of digital content and the problem of valuation of digital transactions

Another topic that must be further analyzed regarding the taxation of digital transactions is the way that the digital economy should actually be taxed and how the value of the relevant transactions is determined. In order to answer (or at least try to) these questions, it is first necessary to mention again in short what is the taxable object in the digital economy. As discussed in the previous chapter, digital transactions constitute of intangible goods and services. Therefore the taxable object in the digital economy is all kinds of intangible goods/assets, such as software, computer code, different programs that are used for the creation of a website, apps and in general assets that are related with technology. Furthermore, assets related with intellectual property, which include patents, trademarks, copyrights, and trade secrets are of the most valuable intangibles that are sold by digital businesses, since those assets protect the intellectual creations of a company and give them exclusive rights to use, reproduce, and profit from their inventions, brands, artistic works, or proprietary information. The list of intangible assets does not stop there,it also includes different kinds of contracts or licenses that permit the use or give access to resources and technology that is owned by a company to other companies. Digital services on the other side constitute of all the services that are provided electronically, such as online learning platforms, streaming platforms where you can watch movies or listen to music (Netflix, Spotify), digital content marketplace (Amazon, Apple Store), digital communication services (WhatsApp, Facebook, Zoom etc) or even digital financial services.[101]

One of the problems regarding the taxation of digital transactions is related to the digital content's valuation. In order to tax a transaction or more specifically the profits of the companies that deal with digital transactions along with the investigation of practicing of tax avoidance, it is first essential to find the value of the executed transactions. The difficulty in this concept is finding the elements that contribute to the creation of an intangible good so as to evaluate their price and their contribution to the ultimate product. The problem with the valuation of intangible assets is that they do not consist of tangible materials, the value of which has already been established in the international markets, but they "consist" of data or other kinds of elements whose value cannot be easily defined[102] because of the fact that most of the times besides the creators of the intangible no one else knows what exactly was used so as to provide this specific intangible good. The only case that the value of the digital product

[101] Lucas-Mas, Cristian Oliver and Raul Felix Junquera-Varela, Tax Theory Applied to the Digital Economy: A Proposal for a Digital Data Tax and a Global Internet Tax Agency, World Bank Publications, 2021

[102] Aqib Aslam and Alpa Shah, Tec(h)tonic Shifts Taxing the Digital Economy, International monetary Fund, May 2020, Working Paper No. 2020/076

may be easy to determine is for example the sale of an e-book. This is attributed to the dual nature of e-books, which often accompany tangible counterparts whose value is established through conventional market valuation. Consequently, the value of the e-book usually aligns with the one of its tangible counterpart because the value of the intellectual work of the author is the same in both cases and what changes is the form of the work that in one case is tangible and in the other intangible. However, the same is not true for the rest of the digital products. For instance software development relies mainly on intangible elements such as source code. This code is created through the computer and it constitutes the basic element of software creation. Despite the use of a computer no other tangible measure is used for its production therefore it is considered as an intellectual property. Assessing the value of the software entails evaluating production costs, yet this proves tricky due to the absence of established international markets for source code valuation, which gives the freedom to the programmers who produce the source code to value their product as they wish. Since the code most of the times is a unique creation it is reasonable to have a relatively high price, however since there are not internationally provided guidelines regarding the valuation of intangible goods, it is quite difficult that tax authorities would characterize a relevant transaction as abusive on the basis of the ALP.[103] Furthermore, it is quite possible that the value of code fluctuates in relation with the final product, meaning that if the used code led to the creation of a website or an application which is later used by millions of users and creates a lot of profit for its owners, it is worth more in value than it did when it was first created.

An integral aspect of numerous digital transactions belongs to data, which significantly influences their valuation. Almost all digital businesses collect and use users' data to help themmake better business decisions and shape entire business models. Data are generated from users, whether willingly or not, whenever they execute a digital transaction or when they create digital content through digital platforms.[104]By purchasing a digital product at the same time, they reveal information about their preferences, which are then recorded by the business for future use and monetization. Similarly, interactions with search engines like Google reveal to the website administrators the sectors that interest the users and this info is then gathered and analyzed to advertise and promote relevant products, news or information to the users. As it can be understood, data proves invaluable to digital businesses, facilitating the provision of tailored services and products that align with user preferences and enhancing the likelihood of purchase. Moreover, data themselves can serve as commodities since there are businesses that only engage in their collection and subsequent sale to other entities that seek for strategic

[103] Marcin Szczepański, Taxing the digital economy New developments and the way forward, EPRS | European Parliamentary Research Service, October 2021
[104] Aqib Aslam and Alpa Shah, Tec(h)tonic Shifts Taxing the Digital Economy, International monetary Fund, May 2020, Working Paper No. 2020/076

insights for product development. Those businesses gain profits just by the sale of these data, which usually are sold at a really high price, reflecting their importance for the buying companies.[105] However, as with the rest of the intangible products, determining the value of data poses challenges due to the absence of standardized valuation guidelines. Typically, the estimation of their value is established in relation to the importance of those data for the buying company, with their quality (for example, if they contain the necessary targeted information for the company's business purpose) and quantity.

In the author's opinion, these parameters serve as critical indicators for assessing the worth of the sold data since there are not other elements on which their price can be assessed, as the importance of data relies on their content. Furthermore, data contributes to the creation of value for other intangible goods and services. When businesses collect the data from the users, they later proceed with their analysis to extract all the info they need regarding behavioral trends and preferences so as to create more targeted advertisements either for their own products and services or to provide advertising services to third parties. This way data helps with value creation because it facilitates businesses in increasing the value of their products by aligning offerings to consumer needs.[106]Digital platforms use the same strategy to deliver personalized content that satisfies the users' interests and needs; this way, platforms ensure that they will not lose their clients.[107]

As it can be understood, the valuation of digital goods is yet under the absolute control of their sellers due to the lack of international accepted value standards and as a consequence tax authorities do not have the option but to accept the relevant prices.

When it comes to taxation of digital economy, the situation becomes quite blare. As mentioned in the previous chapters, digital businesses are distinguished by the absence of physical presence in the jurisdictions where they conduct business. Consequently, despite these countries contributing to the company's income generation, they lack the ability to levy taxes on the business's income. Therefore, a business is subject to taxation on its worldwide income only in the country where it maintains its headquarters, fact that, in the author's opinion is not really fair for the rest of the countries that contribute to profit making. According to the principle of source, jurisdictions that contribute to the production of a business's income, should have the right to tax the foreign businesses for income derived from their territory. Pillar 1 Amount A has addressed this issue by introducing the distribution

[105] Marcin Szczepański, Taxing the digital economy New developments and the way forward, EPRS | European Parliamentary Research Service, October 2021
[106] Aqib Aslam and Alpa Shah, Tec(h)tonic Shifts Taxing the Digital Economy, International monetary Fund, May 2020, Working Paper No. 2020/076
[107] Marcel Olbert and Christoph Spengel, Taxation in the Digital Economy- Recent Policy Developments and the Question of Value Creation, International Tax Studies 3-2019, IBFD

of business profits in the market jurisdictions that contribute to its creation by implementing at the same time revenue thresholds primarily aimed at high-revenue enterprises so as to prevent the shift of profits to low tax-jurisdictions.[108]Given that high-revenue businesses are the ones that could lead to the acquisition of important amounts of income for the source countries, it is logical to focus on capturing their profits. However, in the author's view, these proposed regulations should include all kinds of digital businesses, including smaller ones. For instance, if a country hosts 200 different small businesses that operate remotely each of which generates 150.000 euros through their territory, the total amount of generated profits becomes significantly important so as to refrain from their taxation.

In conclusion, these new regulations hold promise for an effective taxation of the digital economy in relation to the allocation of profits. Nevertheless, the practical implementation of these rules may prove challenging due to the necessity for cooperation between the tax authorities of numerous MS in order to determine and reallocate the generated profits to the relevant market jurisdictions.

### 4.3 Lack of international consensus

As it can be understood, plenty of legal attempts have been made to find a common solution for how states and tax authorities should practice the taxation of the digital economy. However, none of the proposed measures and solutions have led to an international consensus, fact that eliminates the efficiency of these rules. The measures proposed in the TDEF 2018 were not accepted by all the MS so as to become law, as MS could neither agree on a reform of the permanent establishment nexus towards a significant digital presence nor on the introduction of a digital services tax. Nevertheless, countries such as France or Austria took the initiative to establish some domestic rules concerning the digital services tax. This non – unified approach is the worst approach that MS (and countries all around the world in general) can follow, since it creates confusion and uncertainty regarding the application of tax rules and the taxation system that is followed both for taxpayers and tax authorities and also is really possible to trigger both double taxation or non – taxation for plenty of cross-border transactions.[109] Furthermore, the complexity that is caused regarding the rules that apply in every case may also lead to a distortion of competition both between analog and digital business models since the lack of a unified approach regarding the taxation of digital business models may lead plenty of businesses to stop their online sales because of the "danger" to be taxed wrongfully by the different tax authorities. In addition, it is even possible to create problems in the economy of the countries that follow arbitrary tax rules, because these rules

[108]https://www.oecd.org/tax/beps/multilateral-convention-to-implement-amount-a-of-pillar-one.htm
[109] Thomas Fetzer & Bianka Dinger, "The Digital Platform Economy and Its Challenges to Taxation" Tsinghua China Law Review 12 (29)

will work as anti-investment measures for non-residents businesses comparedto the other countries that do not tax digital services. It is also worth mentioning the fact that if every MS chooses to apply its own rules in relation to the taxation of the digital economy, there will be a patchwork of legal rules that will increase compliance costs for the companies that do business online, since they need to hire plenty tax expertise with specific knowledge in every country's legislation so as to be able to have a level of legal security for the transactions that they want to execute in different MS.

However, the fact that countries were not able to reach a consensus regarding the taxation of the digital economy does not mean that a unified approach on this topic should be neglected. The reason why reaching a consensus is so difficult is because so many different countries (if we take as an example the OECD, 130 countries) with different approaches and principles need to cooperate and find a common solution that includes the requirements of all MS. If this joint solution succeeds, this will lead to fewer concerns about inconsistent rules with inconsistent definitions, and also it should necessarily include provisions for eliminating double taxation and for providing dispute resolution mechanisms. These would offset the present concerns of the companies, mostly those operating in the digital world, which could be taxed in multiple countries on their income.[110]

All in all, it can be understood that to agree with this common approach, plenty of political, legal and technical issues should be solved along with plenty of relevant questions without neglecting that any new measure should always comply with European Union law. The new Pillar One proposal tries to impose a unified approach on this topic, but what is left to be seen is whether the countries will follow the proposed measures as a collective effort to tackle the relevant problems.

### 4.4 Future trends and opportunities

As mentioned above MS and also OECD's member countries have not, until now, agreed on an international consensus regarding the taxation of digital economy. Nevertheless, there are two newly proposed legal rules that may help implement a unified approach to this topic. These new rules are Pillar One Amount A[111] and Amount B[112] (that were analyzed in subchapter 3.1) and Pillar 2, the rules of which have been integrated in the Council EU Directive 2022/2523 of 14 December 2022 on ensuring a global minimum level of taxation

[110] Lilian V. Faulhaber, Taxing Tech: The future of digital taxation, Virginia Tax Review, Vol. 39.2, 2019
[111] https://www.oecd.org/tax/beps/multilateral-convention-to-implement-amount-a-of-pillar-one.pdf
[112] https://read.oecd-ilibrary.org/taxation/pillar-one-amount-b_21ea168b-en#page1

for multinational enterprise groups and large-scale domestic groups in the Union.[113]According to the preamble of the Directive (para. 2-3), the proposed rules came as a consequence of a continuous effort to put an end to tax practices of MNEs that allow them to shift profits to jurisdictions where they are subject to no or very low taxation and for this reason the OECD has further developed a set of international tax rules to ensure that MNEs pay a fair share of tax wherever they operate. That political objective has been translated into the Tax Challenges Arising from the Digitalisation of the Economy – Global Anti-Base Erosion Model Rules (Pillar Two) ('OECD Model Rules')[114] approved on 14 December 2021 by the OECD/G20 Inclusive Framework on BEPS to which Member States have committed. In its report to the European Council on tax issues approved by the Council on 7 December 2021, the Council reiterated its firm support of the global minimum tax reform and committed to a swift implementation of that reform by means of Union law. In that context, it is essential that Member States effectively implement their commitment to achieve a global minimum level of taxation. More specifically, according to the scope of the Directive as established in Art 2, "the Directive applies to constituent entities located in a Member State that are members of an MNE group or of a large-scale domestic group which has an annual revenue of EUR 750 000 000 or more, in its ultimate parent entity's consolidated financial statements in at least two of the four fiscal years immediately preceding the tested fiscal year".[115] The two basic proposed rules, alsoreferred to as the 'GloBE rules, are presented in Art. 1 of the Directive and are called the Income Inclusion Rule (IIR) and the Undertaxed Profit Rule (UTPR). The first one states that "an income inclusion rule (IIR) in accordance with which a parent entity of an MNE group or of a large-scale domestic group computes and pays its allocable share of top-up tax in respect of the low-taxed constituent entities of the group", while the secondregulates that "an undertaxed profit rule (UTPR) in accordance with which a constituent entity of an MNE group has an additional cash tax expense equal to its share of top-up tax that was not charged under the IIR in respect of the low-taxed constituent entities of the group".[116]As expressed in the preamble of the Directive, it has the principal scope to fight the basic problem related to the digital economy: tax avoidance from the perspective of usually paying really low taxes for the executed transactions because of the lack of physical presence. By reading this, it can be concluded that maybe this problem will be solved with the implementation of these rules since MSs are obliged to transport the Directive into their

[113]https://eur-lex.europa.eu/eli/dir/2022/2523/oj Council Directive (EU) 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

[114]https://www.oecd-ilibrary.org/taxation/tax-challenges-arising-from-digitalisation-of-the-economy-global-anti-base-erosion-model-rules-pillar-two_782bac33-en

[115] Article 2 par. 1 of Council EU Directive 2022/2523 of 14 December 2022, https://eur-lex.europa.eu/eli/dir/2022/2523/oj

[116] Article 1 of Council EU Directive 2022/2523 of 14 December 2022

domestic legislation. However, no certain results can be drawn until there is a significant amount of results from the practical implementation of the Directive in various MS so as to see if tax avoidance practices can be effectively avoided by implementing the new rules at a worldwide level.

## 5. Conclusions

In this chapter, the author will present her opinion regarding the main research question related to the effectiveness of GAARs in tackling tax avoidance in the digital economy. After analyzing all the relevant factors, meaning the wording and scope of the existing GAARs along with the specific characteristics of digital transactions, the following can be concluded.

In the author's opinion, from the first point of view, the existing GAARs can provide an effective tool for detecting and preventing abusive practices that occur in the digital environment. The abusive practices described in the wording of the rules can also cover similar practices that are exercised by digital companies to take advantage of tax loopholes and receive a tax benefit. Digital companies may present various characteristics compared to traditional ones (which creates the necessity for new taxation rules regarding the digital economy), but their basic economic structure remains the same as the rest of the companies. Fact that they do not have a physical presence in all the countries that they operate by exercising this way, transactions all around the world may be challenging for tax authorities mostly because of the intangible character of the transactions that make them more difficult to reach by the authorities but still if they want to follow an abusive scheme in cooperation with their possible subsidiaries or with other digital companies, they will leave a footprint for tax authorities eventually in order to track the possible abusive scheme (e.g., transfer of headquarters to another jurisdiction as the easiest trackable activity). However, the challenging point in the application of the existing GAARs in the digital economy is mostly observed at a practical level when the authorities have to investigate whether or not the arrangement under question has been established for business/commercial purposes. This difficulty is related to the nature of the assets that are exchanged or for the use of which the relevant transactions take place, making the assessment of their contribution to value creation and profit-making way more challenging. This challenge is created because of the fact that most of the time, the personnel that deals with the application of these measures do not have the required expertise to be able to evaluate with high probability the abusive character of the arrangement and present the actual benefit at which the companies were aiming when they got involved in the suspicious arrangements.

To conclude, the wording of the existing GAARs may not be perfect for every case and may also raise some interpretive questions regarding the meaning and the application of some terms; however, they can provide a starting point for the detection of tax avoidance practices in the digital world. Nevertheless, the introduction of new GAAR rules that will only be applied in the digital economy could work as a more effective measure for the future as they would be designed according to the specific characteristics of these transactions by "helping" also this way, tax authorities to detect the relevant (digital) abusive practices more easily and effectively. If this does not happen, collaboration and cooperation between the different tax authorities will be needed in order to find the real value of the digital transactions.

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